

# A Summary of the Key Points From “Hacienda and the Dual State”

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## Introduction

This note explores the relevance of the ‘dual state’ analysis, propounded by Ernst Fraenkel, to the administration of the tax system in Spain. It draws on research conducted under the auspices of ‘Spanish Tax Pickpockets’ programme and tests the proposition that the normative state and the prerogative state coexist, however uneasily and however symbiotically, in Spain, enabling and empowering Agencia Tributaria (AEAT) to assess and collect taxes using coercive techniques that would likely be considered criminal if adopted by private sector firms.

It is a given, among other tax administrations and international institutions, that AEAT is an outlier. Its people behave, domestically and internationally, in a manner that is different from the behaviour observed in almost every other tax agency. This behaviour creates a strong, repressed negative dynamic in Spain and threatens the carefully constructed balances that maintain the international tax processes, including relief under tax treaties, exchange of information on request and the mutual agreement procedures, upon which modern tax administration is so heavily dependent.

## The structural theory of Fraenkel’s dual state

In order to understand this clear divergence of AEAT’s behaviour from international norms, we consider whether the analysis propounded by Ernst Fraenkel in his book, *‘The Dual State’*, could be a good fit for the situation of AEAT and provide an explanation of what is seen and experienced by Spanish taxpayers.

*‘The Dual State’* sets out a structural theory of governance in which two distinct and objectively incompatible elements are present simultaneously: a normative state based on and governed by general rules, procedural regularity, and legal predictability which provide the appearance of certainty and consistency, and a prerogative state governed by discretionary power, used purposively, and unconstrained by the rule of law in practice even when it relies on the legal forms of the normative state to support it.

The prerogative state draws heavily on the laws, structures, processes and mechanisms of the normative state. They give it the appearance of regularity, while providing it with the power and authority

to subvert rationality and objectivity. The normative state does not restrain the prerogative state. On the contrary, it stabilises and legitimises it. The boundary between the two is not legal but political and functional, shifting – although in one direction only – according to perceived necessity. The rule of law persists, but it persists within a conditional framework that both parts of the dual state understand.

The normative state is tolerated for its usefulness, for its ability to cloak with legitimacy what would otherwise appear, undisguised, as the brutal exercise of political power. The prerogative

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state needs the cover that the normative state provides. The normative state needs the prerogative state in order to survive. It does not have the power to control, let alone overthrow it, even though its overthrow would restore the normative state to the pre-eminence that it has in most democratic frameworks. In the face of the exercise of unstoppable political power, the normative state bends in order to avoid breaking.

## The application of the dual state analysis to tax administration

Fraenkel’s dual state is not simply an historical concept that vanished with the downfall of fascism as an overt political force in the mid twentieth century. In the 2020s, it is enjoying a resurgence. The benign leadership, endowed with

traditional values of trust, respect for the rule of law, for democracy and individual freedom, which kept it at bay for many years, is weaker today. Governments, even social democracies, or perhaps especially social democracies, face the temptations

that come from having much greater power than their citizens, the temptation and the technology to create the surveillance state. Enhanced by the imaginings of AI, the power spills over into those domains where the need to know is easily justified: the police, the security services, the customs authorities at the border and, of course, the tax administrations. The exclusion of the unwanted, the prosecution of offenders, the elimination of fraud, the delivery of additional revenues to fund much-needed public spending, present even a freedom-loving government with clear-cut reasons it can use to defend its decisions to empower state administrations to find out, and to act on what they find. Few set out to enable to coercion but, where checks and balances lag behind technological progress, it happens anyway. Tax administrations march forward as the advance guard of those that benefit from the enabling power and, as the evidence shows, none more so than the tax administration in Spain.

A tax administration can be benign. It can be coercive. It can be neutral. The textbooks say that tax administrations should aim to collect the right amount of tax: the tax that is due in law. Too benign an approach risks higher non-compliance. Too tough an approach damages tax morale, driving activity underground; but “underground” is a less comfortable place in a technology-rich environment. The ability to hide is constrained by the state’s increasing ability to find out.

So, in advanced economies, in western societies,

the balance has shifted. If you hide, the state *will* find and punish you. The uncertainty has gone. Coercion becomes a more effective tool with fewer side effects. The argument against coercion becomes a moral argument, not a financial one. Revenues will not decline if revenue authorities become harder in their approach. Tax morale ceases to be an issue in the face of constant surveillance that can and will check everything you do.

The asymmetry of information between the tax administration and the taxpayer, the complexity of the subject matter, the cost of good advice, the sophisticated technology of the administration, with its easy access to the whole-of-government information base, all facilitate a potential rebalancing of the entire relationship between those paying and those collecting taxes. Tax authorities now have the power, the means to collect the right amount of tax, the tax that is due; and, worryingly, given the motivation to do so, they increasingly have the coercive power to go further: to collect more.

In most countries, the motivation to exploit this shift in relative power, is still weak, often absent altogether. In most countries, there are checks and balances that kick in quickly to detect and correct errant behaviour by an individual inspector or by a team or group. In most countries, there is still a strong public service ethos that underpins the functioning of the tax administration. There may be increasing temptations to be tougher, but the line still holds.

## The dual state in the administration of the Spanish tax system

In Spain, the line has not held. The government has provided tax inspectors with the motivation that is lacking almost everywhere else. It has allowed – even encouraged – tax inspectors to use the power of the state to coerce the citizen; and it has provided additional rewards, in the form of large bonus payments, to those who prove particularly good at it.

The Spanish state needs money to fund its misdirected programmes and out-of-control expenditure needs. This necessity has driven a particular form of permissiveness, and that permissiveness has allowed AEAT to become the epitome of the prerogative state.

***“In Spain, the line has not held.”***

The state does not just need tax revenue. It needs it day-in, day-out. So, inspectors are motivated to collect. No behaviour is off limits. Everything is explained and justified by the ‘system’. Citizens are coerced. The law bends to accommodate whatever is needed by the state.

Taxpayers are constantly reminded, in Orwellian terms of their common duty to contribute in accordance with a framework of normative law that is held out as truly fair and equitable. “*We, the Treasury*”.

Taxpayers’ duties tower high above taxpayers’ rights, putting them in deep shadow. The tax base is minutely but imperfectly elaborated, creating an all-but-impenetrable concentration of private

knowledge, while leaving wide scope for interpretational discretion by the guardians of the legislation, the tax inspectorate.

Enforcement functions at scale through self-assessment, machine scrutiny, an audit process powered by AI and the intrusive use of technology and social media. Coercive measures often precede final adjudication. Blatant use of discretion is shielded from easy scrutiny by the interminable, convoluted repetitiveness of the inspector's communication to taxpayers, with its selective citation of obscure case law. Inspectors are trained to confuse and subjugate taxpayers, to prevent any credible challenge to the inspectorate's aura of natural superiority and apparent expertise.

In a purely normative tax state, there would be symmetrical burdens of proof, balanced access to information, swift and effective judicial remedies and full compensation for enforcement error. Modern fiscal systems see risk in allowing taxpayers so much leeway. In practice, they substitute, de facto, a presumption of guilt for the constitutional presumption of innocence. They prevent taxpayer access to information in the name of derisking inquiries from possible interference and reducing the danger of taxpayer flight.

In Spain, the state constructs high barriers to justice and allows AEAT to operate within a realm free from the deadlines, controls and restrictions that are rigorously enforced on taxpayers, on the basis that *We, the Inspectorate* are the honest and trustworthy agents of *We, the Treasury*, acting in the highest and very best interests of *We, the People*. Thus, the prerogative sphere becomes embedded in a normative framework of legislative and jurisprudential authority, amplified, at least historically, by a respectfully silent media, placing a halo on the heads of all those who take money from the pockets

of taxpayers, irrespective of what would be permitted under a truly normative system.

Our research in Spain has yielded abundant evidence of the prerogative state in action in the administration of the tax system. This evidence shows how the abuse is motivated through a system of financial rewards derived from specific case outcomes and enforced by the imposition of cultural norms within AEAT that would be unacceptable in almost all other revenue authorities. It shows how bad faith investigations have been normalised, such that the Inspectors now see nothing wrong in what they do. The organisation protects itself from discovery by its demands for loyalty, not loyalty to the ethos of public service that public servants in other countries observe, but to the organisation itself. In turn, it also provides protection to its employees against any legal action for malfeasance in public office, even where the evidence of such criminal activity is clear from the documentation in the administrative files of investigations. The prerogative state is rampant in AEAT's Spain. It has everyone at its mercy.

As in all dual states, the ability of the prerogative state to act as it does is built on a number of apparently small and seemingly insignificant factors, often fully legitimised by the normative state, which interact in such a way as to give it almost complete freedom of action.

In this paper, we show how, little by little, the rights of taxpayers have been whittled away in Spain, so that, in the end, they become hollow, meaningless, impossible to operationalise. The cumulative effect is to leave the taxpayer all but powerless. This could be accidental, but its exploitation by AEAT is not.

We start at the beginning of the audit process.

## 1. Audit selection and scope

Audit selection should be based on risk assessment. Selection is of critical importance to the state in the long run and to the individual in the short run. In Spain, selection for audit is transformative for the life of the taxpayer and its impact is wholly negative. It imposes a burden unlike anything else. It requires the taxpayer to produce enormous volumes of documentation. It exposes every aspect of their life to intense scrutiny, from social media posts to visits to the gynaecologist,

from business travel to their children's performance at school. It allows AEAT to demand vast quantities of information about them from third parties in Spain and beyond. The audit is a weapon of control. Once launched, the process is intended to have only one outcome: that the taxpayer will be exposed as failing to make the proper contribution to the state and be punished appropriately. It is clear that the selected taxpayer is understood to be guilty, from the start, not just by AEAT, but

by the “system”. This makes the audit an ideal tool for the prerogative state. It combines the power to disrupt, the power to intrude, the power to make the victim pay, the power to punish, the power to humiliate the victim in society. There is no mechanism that the taxpayer can use to find out why they have been selected for audit: nothing to say whether it was AI or manual selection. Sometimes, the timing makes it clear that there has been a political motivation: the punishment audit for showing disagreement with the government

**“The selected taxpayer is understood to be guilty, from the start.”**

## 2. Audit secrecy

The investigation proceeds in secrecy. There is no rational reason for this, other than to generate fear, doubt, uncertainty for the taxpayer. Risk of taxpayer interference with the process is at all times negligible and, in practice, secrecy makes it more difficult for the taxpayer to cooperate. But secrecy is an important psychological weapon of the prerogative state. It endures until the very end of the investigation process. Information placed in the administrative file is not made available for review by the taxpayer until the investigation phase has been completed, which may be close to

line. Taxpayer rights at this point are minimal. They do not require the Inspector to answer the taxpayer’s questions, except in the blandest and broadest of terms. The notional right in Article 147(2) of the GLT to understand even the rationale and scope of audit is negated in practice by the Inspector’s brush-off. No explanation of the selection is offered. The culture of AEAT is, as highlighted in the Granada Declaration, that the taxpayer is a subject not a citizen who has real rights.

15 months from its official commencement. This limits the taxpayer’s ability to question the content and context of the “evidence” that has been included, the veracity of witness accounts, the circumstances in which witness evidence was obtained, and the absence of key documentation from the file, or to offer alternative validation of his position. A neutral process of investigation would not necessitate secrecy, but AEAT has already decided: selection on its own is sufficient proof of the taxpayer’s guilt.

## 3. Weaponisation of AI, surveillance, social media, “surprise” interviews and searches.

Recent developments in technology have transformed the power and reach of revenue authorities around the world. The *ability to know* has strengthened dramatically. AEAT has a formidable reputation for use of technology for audit and investigation purposes and an increasingly wide set of powers that act as enablers in the use of that technology. The wise know that powers and technology need strong and effective governance if they are not to become instruments of oppression, but this is a lesson that has fallen on deaf ears in Spain. The reckless pursuit of revenue has weakened objectivity and distorted judgements in govern-

**“Almost everything is knowable for AEAT.”**

ment and in AEAT, leaving a system that is vastly empowered digitally, but short of guardrails that could make AEAT’s powers and reach uncontroversial. The prerogative state requires no guardrails and will accept no limits on its ability to reach into people’s lives in order to secure acquiescence and/or take their money. *It can, therefore it will.* Historically, prerogative states used networks of informers to direct their brutal raids. Today’s raids are powered instead by information technology, including the programmed and greedy dreams of AI. Surveillance in all its intrusive forms is commonplace, AI’s imaginings are unchecked. Almost everything is knowable for AEAT. Yet, amid all its AI weaponry, AEAT management still insist on Inspec-

tors finding time for surprise physical raids that are visibly threatening, for intimidating possible witnesses by surprise interviews, or interviewing them as if on their own account, when in fact their off-the-cuff remarks are intended to support action against someone else, turning hearsay into “proven facts”. All of these are familiar tools and tactics of the prerogative state, in action today in modern Spain. The normative state permits it. The

normative state legitimises it as “the fight against fraud”. The government cannot find a democratic mandate for its budget, but it pushes ahead with draconian new powers for AEAT using one or other variant of Royal Decrees which require little or no democratic scrutiny. Parliament has no say, so the people have no say. That is how the prerogative state is stabilised and increases its power at the expense of the people.

## **4. Lack of procedural remedies during audit**

Few procedural routes are available to the taxpayer to challenge a self-evidently abusive investigation before the whole process has been finalised. In principle, a fundamental rights claim ought to be capable of doing that. However, in practice, it is enormously difficult to get a fundamental rights claim admitted for examination by the courts until the final decision has been made and communicated, thus negating the benefit and protection that the law was apparently intended to deliver.

The normative system of the courts thus protects the indefensible inquiry of the prerogative state on the grounds that the final decision has not yet been taken. So, the taxpayer must wait, notwithstanding the emotional, reputational and financial damage that he will suffer in the intervening years, and which will not be adequately compensated by a simple cash refund of tax and interest when an independent court comes to his rescue in the end.

## **5. The difficulty and futility of taxpayer responses to false allegations**

The opening of the administrative file, marking the end of the investigative phase of an audit, does not bring to an end the imbalance between the parties. A very short period – just 15 working days – is all the time that the taxpayer is allowed to review the documentation and potentially counter the analysis put forward by the Inspectorate. This is a particular problem in large and complex cases, where there may be 1,000+ documents, compiled over many months and presented by AEAT, and many thousands of pages in total. In practice, the majority of taxpayers simply do not file any comments or an objection at this stage. The same is true when the final assessment is raised, even in cases where the argumentation put forward by the Chief Inspector is deeply flawed: there is little time to prepare

a detailed rebuttal and, even more significantly, it is seen, repeatedly, that a response carries no weight in the process. Points made by the taxpayer are ignored or dismissed routinely by the Inspectorate. The taxpayer has no lever, no power, no means to make his arguments and his evidence count at this stage. Everything is simply rejected. The same pattern, the same outcome, is repeated across file after file. Culture and training make it so and bonus awards amplify their impact. The taxpayer has to sit on his hands and wait for the court hearings. The normative state allows taxpayers to be treated in this way by providing no swift and ready means of obtaining redress, thereby conforming to the prerogative state’s analysis that they have been identified for audit and must, therefore, be treated as guilty.

## 6. Simulación

In Spain, the prerogative state is well served by the concept of simulación, which is established in domestic tax law and widely used in practice. It gives AEAT enormous, flexible power, particularly in relation to new and smaller businesses, by permitting transactions and, indeed, whole business models which are recognised and used elsewhere, to be recharacterized and taxed in an entirely different way from the basis that their natural form requires. Simulación is often asserted by an Inspector on the basis of a selective choice of facts,

contrived into a narrative for which there is, at best, flimsy evidence. The powerful and coercive effect of an assertion of simulación is that it reverses the burden of proof, in defiance of the constitutional presumption of innocence. Although, in principle, the law incorporates some basic protections for taxpayers, in practice they are largely ineffective. The use of this part of the normative legal framework allows easy exploitation by the prerogative state.

## 7. The appeal system

The appeal system also serves the interests of the prerogative state. Outwardly it is a normative system, encapsulated in legislation and regulation. However, its sting is that it requires taxpayers who have received assessments that are contestable or simply wrong, to pay or to provide costly pledges or third party guarantees for all the tax assessed when they appeal, or risk the likely seizure of their assets and the closure of access to their own bank accounts. Only a few are able to have their payment suspended or deferred. It could easily be changed. Many governments suspend tax collection when an appeal is lodged, preferring to treat their taxpayers as innocent unless the courts decide oth-

erwise, rather than automatically guilty until the tax authority's assessment is finally overturned. They regard the above-market interest rate that is charged on outstanding tax liabilities as deterrent enough against frivolous appeals. Suspension of collection would be a particularly reasonable and balanced approach in a country where the tax authority loses half the cases on which it is challenged in the courts – an extraordinary state of affairs compared with Spain's peers. It is a sign of the Spanish government's rapacious appetite for taxpayer money that it prefers the system as it is and enjoys AEAT's ability to impose it ruthlessly. It is another symptom of the prerogative state.

## 8. The leverage provided by unendurable slowness

Tax justice is very slow to arrive in Spain. Additional resources would help to solve the problem, as would the use of alternative dispute resolution mechanisms, which are commonplace in other countries. The pay-to-appeal requirement acts in a particularly pernicious way in the Spanish system, imposing additional costs on the taxpayer who appeals and giving AEAT additional leverage to press for acquiescence from the potential appellant. The appeal process is almost unendurably slow, accentuating the financial pain for the taxpayer. First, he has to spend years going through the TEAR or TEAC, or both, which are captive institutions of Hacienda, not recognised by the ECJ

as real courts (although nearly 40% of taxpayers win their appeals there anyway). Only then can he have access to independent courts which can take another 5-10 years. In those courts, AEAT loses all but 30% of its cases, a truly shocking condemnation of the corrupt and deeply flawed tax audit process in Spain. AEAT says, without apparent embarrassment, *"The level of conflict surrounding inspection activities is not high. Nor is the percentage of cases that are ultimately overturned in economic-administrative or contentious appeals."*<sup>1</sup> These are brave words, but they belie the facts: there have often been well over 300,000 new cases per year – an astonishing figure in itself – and AEAT loss

<sup>1</sup> The words in quotes in this section are taken from an English translation of an AEAT document dated 19 September 2022, entitled NOTA SOBRE CRITERIOS DE DISTRIBUCIÓN DE LA PRODUCTIVIDAD BAREMADA DE INSPECCIÓN, provided in response to a Madrid court's order that details of the bonus scheme be published.

rates in court cases are spectacularly higher than in most peer jurisdictions. They would not be tolerated elsewhere, even in countries that also have

a relatively strong leaning towards the prerogative state in the administration of the tax system.

## 9. Supreme Court and ECJ judgements often ignored/not implemented.

Spain has adopted a non-compliant stance in relation to key aspects of its tax system, failing, over a period of years, either to make changes in response to judgements of the ECJ (for example, the lack of independence in the lower courts) or to ensure that its laws comply with the requirements of the treaty (for example unequal treatment of non-residents). In a similar way, AEAT has also acted disrespectfully in response to judgements

of Spain's own Supreme Court, either failing to implement them or implementing them in so narrow a way as to make a complete mockery of judicial decisions. These are typical manifestations of the prerogative state in action. The prerogative state has its own rules. It can make use of judgements when they support its authority but, equally, it can set them aside without consequences if they would diminish its power or control.

## 10. Basis of the bonus system

AEAT's bonus system is one of the key motivators for Inspectors' complicity as agents of the prerogative state. While the organisation denies that any individual Inspector is responsible for the outcome of an audit, the bonus system operates on the basis of a different perception of the roles and contributions of those individual Inspectors and their units and teams. Rewards are based on the achievement of targets for revenues assessed and collected. They are allocated to teams and units and ultimately to individuals on a competitive basis which is linked directly to a points system that leads back to individual assessments. Like many utterances of the prerogative state, the asserted lack of individual responsibility quickly falls apart when tested by normative principles. Inspectors and Chief Inspectors who act as mere cogs in the great wheel of AEAT, make no individual decisions and take no individual responsibility, would not, in a normative state, be rewarded highly when AEAT yet again exceeds targets for taxes assessed. But, of course, in Spain, they are rewarded, because the reality is very different from the fiction created by AEAT's leadership.

Official descriptions of the bonus system are designed to obfuscate not to clarify. They are designed to discourage any probing of the system as a whole or the basis of particular awards. The bonus system has been designed, or at least its design is articulated, in a way that is intended to defy normal scrutiny.

The system apparently incorporates so many complex features and measures that it becomes impossible to say who gets paid what amount based on what effort and what outcomes. Some of the measures that are said to be used, look, on detailed examination, to be impossible to implement.

If the design of the system, as described, was intended to motivate individual performance it would fall at the first hurdle. However, in practice, it seems that it works in a much more straightforward way that can easily be understood and followed by AEAT staff: there is acknowledged scope for subjectivity, with rewards following financial achievement and perceptions of individual and team contributions to the prerogative state.

The system is formally designed as a closed bonus pool to encourage competition between teams, thereby creating peer pressure and team pressure for "higher" performance, leading to higher reward. The AEAT documentation confirms the intention to create competition in this way. It becomes an Inspector's duty and responsibility to play his part for the team and for the Inspectorate as a whole, and to go further and achieve more, which means higher assessments.

The inspectors know in advance exactly how many points individual cases can bring to them and their team, even if they don't know exactly how many euros that will represent. They know how many points can be added for resolving a case

within the 12-month limit.

The system uses a whole series of criteria (none of which appear to have been validated by external audit) to create individual responsibility for performance at the Inspector and Chief Inspector level, and the system links performance against the criteria directly to financial outcomes for those individuals and their teams and units. Despite the assertions that Inspectors have no responsibility for assessments, bonuses are nevertheless based on individual contributions within the framework of the team or unit.

Ultimately, the bonus system is driven by the value of assessments, the achievement of centrally determined financial targets. AEAT has never produced a comprehensible account of how it works in practice. No numerical examples. No external audit report. Given the level of controversy that the bonus system has generated, a wise government would, if its defensive assertions were even remotely correct, put in place a system of annual external audits by

independent firms outside the reach of Hacienda, whose reports would be published, without the Ministry's interference, to inform and possibly to reassure citizens about the use of public funds in this way.

As things stand, the explanations published by AEAT look like pure simulación. They look like the way the prerogative state would reward its agents, through a system that is outwardly immensely complex, and which is operated in practice with such a wide margin of discretion that it is perfectly possible to reward key individuals in whatever way the leadership thinks fit.

In any event, the system rewards loyalty, as in any prerogative state. AEAT's Ethical Code, which is weak in the protection it affords to taxpayer rights, is very strong on loyalty to the organisation itself, allowing scope for punishment of one form or another for anyone who shows even limited independence of thought and action.

## 11. Organisational protection against prosecution of Inspectors

Like any well-thought through element of the prerogative state, the Spanish tax administration system has been designed to eliminate the risk that any one official or group of Inspectors can be prosecuted for prevaricación, or malfeasance in public office. AEAT documentation makes it clear that Inspectors who examine a case are not responsible for any assessment that is raised as a result of the audit. They merely make a proposal which is to be considered by others in AEAT. "Is it possible to say that an Inspector or team leader can decide on their own what assessments will be made? The answer is clearly no."<sup>2</sup> The actual assessment is said to be issued by AEAT (which cannot be prosecuted or sued) through a process of review involving the Chief Inspector (who simply communicates the assessment) and

***"The prerogative state has always had ways of protecting its own."***

a technical group, acting as agents of AEAT. "Once the Inspection Unit issues its agreement, this administrative act is not that of the official, but of the Tax Agency itself..." "Any vicissitudes that these acts may undergo during the review process will be the vicissitudes of an administrative act with all its guarantees, without these vicissitudes being attributable to the official who specifically made the original proposal." Summarised more succinctly by AEAT, "Inspection actuaries, Tax Inspectors, or Technicians never decide on their own about settlement actions, but rather limit themselves to issuing proposals. The actions are reviewed and settled by the Chief Inspectors and, therefore, belong to the administrative body that issues them, which guarantees their basis and quality." The prerogative state has always had ways of protecting its own.

<sup>2</sup> These words are again contained in AEAT's note of 19 September 2022

## 12. Impact of organisational protection

This protective model (or at least this picture of the model that is painted by AEAT and the Spanish state) liberates Inspectors and Chief Inspectors to engage in practices which would require dismissal in other tax authorities. This includes the widespread hiding of documents that are legally required to be included and disclosed in the administrative file, the ignoring of evidence that shows the Inspector has no grounds for the case he is making, and the highly creative use of bizarre arguments that sound as if they were invented in a children's playground. The victim's inability to achieve a prosecution of an Inspector who

deliberately perverts the outcome of a particular case simply encourages this type of behaviour. One Chief Inspector was reported as saying, while issuing a final assessment for more than €1 million, "Don't worry, you'll win the case in the courts and get your money back". In a similar way, this lack of accountability empowers Inspectors to ignore with impunity the requirement to give treaty relief to taxpayers with foreign interests; and to ignore statutory deadlines designed to regulate their own behaviour, while routinely and rigorously enforcing those that apply to taxpayers.

## 13. Rationalisation of lost cases

As already noted, where taxpayers are persistent enough and able to bear the costs of appeal through the lengthy court process, it is often the case that they finally win. This is held up by AEAT not as a failure but as something quite different. *"When, on appeal, a reviewing body [ie a court] resolves the dispute by upholding the claims of the inspected party, such a ruling is an expression of the right of every person to obtain adequate legal protection. However, this fact alone does not mean that the authors of the administrative act, and even less so those who drafted*

*the proposal, deserve to be reproached for their performance."* *"...it should be remembered, although it is well known, that the Tax agency has no interest of its own in these actions, but rather that the motivation for its actions lies in the functions assigned to it by the legal system in defence of a general interest."*<sup>3</sup> In other words, AEAT is merely acting as a defender of the rights of citizens in general when it takes action in breach of the rights of one. *We, the Treasury.* The prerogative state has a silver tongue.

## 14. International impacts of AEAT's bad faith investigations

The bad faith displayed domestically by AEAT in Spain has a knock-on impact into the international environment. Its dubious and highly speculative assessments give rise to conflicts that can only be resolved through instruments such as the Mutual Agreement Procedure (MAP), needlessly creating additional administrative costs for other jurisdictions. Once in the MAP, AEAT's approach is out of line with almost all other authorities. It comes to the negotiations, not with an open mind to find a solution as the treaty requires, but to win the ar-

gument. Other Competent Authorities see and are aware of this, as is the OECD. Again, AEAT brings the bullying approach of the prerogative state that it uses domestically, into the international arena, often leading to serious consequences for the taxpayer, unless the other authority stands firm. Examples are in the public domain. Spain's poor performance as a treaty partner has very recently been investigated by the OECD through its peer review process.

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<sup>3</sup> These words are again contained in AEAT's note of 19 September 2022

## 15. Secrecy by revenue authorities is permitted and encouraged by international organisations

International organisations, such as the OECD, which are typically considered to represent the normative state, often provide tacit support for bad faith inquiries where the prerogative state is particularly strong, such as in Spain. A key example is the support it provides for secrecy in the international Exchange of Information process. The OECD has been a champion of openness and transparency in relation to all the actions and transactions of taxpayers, but it has a major blind spot in relation to the actions and interactions of the Competent Authorities of its members. Encouraged by the OECD, revenue administrations and the Competent Authorities may keep secret from the taxpayer the very existence of a request for information, all inter-agency correspondence and the actual “information” requested as well, even in some circumstances where it has direct relevance to a court decision and has been requested by the taxpayer. As in the domestic environment, most information for which tax authorities ask, is, by definition, historical. Most cases present no risk

or opportunity of taxpayer intervention to “tamper with the evidence”. So, secrecy in this domain is clearly excessive. Once again, it gives strength to the idea that the mere identification of a taxpayer as a subject of inquiry is enough for him to be regarded as guilty and to have his natural rights taken away. It is an important enabler of the prerogative state. The degree of secrecy in the current system encourages and allows requesting authorities (particularly those repeatedly involved in bad faith inquiries) to make false statements in order to achieve access to information which a requested authority might otherwise hesitate to provide. As a result of actions taken by more open authorities, we have seen clear evidence of this kind of behaviour by AEAT in the EoI requests made by the Spanish Competent Authority. Elsewhere, secrecy reduces and often eliminates entirely the risk of discovery of wrongdoing, even in front of a court, thereby empowering and feeding Spain’s prerogative state.

## 16. International organisations encourage speed in compliance over fairness

The OECD Commentary and supporting documents encourage speed of compliance with requests for information over taxpayer rights, arguing that consideration of taxpayer rights should not unduly delay the provision of the requested information. Similar considerations apply in relation to the discouragement of scrutiny of the foreseeable relevance of requested information. This discouragement by the OECD occurs in practice, even if not by intent, through the Commentary and the related guidance. The expression of support for exchange of information on the widest possible basis, is effectively given the force of law by the courts, even though it has undergone no democratic scrutiny and embodies no manda-

tory safeguards. It provides cover for Competent Authorities effectively to rubber stamp requests, irrespective of what appear to be well-protected taxpayer rights under domestic law. The normative processes of the requested state, perhaps inadvertently, strengthen the reach and augment the power of the prerogative state that makes the request.

## Conclusions

In the research that underpins this short paper, we set out to test the proposition that the normative state and the prerogative state coexist, however uneasily and however symbiotically, in Spain, enabling and empowering Agencia Tributaria (AEAT) to assess and collect taxes using coercive techniques. The research has identified substantial evidence that the dual state characterisation is valid and applicable.

The question is no longer whether there is a problem, it has become how to address it. The prerogative state is naturally antithetical to reform. It does not recognise the need. It cannot be in its interests. Today, in Spain, it has the power to resist reform. The normative state is afraid to suggest it, even to discuss it.

It is clear, from outside Spain, that a series of reforms should be introduced to regularise AEAT's behaviour and bring it back into line with its international peers. The international institutions and other tax authorities have leverage but there is also a troubling mutuality of interest between them and Spain that encourages the pretence that the problem is small and that it will go away naturally. This seems unlikely but the faint hope has so far proved enough to deter the effective deployment of their soft power.

Ultimately, the Spanish citizen, the Spanish voter, has both the strongest interest and the

most direct means to ensure that changes happen which will regularise AEAT. During the last twelve months, the omertà that has held back discussion and debate among citizens, has finally begun to crack. There are too many voices raised in opposition now to the prerogative state for all of them to be punished by it. There is a window of opportunity.

This requires a political process and a political party that will fully embrace and act on the need to reform AEAT. While a powerful state within a state may seem to be helpful to government in the short term, it is a catastrophic liability in the longer term. The revenue authority cannot be allowed to become the whole state. So, the only way forward for it is down. No political party that seriously seeks to govern in Spain, can contemplate allowing the present situation and the present trajectory to continue.

There are people in Spain who are already working on the specifics of reform that will eliminate the primary motivation that drives the behaviour of inspectors. There are people working on changes to the courts and to the operating modalities of AEAT. There are people working on reforms to its governance framework and its ethical code. These reforms will not reduce the organisation's ability to collect taxes, but they will ensure that tax collection in Spain is brought into line with the international norms and standards set by its peers.

Implementing reform will not be easy but it is essential. The alternative is unthinkable.

***“The revenue authority cannot be allowed to become the whole state.”***