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Departments of Labour and Tax Law

THE SUPREME COURT RATIFIES A MINIMUM EXEMPT FROM TAXATION FOR PERSONAL INCOME TAX IN COMPENSATION FOR DISMISSAL OF SENIOR MANAGERS

The desired legal certainty as to the correct taxation of compensation paid to Senior Management seems to have finally arrived. Indeed, the very recent ***Judgment No. 1139/2020, 4 September, issued by Section 2 of the Third Administrative Chamber of the Supreme Court ("SC")***, confirms that **compensation received by managers in the event of the business's discontinuance**, which art. 11.1 of Royal Decree 1382/1985 of 1 August regulating the special employment relationship of senior management personnel ("**Royal Decree**") sets at **seven days' salary per year of service**, with a cap equivalent to six months' pay, unless otherwise agreed, **should be considered exempt for Personal Income Tax**.

Regarding the above, a careful reading of art. 7(e) of the Personal Income Tax Act requires two conditions to assess whether compensation should be exempt: (i) whether it is "*mandatory*" and (ii) that this be determined by the "*Workers' Statute (WS) by implementing regulations or by those regulating the enforcement of judgments*". Therefore, as the SC judgment says, it should be noted that, in the case under consideration both conditions are met, since, on the one hand, the Royal Decree is the "*development regulations*" of the WS and, furthermore, it states that "*in the absence of an agreement*" it applies subsidiarily and prescriptively to the 7 days of legal compensation.

Meanwhile, it should be added that, although it has taken more than five years for the particular value of the case-law of other jurisdictions to be taken into account, even given that it is not a preliminary ruling in the strict sense of the word, the supplementary nature indicated in the *ratio decidendi* of ***Judgment No. 3088/2014 of 22 April, of the Fourth Chamber of the SC***, has been essentially considered, recognising as a cornerstone of this decision that severance pay for discontinuance is "*minimum and mandatory*" compensation.

In conclusion, this decision establishes, for the time being, the long-awaited jurisprudence that we have been pleading for in the tax and social branches of law [see our previous AJLs on this matter, ***AJL June 2017*** and ***AJL December 2019***], for cases involving discontinuance and we understand that, analogously, also for unfair dismissals, although the latter - readers should note - will very possibly have to be the subject of a fresh decision, in the hope that the adaptation of the General Directorate of Tax's binding criteria is imminent. Without prejudice to this, it is to be expected that there will be, from now on, an avalanche of claims to the Tax Agency requesting the return of undue payments (even with the corresponding interest).

In any event, this clear pronouncement is to be welcomed.