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The Burden of Proof of Valid Economic Reasons

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During the last months, our Supreme Court ("SC") has issued some sentences that judge the application or no application of the special system of mergers, splits, transfers of assets and exchanges of securities ("MSTE") to transactions made before 2001. Although the discussion is about various matters, one of them is common to almost all of them: the retroactive application of the change made, effective as of 1 January 2001, in article 110.2 of the Companies Act by an Act of 2000.

Out of the various changes made in 2000, several relevant conclusions can be drawn; firstly, the apparition of the concept of 'valid economic causes' ("VEC"), which did not exist in the previous wording and that is required for the special tax system to be applied to the transaction; secondly, that in the system effective prior to 2001, the Administration had to prove, as a consequence of the administrative verification, that the transaction had been carried out mainly with purposes of tax fraud or evasion, in order to regularize the tax situation; thirdly, as a logical consequence of the above, that, since 2001, the taxpayers may make binding queries to the Administration on the existence or not existence of VEC in a transaction.

Notwithstanding the foregoing, in inspections of transactions made before 2001 the Inspectorate authorities have denied the application of the tax system when, in their opinion, the transaction has not been carried out by VEC and, more worryingly, they have required from the taxpayer proof of the existence of those VEC. The trouble is that the Supreme Court, with a doctrine that in our opinion is not correct, is following the assumptions of the Inspectorate authorities.

The debate is focused on the retroactive application of the change made in 2001 in two aspects: the substantive one, that is, the need or no need of existence of VEC in a transaction made prior to 2001, and the formal one, that is, who should prove the existence or non existence of those VEC.

Regarding the first question, the argument of the Inspectorate authorities is that the transaction made for the purposes of tax fraud or evasion has no VEC, and vice versa, and that the new article 110.2 has not added anything, as it only completes the previous one with a new wording that is used to interpret previous

situations. The SC supports this argument by saying that the wording previous to 2001, in a teleological interpretation, permitted the exclusion of the special system of MSTE in the case of non-existence of VEC.

Although it is conceivable the existence of transactions that, not having a VEC, were not undertaken for the purposes of tax fraud or evasion, we can not deny that the SC, in its highest duty of interpretation, may understand that the new wording is, at this point, an interpretation of the previous one.

Even accepting that it may be required that a transaction made in 2000 needs a VEC, it can not be accepted the reversal of the burden of proof on the existence thereof. Both the Inspectorate authorities and the SC are demanding that the taxpayer should prove the existence of VEC, when in the pre-2001 wording the Administration was committed to prove its non-existence.

A clear retrospective bias is incurred here (as brilliantly explained in this magazine by Manuel Conthe on 9 July 2012), which is what happens when, once it is known what occurred, there is the tendency to modify the remembrance of the opinion previous to the occurrence of the events. Applying it to our case, the judge in 2013 who analyzes a transaction made in 1999 the regulation of which was changed in 2001, is not able to pass judgment on such transaction without being completely oblivious to this change, and automatically and unconsciously projects his knowledge of the regulatory change on the transaction.

If we put ourselves in 1999 or 2000, which is the time one must be prepared to consider for passing judgment on anything then done, upon implementing a restructuration transaction, the rule in force, the only existing rule, said that it was the Administration which had to prove that the transaction was made for the purposes of tax fraud or evasion, not the taxpayer. The content of tax fraud or evasion may be set up with the (absent) concept of the VEC, but it can not be forgotten that then, before 2001, it was the Administration which had the burden of proof.

It is precisely the reversal of the burden of proof operating from 2001 what justifies the other novelty: that taxpayers can make queries to the Administration on the existence or not existence of VEC, being binding the reply to those queries. It can be said that this power did not make any sense before the reform because it was the Administration which then had to prove the purposes of tax fraud or evasion.

And if the taxpayer intending to carry out a merger in 1999 and 2000 did not have this option, that is, he could not submit to the Administration a binding query on the existence of VEC, and the law expressly said that it was the Administration which had to prove the purposes of tax fraud or evasion, how can the taxpayer now be told that it was he who had to prove the non-existence of such a fraud?