

## Employment Update

# Taxation of the amounts deriving from the payment of severance indemnities recognised as unjustified

04th November 2019

Regarding the Judgment of the Administrative Chamber of the National High Court of 3 July 2019

The Administrative Chamber of the Supreme Court, is responsible for reviewing the resolution issued by the Central Economic-Administrative Tribunal ("TEAC") by which it is considered that the amounts paid by the Consortium of the Zona Franca de Barcelona to fifteen (15) workers, by way of compensation for unfair dismissal, are not exempt from taxation.

In order to reach this conclusion, the Inspection of the Treasury, firstly, and subsequently, the aforementioned TEAC, are based on the fact that the compensations paid respond to the materialisation of an agreement or agreement between the Company and each one of the workers for the extinction of the employment relationship, and not to their dismissal.

The study of the issue raised must be based on the literal wording of Article 7.e) of the Personal Income Tax Law ("LIRPF"), according to which compensation for dismissal or cessation of the worker shall be exempt, *"in the amount established as compulsory in the Workers' Statute, in its implementing regulations or, where applicable, in the regulations governing the execution of sentences, without the amount established by agreement, pact or contract being considered as such"*.

Therefore, based on the compensatory nature of severance pay, that rule provides special consideration - in the form of a tax exemption - to those workers who are affected by the **forced loss** of their job, by unilateral decision of the employer. On the other hand, the exemption does not operate in cases of termination of the employment relationship agreed between the parties, as is clearly reflected in the regulatory precept itself.

Therefore, in the specific case under trial, the SC confirms the existence of evidence which, in its joint assessment, rationally and reasonably leads to the conclusion that there was an agreement terminating the employment relationship, and not a dismissal, the following being considered especially revealing:

**a.- Indications regarding the business situation:** the extinctions took place in an environment in which the company had to reduce personnel by imposing measures restricting public expenditure;

**b.- Indications related to the age of the workers:** all of them (up to 15), at the time of the extinction of their employment relations, were between 62 and 65 years old;

**c.- Indications regarding the amount of compensation:** compensation far lower than that legally required in the event of dismissal declared unjustified was accepted. Thus, the calculation of the amounts did not consider the seniority of the workers, **but rather the time remaining to reach the legal age of access to ordinary retirement in its contributory modality;**

**d.- Indications as to the form and substance of the dismissal:** there was no element in the process that there were signs of litigiousness. Moreover, all the dismissals were verbal, without specifying the facts or causes on which the extinctive decision was based;



**e.- Indications regarding the Settlement Proceeding and Act before the Arbitration and Conciliation Mediation Service ("SMAC"):** the fifteen (15) workers signing identical pleadings, all conciliation acts ended with compromise between the parties before the SMAC and in all cases the workers waived any subsequent claims;

**f.- Other indications:** in addition to the foregoing, the taxpayer accepted that the amounts of compensation were *"the result of negotiation"*.

In short, this resolution once again confirms that the mere fact of appealing to the SMAC is neither a sufficient guarantee nor a synonym for the automatic application of the tax exemption in those amounts derived from the payment of compensation in the event of dismissal recognised as unjustified, but rather, on the contrary, it must be based on the set of elements and facts that, in each case, operate. And this is because the Tax Inspectorate, making use of its competencies and powers, has the capacity to reclassify the nature of a contractual resolution and may deny the exemption in those cases where it considers that instead of operating a dismissal, what really would have happened would be a previous agreement to terminate the employment relationship between the parties.

The sentence analysed does not respond to an isolated or novel pronouncement in the matter, but rather the SC, as has already been said, has already pronounced itself previously and recently in similar terms, among others, in its Judgment of February 6, 2019 (Rec. 329/2016), reaching the same conclusion. In short, and by way of recapitulation, this analysis should be concluded with the following considerations:

**First:** for compensation for dismissal, termination of the contract for objective reasons or cessation of an employee to be exempt from taxation, it is necessary that they be obligatory, and those established by agreement, pact or contract are not covered by such exemption.

**Second:** the employer must act with maximum rigor and neatness in the fulfilment of the requirements, both formal and substantive, legally required for the extinction of employment contracts. Among others, the delivery of written communication to the worker detailing in a reliable, solid and enough manner the reasons for the termination decision, compliance with formal requirements in the termination of contracts for objective reasons, etc.

**Third:** in certain cases and depending on the different circumstances inherent to them (age of the employee, type of termination, amounts, history of the specific case, situation of the company, etc.), it may be advisable, when the time comes and always based on the prior premise that the termination decision is adopted unilaterally by the Company, to sign an eventual agreement in the corporate headquarters and not previously in the administrative phase (i.e. before the Conciliation, Mediation and Arbitration service).

You can read the full [sentence](#) for more information

For more information please contact:

[José Antonio Sanfulgencio](#)

[jose.sanfulgencio@AndersenTaxLegal.es](mailto:jose.sanfulgencio@AndersenTaxLegal.es)

[Alfredo Aspra](#)

[alfredo.aspra@AndersenTaxLegal.es](mailto:alfredo.aspra@AndersenTaxLegal.es)