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Spain – Case Considers Tax Deductibility of Stock Options

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In this *Flash International Executive Alert* we examine the recent judgment issued by Spain's Supreme Court (Tribunal Supremo) regarding the tax deductibility, for Corporate Income Tax purposes, of the expenses incurred by a company as a result of "stock option" plans provided to employees.¹

This judgment comes following a review of an appeal filed by a Spanish company (the taxpayer) against a previous judgment issued by the National High Court (Audiencia Nacional), which first considered the case that concerned the company's related costs for the provision of stock options and their characterization as a non tax-deductible expense (assuming that those expenses were not based on any contractual obligation legally imposed that could oblige the company to support the cost of executing the stock option plans).

Supreme Court Judgment

The Supreme Court has essentially rejected the taxpayer's appeal of the National High Court's decision. In its review of the case, the Supreme Court found that in addition to the facts and circumstances reviewed in the National High Court case, it was important to consider whether the stock option plan was an obligation established by contract – and even suggesting that the stock option plan may be deemed as a gift – provided that this plan was not an obligation legally imposed, for instance, by means of a collective labor agreement.

In essence, the Court understands that the expenses tied to the execution of a stock option plan can arise as a consequence of an "obligation" freely assumed by the employer based on that employer's express will – therefore, the employer is not obligated contractually to carry out the activity nor required to do so by any applicable regulation – and, that, in such cases, the expenses are considered as non-deductible.

According to the judgment issued by the Supreme Court, this interpretation might not correspond to the "income and expenses correlation" criteria set down in the Corporate Income Tax regulations for the deduction of expenses incurred by companies (which should in fact be applied irrespective of the characterization as "mandatory" or "expressly required" of those expenses).

As a consequence, the particular rationale applied in this judgment might suggest a return to older Spanish Corporate Income Tax regulations, whereby only the mandatory or expressly required expenses tied to such stock option plans were deemed as tax deductible.

What This Means for Companies Providing Stock Option Plans

This Supreme Court's judgment confirms the National High Court's resolution which had deemed the qualified stock option plan expenses as non-deductible. This judgment, however, appears to place in jeopardy the tax deductibility of stock options plans for Corporate Income Tax purposes.

The KPMG International member firm in Spain understands that there may be legal bases for defending a taxpayer's claim to deduct these expenses for tax purposes, given that the costs linked to the stock option plans are directly related to the work performed by the employees for the benefit of the company that is providing the equity-based remuneration schemes as a means to motivate and retain its employees.

Footnote:

1 Please see the Supreme Court judgment (in Spanish) at <http://www.poderjudicial.es/search/doAction?action=contentpdf&databasematch=TS&reference=6749019&links=&optimize=20130614&publicinterface=true>.

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The information contained in this newsletter was submitted by the KPMG International member firm in Spain. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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