THE FOCUS

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The author analyzes the decisions of the Directorate General of Taxation and the Supreme Court which reject the deductibility of directors' remuneration in the Corporate Tax

Is the Director's Remuneration Tax Deductible?

Commercial companies are now the natural environment to undertake business activities for profit, especially if the liability of the partners is wanted to be limited to a certain amount. That profit or benefit will result from the algebraic sum of the positive and negative income, as obtained in a certain year, all of that (the condition of income, the amount thereof and the timing that it is understood that it was obtained, i.e. the what, how and when) according to principles that are set out in the Commercial Code and developed in the General Accounting Plan (GAP).

Since 1996, the result derived from accounting books is the basic parameter of the profit subject to tax on the corporate tax (CT). Not without controversy, since Act 43/1995 (the CT Act), the taxable base of the tax is determined from the accounting result arising from the application of commercial rules, of which the GAP is a development. That accounting result, as the CT Act continues to state, shall be corrected by applying the rules contained therein.

These corrections are derived, as it can not be otherwise, from differences between the accounting and tax standards of qualification (what), of valuation (how much) and of temporal allocation (when). Thus, the corrections for redemptions usually come from the existence of different temporal allocation rules.

With regard to what it is deductible (what), the CT Act reserves article 14 for setting the non-deductible items. We must not forget that the general rule (as it is said in article 10 of the CT Act) is that all costs as such and accounted for are deductible, as they reduce the accounting result. The special rule in article 14 states that, among others, dividends (normally they shall not be expenses, but just in case), fines and donations or gifts are not deductible.

If the bylaws say that the position is free, then its remuneration is not mandatory

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Regarding the latter, it has being recently questioned whether the remuneration of a worker, who is also a director of the company, is or is not deductible when the bylaws say that the position of a director is free.

"The joint taxation for the same income may exceed 65% "

What the Directorate General of Taxation (and surprisingly also the SC in a recent sentence) basically comes to say is that a worker who discharges managerial functions (for example, as CEO) and is also a director, having a salary for his managerial duties, has these duties absorbed by the position as a director. And if the bylaws say that this position is free, then his remuneration, as earned by his CEO position, is not mandatory. According to this opinion, the payment of such remuneration is an altruistic fee and therefore is not deductible in the CT of the company. In other words, that the salary of the director is a gift for his work. And this absurd conclusion is held by the SC although the salary is taxed, as it is actually done, for the Income Tax and at a higher rate generally. In such a situation, the joint taxation for the same income may exceed 65%. A big deal for the Treasury. There are many arguments against this mess. We will expose only one, that is the simplest, which is derived from a thorough reading of the contents of letter e) of article 14. It is not enough to examine the first line; if we read the entire paragraph, we shall see that the following is not deemed to be included in that paragraph e): expenditure on public relations with customers or suppliers, or expenses which, under the customs and practices, may be made regarding the company staff, or expenditure made to promote, directly or indirectly, the sale of goods and services, *or expenses which are correlated with income*. Italics added.

Thus, if the company needs a CEO for its activity, and this activity generates income to the company (as this issue is supported by the SC in its sentence), the remuneration of the CEO will be correlated with income, will not be deemed as an altruistic fee by reason of the law, and will be deductible.

A different question is that of the assessment thereof. As they are linked transactions (any transactions between a company and its directors are always linked), their assessment must be done at market prices. This is an unavoidable assessment rule regulated by article 16 of the CT Act, and the breach of it leads, since 2007, to heavy penalties. Very briefly, these rules provide that, regardless of the agreements reached by the parties and the documentation of the transaction, the company receiving a service from a linked person has to reflect a tax expenditure at the market value of it, and the person performing that service must record a taxed income in the same amount. That is, although neither the relevant director-CEO had been assigned any salary nor logically had received it, the company could have deducted an expense in an amount equal to its market value.

We can not finish without proposing a reform whereby courts specialized in taxation shall come into being

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This sentence and others by the SC and other courts that ultimately did not do justice revive the debate on the necessary specialization of our judges in tax matters, which is essential for enforcing the law. Accordingly, we can not finish without proposing, once again, a reform of our Judiciary system whereby courts specialized in taxation shall come into being for them to be able to solve quite complex issues with appropriate technical knowledge.