

## Directors' income and the exemption for work abroad

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*Analysis of the scope of the expression "employment income for work actually carried out abroad" - contained in Article 7p of Act 35/2006 - to determine its application to directors' earnings when sitting on the board of directors of a subsidiary abroad.*

The Supreme Court, in its Judgment of 22 March 2021 (appeal no. 5596/2019), examines in cassation, among other issues, the scope with which the expression "employment income for work actually carried out abroad" - contained in Article 7p of Act 35/2006 - must be interpreted in order to determine whether or not the exemption regulated in that provision is applicable to income from undertaking oversight and management work intrinsic to sitting on the board of directors of a subsidiary abroad.

To this end, the Supreme Court begins by invoking the interpretative line followed in its Judgment of 28 March 2019 (appeal no. 3774/2017) - interpreting in that case the scope of Article 7p in a case relating to the services of Bank of Spain civil servants in international organisations - a ruling from which several conclusions can be drawn, among which we highlight the following:

- Article 7p does not require two different companies: the (resident) employer and the foreign company for whose benefit the services are provided. What the article requires is the involvement of a natural person resident for tax purposes in Spanish territory who works as an employee in a non-resident company or entity or in a permanent establishment located abroad. Therefore, it does not exclude from its scope cases in which the entity receiving the work is related to the entity employing the worker or to that in which he provides his services.
- The article in question requires the recipients entity of the work to benefit from the work undertaken by the taxpayer of the personal income tax, but this does not prevent there being multiple beneficiaries, nor does it prevent the employer of the taxpayer from being among them.
- On the other hand, Article 7(p) does not stipulate what the nature of the work must be, nor does it require a certain duration or length of time spent on secondment. Thus, there is nothing excluding supervisory or coordinating work, nor is there anything to prevent sporadic or even ad hoc posting outside the national territory.

Having recalled the above, the Supreme Court points out that the contested judgment of the High Court of Justice of Catalonia rejected the appellant's claim, relying above all on the fact that the latter failed to prove that his acts - basically consisting of oversight and management work intrinsic to sitting on the board of directors of a subsidiary abroad - generated any added value in the business of the non-resident entity.

The Supreme Court now confirms the conclusion reached by the lower court, for the following reasons:

- Article 7p of Act 35/2006 demands as a requirement (normal in the logic of the tax benefit we are examining) that the provision of the work in question produces or may produce an advantage or profit for the recipient entity, which has not been proven in the case under review.
- The fact that the appellant's reasoning could be accepted in general terms, according to which the function of directors and members of boards of directors is always, by definition, for the benefit of the company - the foreign subsidiary, where appropriate - but, as the Court points out, the examined article, for the purposes of recognising the exemption, requires something more, namely proof of the added value provided by such work to the non-resident company, and it is that proof which, in the opinion of the lower court, has not been provided in this case.

- On the other hand, the expression "work", used in the article, does not cover activities intrinsic to sitting on boards of directors. As can be deduced from the aforementioned Judgment of 28 March 2019, the expression "work" used in the article in question must be understood to be limited to remuneration derived from personal work within an employment relationship, but does not extend to activities intrinsic to sitting on boards of directors.
- Lastly, although the aforementioned 2019 judgment stated that Article 7p "does not prohibit work actually carried out outside Spain from consisting of supervisory or coordination tasks", it should be borne in mind that the supervisory and coordination tasks with the representatives of other Member States examined in the judgment are not comparable to the oversight and management work carried out by a director representing the parent company in the non-resident entity, since this is not a personal service provided by the member of the board of directors, but rather the exercise of the parent company's own oversight and management powers.

In accordance with the foregoing, the Supreme Court rejects the appellant's claim, concluding that the expression "employment income for work actually carried out abroad" contained in Article 7p of Act 35/2006 cannot be applied to income from undertaking oversight and management work intrinsic to sitting on the board of directors of a subsidiary abroad, and therefore the exemption in question cannot be applied in such cases.

However, the following points should not be forgotten:

- a) The specific case addressed by the judgment under review refers to income from undertaking oversight and management work intrinsic to sitting on the board of directors of a subsidiary abroad, but does not analyse different cases such as the provision of other services by the director to the foreign subsidiary. Note that an appeal in cassation on this issue is pending before the Supreme Court.
- b) In order to deny the exemption, the aforementioned judgement repeatedly cites the lack of proof of the added value generated for the foreign subsidiary.

We can thus draw the following conclusions:

- 1) In cases which match exactly the situation envisaged in the judgment in question, i.e. earnings from undertaking oversight and management work intrinsic to sitting on the board of directors of a subsidiary abroad, the exemption does not apply.
- 2) In cases concerning other services provided by the directors to the subsidiary abroad that do not derive exclusively from the oversight and management intrinsic to sitting on a board of directors and where it is possible to prove the added value generated in the subsidiary, as of today's date, it could be considered that there are still arguments to defend the application of the exemption.

It is true that the Supreme Court has pointed out that the expression "work" used in the article under examination must be understood as limited to remuneration derived from personal work within an employment relationship, but does not extend to activities intrinsic to sitting on boards of directors, so it is possible that the Supreme Court, in cases other than the one specifically envisaged in the judgment, will continue to deny the application of the exemption. However, we cannot rule out the possibility that the stand taken by the Supreme Court may be different, especially if the added value generated by the director for the entity not resident in Spain is adequately proven.