

DEFLATING GOLDEN PARACHUTES - BARROCAS SARMENTO NEVES

Posted on 29/10/2009



Alexandra Almeida Mota

Category: [Tax](#)



Following a Recommendation from the European Commission in April 2009 on remuneration policies, Portugal recently introduced changes to its personal income tax (PIT) and corporate income tax (CIT) legislation, with the aim of limiting excessive termination indemnities paid to top executives, so-called 'golden parachutes' .

Como consecuencia de una recomendación de la Comisión Europea en abril 2009 en materia de política de remuneración, Portugal ha introducido recientemente cambios en la legislación relacionados con el régimen de impuestos sobre la renta de las personas físicas y el impuesto de sociedades. Las enmiendas tienen como fin limitar las indemnizaciones por rescisión del contrato

cobradas por altos directivos, los supuestos "paracaidas de oro".

The new rules came into force on 12 September 2009 and are thus applicable to compensations, indemnities and any other payments made to senior executives, including managers, general managers, directors and other board members, depending on the nature and type of business, upon the termination of their contracts or executive functions.

Up until now and for PIT purposes, termination payments to an employee, including the highest-ranking executives of a company, were exempt from tax up to an amount representing 1.5 times the average 'regular remuneration', which during the employment contract was subject to tax, received in the 12 months prior to termination, multiplied by the number of years of seniority (length of service).

However, under the new regime, this exemption will no longer be available to managers, general managers, directors and board members, whose termination indemnities or payments are now entirely subject to PIT. The exemption is, nevertheless, still available to most other non senior executive employees and does not apply retrospectively.

For CIT purposes, any indemnities or compensation paid to top management on the termination of their contracts or executive functions will be subject to a 35% CIT rate, insofar as these payments are not related to previously agreed performance goals. Likewise, in the event of an early termination of a contract or executive functions, the 35% CIT rate will apply to any sums paid to top management in excess of the remuneration that would have been due to the relevant individuals for the performance of their functions until the end of the respective period.

Regrettably, the new regime contains some grey areas that require urgent clarification. For instance, the rules provide no clues on what should be considered 'remuneration that would have been due' for the purposes of determining the amount that will be subject to the 35% CIT rate in the event of early termination of the contract or executive functions – should only remuneration which is generally deemed to be 'salary' be considered or other potential components of the remuneration (eg commissions, bonuses, variable remuneration, pensions, etc.) be considered as well?

Under the Portuguese Labour Code 'base salary' generally excludes, for example, commissions and bonuses; however, certain payments although not described as forming part of base salary may, due to their regular and periodic payment nature, be caught under the relevant provisions. The new tax regime does not, however, make reference to the Portuguese Labour Code definition and therefore this point remains open to debate. Since there does not appear to be a uniform definition of 'remuneration' vis-a-vis 'salary' between the two codes determining the taxable income will in all likelihood need to be undertaken on a case-by-case basis.

Similarly, the new regime is applicable to top executives, including 'managers' ('gestor'), a professional category not defined under Portuguese law. Hence, will the tax authorities seek to interpret the new regime widely and seek to apply it to all employees with executive functions or to high-ranked employees, even if their employment relationship proves in practice to be subordinated? This could mean that termination payments to employees with a subordinated employment relationship, but who perform management or executive functions, could also fall within the scope of the new regime, be entirely subject to PIT and taxed at 35%.

The new regime may have a serious impact on senior executive compensation packages and companies may wish to review any existing contracts with top management from a tax, corporate and labour law perspective, whilst considering its implications on future contracts with key employees performing executive functions. Given the current economic climate and wave of redundancies we are seeing, the practical impact of the new framework may well be that many senior executives see their compensation packages significantly reduced or employers forced into agreeing higher settlement amounts to compensate the employee for the increased tax burden if

they wish to terminate contracts by mutual agreement.

Guilherme Figueiredo is a senior associate in the Tax Department of Barrocas Sarmento Neves. He can be reached via gfigueiredo@barrocas.com.pt