

# Directors' remuneration



CONCEPTION



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Barcelona



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# 01

## Introduction

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The system for company directors and their remuneration has stirred up various controversies due to the changes in the regulations surrounding it, among other reasons. With a view to clarifying some of the potential queries there may be in relation to this subject, this report is made up of three sections:

- 1.** The first refers to the background of this issue. The **Spanish Act 31/2014**, of 3 December, amending the Spanish Corporate Enterprises Act in order to improve corporate governance (hereinafter, CEA), provided for two types of remuneration: 'statutory' remuneration, for the 'ordinary' director's role, and 'extra-statutory', regulated by a contract, for any additional functions. Therefore, this law generated the possibility of directors receiving double remuneration. However, the **Spanish Supreme Court's ruling of 26 February 2018** put an end to this possible double remuneration and indicated that the provisions of article 217 of the CEA apply to all directors.
- 2.** The second section will explain the types of remuneration directors may receive and the conditions for establishing their maximum limit, as well as the powers of the Board of Directors.
- 3.** Finally, the last section will examine the tax conditions and rates relating to this issue.

# 02

## Background

Since late 2014, various reforms have been published, both tax-related (for example, the Corporation Tax Act reform) and commercial (the CEA reform).

One of these changes refers to the system for company directors and their remuneration, which has caused companies problems due to a lack of coordination between their articles of association and payments made to directors. On many occasions, the Tax Office has questioned whether these are tax-deductible. The reform to directors' remuneration made by Act 31/2014, amending the CEA, introduced significant changes in this area, as well as controversy, due to its vagueness.

### **IS THE POSITION OF DIRECTOR OF A CORPORATE ENTERPRISE REMUNERATED?**

The general rule is that the position of director is not remunerated, unless the company's articles of association indicate otherwise. Companies' articles of association must establish the system of remuneration and the items included in it. If they do not, the position is assumed to be non-remunerated.

### **TWO TYPES OF REMUNERATION**

Act 31/2014 **differentiates between remuneration for directors** 'acting in such a capacity', for their deliberative, supervision and control functions, and remuneration for 'executive' directors, for additional functions within the company.

The former type of remuneration must still be provided for in the articles of association and approved by the General Meeting, while the latter requires a contract detailing each and every item for which the director will receive remuneration in the performance of their executive functions.

### **WITH THIS IN MIND, COULD A DIRECTOR RECEIVE TWO TYPES OF REMUNERATION, DEPENDING ON THEIR ASSIGNED FUNCTIONS?**

Act 31/2014 provided for two types of remuneration: 'statutory' remuneration, for the 'ordinary' director's role, and 'extra-statutory', regulated by a contract, for any additional functions. Therefore, it established the possibility of directors receiving double remuneration. This remuneration caused some confusion around the distinction between the functions of the director acting in such a capacity and executive functions, as regulations do not establish any differences between these types of functions.

According to this law, these two types of function (deliberative and executive) were different in the following aspects:

- a) The deliberative function was carried out collectively within the Board of Directors. Meanwhile, the executive function was carried out individually and continually.
- b) The purpose of the executive function was to manage the company, while the aim of the deliberative function was to oversee.

Therefore, the prevailing interpretation of this doctrine was that of a **dual system that separated and distinguished two types of remuneration**:

- a) **'Acting in such a capacity'**: the remuneration system must appear in the articles of association and the maximum amount paid to all directors acting in such a capacity must be approved by the General Meeting (articles 217.2 and 3). Functions and duties must be taken into account.
- b) **'As an executive director'**: remunerable items must appear in a contract signed with the Board. Remuneration may only be received for executive functions provided for in the contract, which must be approved beforehand by two thirds of the Board of Directors through a vote (article 249.3).

#### THE SPANISH SUPREME COURT'S DECISION

On 26 February 2018, the Supreme Court issued a ruling rejecting this double remuneration system, viewing the position of director in a unified way. It deems that the statutory remuneration established by article 217 of the CEA extends both to functions inherent to the position and executive functions. Therefore, it favours a cumulative interpretation, which supposes that the remuneration rules in article 217 of the CEA apply to all directors.

The ruling of 26 February 2018 states that, when the CEA mentions 'directors acting in such a capacity', it is referring to both non-executive directors and executive directors. According to the Supreme Court, the CEA uses the term 'directors acting in such a capacity' to regulate all remuneration a director may receive through carrying out any of the deliberative or executive functions inherent to the position of director. The Supreme Court therefore indicates that the difference in remuneration system is not linked to the comparison between an executive director's remuneration and a non-executive director's remuneration.

All remunerations are subject to the same remuneration system. A director's remuneration, whether executive or non-executive, is subject to the following: the articles of association, which must determine the compensation system; the agreements made by the General Meeting regarding the maximum compensation amount; and the agreements made by the Board of Directors to distribute the remuneration among the directors according to their functions and duties.

Therefore, in unlisted corporations, the articles of association must establish whether or not the position of director (including executive directors) is remunerated, and if it is, they must establish the remuneration system. If the articles of association indicate that directors are to be remunerated, the General Meeting will approve the maximum amount of that remuneration. Ultimately, unless the General Meeting decides otherwise, the directors themselves will agree on how to distribute the remuneration amongst themselves. In the case of the Board of Directors, this body will make a decision in accordance with article 249 of the CEA.

# 03

## Directors' remuneration

In conclusion, the directors' remuneration system is governed by the following elements:

1. The position being assumed not to be remunerated
2. The principle of statutory remuneration
3. The setting of the remuneration system in the articles of association (article 217.1 CEA)
4. The principle of freedom in choice of system:
  - Fixed amounts
  - Expenses
  - Bonds or share of profits
  - Shares or options
  - Benefit systems

The text of the articles regulating the directors' remuneration system in Act 31/2014, of 3 December, amending the CEA for improving corporate governance, is as follows:

### **ARTICLE 217.**

#### **DIRECTORS' REMUNERATION.**

- 1. The position of director is non-remunerated, unless the articles of association stipulate otherwise and determine a remuneration system.*
- 2. The established remuneration system will determine the remunerable item(s) payable to directors acting in such a capacity, which may include the following:*
  - a) a fixed salary*
  - b) travel expenses*
  - c) share of profits*
  - d) variable remuneration with general reference indicators or parameters*
  - e) remuneration through shares or linked to share price*
  - f) severance pay, provided that the severance is not caused by the director's failure to carry out their functions*
  - g) the appropriate savings or benefits systems*

- 3. The maximum amount for the remuneration of all directors acting in such a capacity must be approved by the General Meeting and shall remain in effect until any modification to it is approved. Unless the General Meeting decides otherwise, the directors will agree on the distribution of the remuneration among them. In the case of a Board of Directors, the Board will decide this, taking into account the functions and duties assigned to each director.*
- 4. In any case, the directors' remuneration must be reasonably proportional to the size of the company, its economic status at any given time and the market standards set by comparable companies. The established remuneration system must be designed to promote the company's profitability and sustainability in the long term and to incorporate the precautions required to avoid excessive risks being taken and unfavourable results being rewarded.*

**ARTICLE 218.****REMUNERATION THROUGH SHARE OF PROFITS.**

- 1. When the remuneration system includes a share of profits, the articles of association will determine the exact share or the maximum percentage of the share. In the latter case, the General Meeting will determine the percentage applicable within the maximum established in the articles of association.*
- 2. In limited liability companies, the maximum percentage of profits shared shall not exceed ten percent of the profits distributable among members.*
- 3. In public limited companies, a portion of the net profits is shared, once all statutory and legal reserve requirements are covered and shareholders are granted a dividend of four percent of the shares' nominal value or the highest rate established by the articles of association.*

**ARTICLE 249.****DELEGATION OF POWERS BY THE BOARD OF DIRECTORS.**

- 1. Unless the company's articles of association provide otherwise, and without prejudice to any powers it may grant to anyone, the Board of Directors may appoint one or several chief executive officers or executive committees among its members and establish the contents, limits and modalities of the delegation.*



- 2. In order to be valid, the permanent delegation of a power by the Board of Directors to the executive committee or chief executive officers and the appointment of directors to take on these positions must be approved by two thirds of the components of the Board through a vote. This delegation and appointment will not take effect until they are recorded in the Company Register.*
- 3. When a member of the Board of Directors is named chief executive officer or assigned executive functions by virtue of another title, a contract must be signed between this member and the company and approved beforehand by two thirds of the members through a vote. The director in question must not attend the deliberation or take part in the vote. The approved contract shall be included as an appendix to the session minutes.*
- 4. The contract shall detail all the items for which the director may receive remuneration by carrying out executive functions, including, if applicable, any compensation for early termination of these functions and the amounts to be paid by the company by way of insurance premiums or contribution to saving systems. The director shall not receive any remuneration for carrying out executive functions whose remuneration amount or item details are not established in the contract.*

*The contract must comply with the remuneration policy approved by the General Meeting, if applicable.*

# 04

## Tax aspects

### IS THIS AN EXPENSE DEDUCTIBLE FROM CORPORATION TAX?

One of the aspects that has caused companies the most problems with the Tax Office is the deductibility of remuneration paid to directors, and the retention tax applicable to it.

The precedent for this issue is the **Spanish Supreme Court's ruling of 13 November 2008 (Mahou case)**, which determined that, if the articles of association do not provide for the remuneration of directors, payments shall be considered a gift and, therefore, a non-deductible expense.

Subsequently, various **consultations with the Directorate General for Taxes (DGT)** have touched on the subject, especially regarding the extent to which it must be specified and quantified in the articles of association.

#### MUNERATION FOR SHAREHOLDER-INVESTOR VIA DIVIDENDS

- This is not a deductible expense in the company
- 'Fixed' average company-shareholder rate of 39% to 42.5%
- Taxation at source of 19%

#### REMUNERATION FOR SHAREHOLDER-DIRECTOR

##### 1. Exercising non-delegable director functions ('acting in such a capacity')

- Corporation tax: deductibility conditioned by recognition in articles of association + General Meeting
- Income tax (IRPF): yield of personal work
- IRPF retention: 35% (19% if the net amount of business turnover is less than 100,000 €)

##### 2. Exercising executive functions (management: general manager, CEO)

- Corporation tax: remuneration for directors for carrying out functions other than those that correspond to their position as director (management, senior leadership) are deductible regardless of the commercial or occupational nature of the relationship
- Spanish Supreme Court's ruling of 26 February 2018: articles of association + General Meeting
- Income tax (IRPF): yield of personal work
- IRPF retention: 35% (19% if the net amount of business turnover is less than 100,000 euros)

**Special chief executive officer: Board of Directors or any member of the Board of Directors with executive functions (general management, commercial powers, etc.):** a contract approved by the Board of Directors is required if these functions are remunerated.

Remuneration may only be received for executive functions provided for in the contract.

If they are not covered by the contract, the expense is in breach of the law.

For more information on tax matters, take a look at the dates and times of our training sessions **'Tax for start-ups' 1, 2 and 3**, during which we explain the tax rates to be taken into account when starting a company. You will find them in the **'Legal structures and tax'** section of the Activities Calendar: <https://emprenedoria.barcelonactiva.cat/>

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