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THE CONSTITUTIONAL COURT DECLARES CONSTITUTIONAL THE DEFINITION AND SYSTEM OF SANCTIONS ESTABLISHED BY THE ACT ON "RELATED PARTY TRANSACTIONS."

The Plenary Meeting of the Constitutional Court has ruled against an unconstitutionality case brought up by the Third Chamber (Contentious-Administrative Matters) of the Supreme Court against Royal Legislative Decree 4/2004, of 5 March 2004, whereby the rewritten version of the Corporate Tax Act was enacted. The Supreme Court halted the proceedings begun as a result of an appeal filed by the Senior Council of Official Commercial Titleholders Associations, because doubts arose amongst the magistrates regarding the constitutional suitability of Sections 2 and 10 of Article 16 of said Royal Decree. More specifically, they had doubts regarding the potential violation of the principles of legality in sanctions and proportionality which the Constitution establishes in Article 25.1.

The questioned precepts establish the system of sanctions which the Government designed for so-called "related party transactions" in order to fight tax fraud, or in other words, for those transactions completed by companies or related parties between each other or somehow subject to the same decision-making power. It may be that these entities agree to the prices of their transactions and thereby alter the taxes to which they are subject, or they may even feign competition. Both the Organization for Economic Cooperation and Development (OECD) and the European Union and Government have attempted to keep these transactions from being used in a fraudulent manner to conceal a transfer of the profits or losses of some companies to others in order to avoid paying taxes.

Royal Legislative Decree 4/2004, of 5March 2004, designs a different fiscal treatment for "related party transactions" from that which it establishes for transactions between independent companies. In order to determine whether related party transactions are or are not categorised as a potential fiscal crime, the regulation requires that documentation be provided. If this "documentary obligation" is not fulfilled, the companies may be sanctioned. The Supreme Court poses to the Constitutional Court its doubts about the constitutionality of the system of sanctions, because it believes that Royal Legislative Decree 4/2004 (Article 16.2 and 16.10) lacks "rigor or precision in defining the illicit acts foreseen."It also believes that the fines are "disproportionate."

The judgment issued by the Plenary Meeting of the Constitutional Court, for which Andrés Ollero wrote the majority opinion, analyses whether the questioned rule of law respects the principle of sanction legality in terms of both the material aspect (it requires that conduct in violation and the corresponding sanctions be pre-determined by law so that the people may be aware of the prohibited forms of conduct in advance,

and therefore the consequences of their actions) and in the formal aspect (the regulations which define these conducts and sanctions must have the status of an Act). The formal requirement, very strict in the penal sphere, is more flexible when it involves administrative violations and sanctions. For this reason, the Constitutional Court explains, the law may refer to the regulation regarding these matters whenever it determines "the essential elements of the anti-legal conduct in advance."

The Constitutional Court warns that, because reference is made to the regulation, the regulation must pass the test of providing a constitutional guarantee of predictability: "This means that the ordinary jurisdiction, which holds the competence of overseeing the legality of regulatory norms, must verify not only the regulation's compliance with the developed law (principle of hierarchy in Art. 9.3 CE), but also its compliance with the constitutional requirement of legal certainty governing administrative infractions (material dimension of the sanction legality principle in Art. 25.1 CE)."

In the case at hand, the Plenary Meeting highlights, "the law contains the basic definition of the prohibited behaviours; it materially delimits the scope to which the system of sanctions must adhere, it states its specific purpose, identifies the responsible parties and sufficiently describes the objective elements of the anti-legal behaviour in a specific, mutable matter which requires regulatory collaboration." "The reference to the regulation governing the documentation associated with related party transactions is, therefore, not an open reference: the regulatory power is subject to sufficiently precise legal guidelines. Consequently, one can state that the definition of the administrative violations in Section 10 of Art. 16 is conformant with the formal guarantee of the principle of legality in sanctions" under Article 25.1 of the CE.

The same conclusion is reached by the Plenary Meeting in terms of the proportionality of the sanctions and the material facet of the principle of legality. Regarding this last matter, the judgment points out that "the legal regulation of the sanctions is plainly clear and precise, and therefore it meets the formal requirement of law and in and of itself fulfils that of predictability." And it adds: "The law tirelessly establishes the sanction consequences of the two types of administrative infractions regulated. It does not enable discretionary exercise even in terms of specifying amount; instead of ranges of amounts, there are perfectly determined or determinable sums which are therefore completely foreseeable."

Last of all, the judgment states a warning about the proportionality of the sanctions specified by the regulation. "The regulation," the Constitutional Court states textually, "by completing the system of sanctions, must select, from among all the information strictly necessary to avoid fraud in related party transactions, only that whose omission or inadequate contribution may effectively be defined as major or worthy of the pecuniary sanctions established by law." However, it concludes, it is not the competence of the Constitutional Court, "but rather of the ordinary jurisdiction, to verify whether there is proportionality between the infractions (as they have been definitively profiled in the regulatory rules) and the sanctions (legally assessed)."

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