The Executive Remuneration Review

Ninth Edition

Editors
Michael Albano and Janet Cooper

The Law Reviews

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PREFACE

Executive remuneration encompasses a diverse range of practices and is consequently influenced by many different areas of the law, including tax, employment, securities and other aspects of corporate law. We have structured this book with the intention of providing readers with an overview of these areas of law as they relate to the field of executive remuneration. The intended readership of this book includes both in-house and outside counsel who are involved in either the structuring of employment and compensation arrangements, or more general corporate governance matters. We hope this book will be particularly useful in circumstances where a corporation is considering establishing a presence in a new jurisdiction, and is seeking to understand the various rules and regulations that may govern executive employment (or the corporate governance rules relating thereto) with regard to newly hired (or transferring) executives in that jurisdiction.

The most fundamental considerations relating to executive remuneration are often tax-related. Executives will often request that compensation arrangements be structured in a manner that is most tax-efficient for them, and employers will frequently attempt to accommodate these requests. To do so, of course, it is critical that employers understand the tax rules that apply in a particular situation. To that end, this book attempts to highlight differences in taxation (both in terms of the taxes owed by employees, as well as the taxes owed – or tax deductions taken – by employers), which can be the result of:

a the nationality or residency status of executives;
b the jurisdiction in which executives render their services;
c the form in which executives are paid (e.g., cash, equity (whether vested or unvested) or equity-based awards);
d the time at which executives are paid, particularly if they are not paid until after they have 'earned' the remuneration; and
e the mechanisms by which executives are paid (e.g., outright payment, through funding of trusts or other similar vehicles, or personal services corporations).

In addition to matters relating to the taxation of executive remuneration, employment law frequently plays a critical role in governing executives' employment relationships with their employers. There are a number of key employment law-related aspects that employers should consider in this context, including:

a the legal enforceability of restrictive covenants;
b the legal parameters relating to wrongful termination, constructive dismissal or other similar concepts affecting an employee's entitlement to severance on termination of employment;

c any special employment laws that apply in connection with a change in control or other type of corporate transaction (e.g., an executive's entitlement to severance or the mechanism by which an executive's employment may transfer to a corporate acquirer); and

d other labour-related laws (such as laws related to unions or works councils) that may affect the employment relationship in a particular jurisdiction.

The contours of these types of employment laws tend to be highly jurisdiction-specific and, therefore, it is particularly important that corporations have a good understanding of these issues before entering into any employment relationships with executives in any particular country.

Beyond tax and employment-related laws, there are a number of other legal considerations that corporations should take into account when structuring employment and executive remuneration arrangements. Frequently, these additional considerations will relate to the tax or employment law issues already mentioned, but it is important they are still borne in mind. For example, when equity compensation is used, many jurisdictions require that the equity awards be registered (or qualify for certain registration exemptions) under applicable securities laws. These rules tend to apply regardless of whether a company is publicly or privately held. In addition to registration requirements, it is critical for both employers and employees to understand any legal requirements that apply in respect of executives' holding, selling or buying equity in their employers.

Given the heightened focus in many jurisdictions on executive remuneration practices in recent decades – both in terms of public policy and public perception – the application of corporate governance principles to executive compensation decisions is crucial to many companies. The covid-19 pandemic has presented novel challenges for companies and resulted in renewed scrutiny on executive remuneration practices. Decisions about conforming to best practices in the field of executive remuneration may have substantial economic consequences for companies and their shareholders and executives. Corporate governance rules principally fall into two categories. The first concerns the approvals required for compensatory arrangements: a particular remuneration arrangement may require the approval of the company's board of directors (or a committee thereof). Many jurisdictions have adopted either mandatory or advisory say-on-pay regimes, in which shareholders are asked for their view on executive remuneration. The second concerns the public disclosure requirements applicable to executive remuneration arrangements: companies should be aware of any disclosure requirements that may become applicable as a result of establishing a new business within a particular jurisdiction, and in fact may wish to structure new remuneration arrangements with these disclosure regimes in mind. In recent years, there has also been increased legislative and shareholder focus in many jurisdictions on environmental and social governance issues, such as the gender pay gap, tying executive compensation to environmental and social goals and diversity initiatives.

We hope that readers find the following discussion of the various tax, statutory, regulatory and supervisory rules and authorities instructive.

Michael Albano
Cleary Gottlieb Steen & Hamilton LLP
New York
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Chapter 17

SPAIN

Raúl Boo, Miguel Pérez and Aina Valls[1]

I INTRODUCTION

The Spanish market combines the discipline and stability brought about by EU legislation and the expertise and innovation of its players. It is a competitive and open market populated by national and international service providers who are driven by its harmonised regulations and the diversity of its demand.

The Spanish tax code is competitive for entities incorporated or domiciled in Spain, for non-Spanish investors in Spanish-resident entities and for employees moving to Spain to provide services to Spanish-resident entities.

In addition, companies that decide to set up in Spain will find a very competitive country in relation to the following: employment costs; increasingly flexible regulations; a fully professionalised judicial system; a reasonable role for employee representatives and trade unions in a context without industrial disputes. In addition, Spanish immigration regulations facilitate obtaining work and residence permits in a short time for highly qualified professionals, large companies and intragroup employee transfers.

From a corporate standpoint, there is harmonised and EU-based regulation on directors' remuneration in listed companies, aimed at promoting transparency and enhancing the protection to shareholders. Although inspired in such regulations with regard to good governance, the legislation applicable to executive directors remuneration in non-listed companies has been on the spot of the Spanish Supreme Court, issuing a breaking ruling which trying to unify the applicable regimes.

This chapter reviews the main advantages of the Spanish systems in terms of tax, labour and corporate law associated with the remuneration of executives and directors. In recent years this area has undergone multiple statutory amendments and the courts and administrative authorities have set important precedents and doctrine. With this in mind, this chapter seeks to provide a practical guide to the main issues and the latest developments.

1 Raúl Boo is a counsel, and Miguel Pérez and Aina Valls are associates at Uría Menéndez.

II TAXATION

i Income tax for employees

Tax residency

When analysing Spanish taxation for employees, including executives and directors, we should first determine whether the natural person is tax resident in Spain. The rules for determining tax residency in Spain are set out in Article 9 of the PIT Law.[2]

This provision establishes that a natural person is deemed to be resident in Spain for tax purposes, if either:

a he or she remains in the Spanish territory for more than 183 days during a calendar year; or

b the main centre or base of his or her activities or economic interests is, direct or indirectly, located in Spain.

In addition, the Spanish tax authorities may presume iuris tantum that an individual is resident in Spain when his or her spouse and underage children are resident in Spain under any of the criteria laid down in (a) and (b) above.

Regarding occasional absences from Spain, they will be calculated as days spent in Spain unless there is evidence that the natural person is tax resident in another country. However, if the person states that he or she is tax resident in a country considered a tax haven by Spain, the tax authorities could request him or her to prove that he or she has remained in such country for more than 183 days.

The binding ruling by the Spanish General Directorate for Taxes (GDT) of 17 June 2020 is especially relevant for the purposes of determining tax residency in Spain in 2020. This ruling concerned whether the period during which the state of emergency declared by the Spanish Government as a result of the covid-19 pandemic was in force, and which entailed restrictions on the free movement of people, could be taken into account for the purpose of the 183 days established above. The GDT, disregarding the OECD's recommendations, stated that this period should be taken into account. Therefore, individuals who were forced to stay in Spain due to the covid-19 pandemic could be deemed to be tax resident in Spain in 2020 if they met the relevant requirements (i.e., if they were in Spain for more than 183 days).

The above domestic rules must be complied with along with the rules contained in the tax treaties signed by the Kingdom of Spain when each signatory country consider that the natural person is tax resident in that respective country.

General taxation on employment income

Spanish tax residents

Once the tax residency of the executive or director is determined, if they are deemed to be tax resident in Spain, they will be subject to PIT and net wealth tax in Spain on a worldwide basis. PIT has two different taxable bases: a general one, which includes employment income, and a saving one.

2 Law 35/2006 of 28 November on personal income tax and amending corporate income tax, non-resident's income tax and wealth tax laws (PIT Law).

The general taxable base rates vary in the different Spanish autonomous regions. For instance, the maximum tax rate is 43.5 per cent in Madrid and 48 per cent in Barcelona and Valencia.

However, the saving taxable base is taxed at up to 23 per cent in the entire Spanish territory (except the Basque Country and Navarre, which follow their own rules).

Regarding net wealth tax, tax rates also vary in the different Spanish autonomous regions as well as the minimum amount of wealth that is exempt. For instance, tax residents in Madrid are exempt from wealth tax while, for example, the net wealth of tax residents in Valencia in excess of €600,000 is taxed at up to 3.12 per cent.

Non-Spanish tax residents

If the executive or director is not deemed to be tax resident in Spain, his or her employment income may be subject to non-resident income tax (NRIT). In principle, income derived directly or indirectly from a personal activity carried out in Spain is subject to taxation in Spain. In addition, payments to directors or members of a board of directors of Spanish resident entities are taxed in Spain.

This rule must be complied with along with the regulations contained in the relevant tax treaties Spain has signed with other countries. Although the regulations in the corresponding treaty signed by Spain and the country of residence of the employee or director should be checked, the general rules set out in the OECD's Model Convention are the following:

a Employment income can only be taxed in the worker's country of residence unless his or her work is carried out in a different country. If so, this income can be taxed in the country in which the work is actually carried out. However, according to the Model Convention, if certain requirements are met, the employment income derived from this work will not be able to be taxed in the country in which the work is actually carried out. Therefore, the general rules contained in the Spanish NRIT law will not apply.

b For directors, the Model Convention establishes the same rules as the Spanish NRIT law; that is, remuneration received as a director of a company resident in one country can be taxed by this country (regardless of where the director's tax residence is).

If the employment or director income is subject to NRIT, it will be taxed at a flat rate of 19 per cent for residents in the EU, Norway and Iceland and 24 per cent for residents in the rest of the world.

ii Social taxes for employees[3]

Spanish social security covers all Spanish nationals who reside and perform their activities in Spain, as well as foreigners with work permits. The social security system is mainly financed through contributions made by employers and employees based on the salary received by the employee.[4]

3 Spanish social security provisions are applied based on a territoriality principle, meaning that any person performing an activity or working in Spain falls under the scope of the Spanish social security. However, there are exceptions to this rule for transferred employees in EU regulations and international treaties.

4 As a rule, social security contributions are not deducted from statutory payments for death, relocation or temporary or permanent lay off.

Each year, the government establishes the maximum and minimum amounts used to calculate social security contributions and the percentage payments to be made by employers and employees (the monthly cap for 2020 is €4,070.10).[5] As a general rule, employers must contribute at a rate of 29.9 per cent (plus an amount to cover accidents) and employees at a rate of 6.35 per cent. These rates apply to both Spanish and foreign employees.

Executives must be registered under the General Social Security Regime, which entitles those who fall under its scope to unemployment benefits and protection from the Wage Guarantee Fund.

Directors who do not control the company (i.e., do not hold a specific percentage of the company's share capital) and are paid to carry out management/executive functions must be registered under the Social Security Regime for Assimilated Employees, which does not entitle those who fall under its scope to unemployment benefits and the protection from the Wage Guarantee Fund. In contrast, directors who control the company, even if they are not paid to carry out management/executive functions, must be registered under the Social Security Regime for Self-Employed Workers. In this case, only the director makes social security contributions for him or herself.

iii Tax deductibility for employers

In principle, to the extent that the remuneration paid is duly justified and accounted for, these payments are tax deductible for corporate income tax (CIT) purposes. As a general rule, employees' remuneration is deductible in the period in which it is accrued.

Notwithstanding the above, there are two issues regarding tax deductibility of payments to employees and directors which should be borne in mind.

Deductibility of payments to directors

The Spanish tax authorities have been very strict with regard to the deductibility of payments to directors. These discrepancies between the tax authorities and taxpayers are due to two issues:

a according to the Spanish Supreme Court case law, executives who are also members of the board of directors cannot have both an employment and corporate relationship with the company at the same time. If they do, the corporate relationship prevails over the employment one; and

b according to the Spanish Companies Law,[6] the position of director is not remunerated unless the company's articles of association state otherwise. In addition, the SCL provides some strict requirements for the approval of directors' remuneration.

In view of the above, particularly in cases in which an executive had an employment relationship with the company before becoming a member of its board of directors, companies considered that remunerating executives was justified by their employment agreement and the articles of association contained no provision on director remuneration. In this scenario,

5 Royal Decree-Law 18/2019 of 27 December adopting measures on taxation, cadastre and social security.

6 Royal Legislative Decree 1/2010 of 2 July, which approves the consolidated text of the Companies Law (SCL).

the tax authorities considered that this type of remuneration was unlawful and therefore the payments were actually gifts, which are not deductible for CIT purposes but are subject to PIT.

Similarly, the tax authorities have adopted the same reasoning in cases in which the requirements set out in the SCL are not strictly met. In those cases, director remuneration has also been considered a gift and therefore not deductible for CIT purposes.

The Spanish Parliament has tried to remedy this situation and since 2015 the CIT Law[7] states that payments to directors for their role as executives or for performing their functions under other employment agreement with the company cannot be considered a gift.

However, this clarification does not completely solve the situation and, it is still necessary to analyse whether remuneration paid to executives and directors complies with both employment and corporate law requirements in order to be considered tax deductible.

Deductibility of severance payments

The CIT Law contains a special rule that states that severance payments are not deductible in the amount exceeding the greater of the following two amounts:

a €1 million; or

b the mandatory amount stated in the employment law for redundancies.

This rule applies to amounts paid in one or several years by the company or a group company.

iv Other special rules

In addition, there are other special rules on taxation of remuneration in kind for employees that offer tax benefits. The following rules only apply to employees who have an employment relationship with the company. Therefore, in principle, directors cannot benefit from the following tax benefits:

a The following remuneration in kind is not subject to PIT:
- amounts paid by companies for professional training, retraining or upskilling to the extent that it relates to the relevant employee's job position; and
- amounts paid by the company for occupational accident insurance and/or civil liability insurance.

b The following remuneration in kind is exempt from PIT:
- food and drink for employees at the company canteen and meal vouchers worth up to €11 per day for use in restaurants;
- social or cultural services at the company, such as childcare services. These services can be outsourced. If the employer is an educational institution, free or discounted education for employees' children is also exempt from PIT;
- health insurance for employees, their spouses and children. This exemption is capped at €500 per person (or €1,500 for disabled persons);
- up to €1,500 per year for employees' public transport costs; and
- shares in the company or in the company's group for free or at a discounted price. This exemption is capped at €12,000 per year. In this regard, the conditions offered should be the same for all the employees of the company or group or subgroup of companies.

7 Law 27/2014 of 27 November on corporate income tax (CIT Law).

Finally, special valuation rules apply to other remuneration in kind. In principle, remuneration in kind must be valued at an arm's length basis. However, the PIT Law contains special rules for some type of remuneration:

a When using property that belongs to the employer, the employee's remuneration in kind will be valued at 10 per cent of the property's cadastral value (i.e., value for tax purposes). However, if the cadastral value has been reviewed in the past 10 years, the valuation will be 5 per cent of the cadastral value. In any case, the valuation of the right to use the property cannot exceed 10 per cent of the remaining remuneration.

b Regarding company cars provided to employees, the valuation will be the cost of the car for the employer, including taxes. If the employee is only given the right to use the car, remuneration will be valued annually at 20 per cent of the cost of the car. If the car is energy efficient, the valuation of the remuneration in kind will be reduced by up to 30 per cent.

c As to loans where the interest rate is below the legal interest, the remuneration in kind will be the difference between both interest rates.

III TAX PLANNING AND OTHER CONSIDERATIONS

The PIT Law provides some tax benefits or special tax regimes that apply to the remuneration of executives.

i Severance pay exemption

Severance payments paid to employees are exempt from PIT when they do not exceed the amount legally established by labour law. However, this exemption is capped at €180,000.

In this regard, the tax authorities have traditionally considered that this exemption does not apply to executives who were subject to a special employment relationship. However, in 2019, the Spanish Supreme Court held that executives can apply this exemption for the minimum severance payment amount established by labour law; that is, seven days of salary per year of service.

ii Exemption on remuneration for work performed abroad

The PIT Law provides an exemption on remuneration for work performed abroad. Employees can apply the exemption up to €60,100 per year when the following requirements are met:

a The employee must perform work for a non-resident company or for a permanent establishment abroad. If the company that receives the service is related to the Spanish company other requirements apply.

b The country in which the work is performed must have a similar tax to PIT and cannot be a tax haven. This requirement is fulfilled if that country has signed a tax treaty with Spain and the treaty includes an exchange of information clause. However, the employment income need not be effectively taxed in that country.

c This exemption is not compatible with the 'surplus regime', as explained below.

Regarding the exemption on remuneration for work performed abroad, the tax authorities have traditionally considered that it does not apply to executives who are directors. However, the Spanish Supreme Court has very recently (in February 2020) admitted a claim that will establish whether a director can apply this exemption for remuneration received as a member of the board of directors of a subsidiary located abroad. This judgment will be very important for the future of taxation of remuneration of directors in Spain.

iii 'Surplus regime' for work performed abroad

Another option when performing work abroad is to apply the 'surplus regime'. As mentioned above, this regime is not compatible with the exemption on remuneration for work performed abroad.

The 'surplus regime' establishes that any surplus received for performing work abroad is exempt from PIT. In other words, additional remuneration received for performing work abroad in excess of what the employee would have received in Spain would be exempt from PIT.

For this regime to apply, the employee would need to move to another 'workplace' as this term is defined under labour law. According to the GDT (for instance, resolution V4107-16), the employee would also have to remain abroad for over nine months, but still be tax resident in Spain.

iv Special tax regime for executives transferred to Spain (the 'Beckham Regime')

According to the special tax regime for individuals who are transferred to Spain, an individual who becomes a Spanish tax resident as a consequence of moving to Spain for work reasons may choose to be taxed under a regime similar to that applicable to non-residents in Spain when the following requirements are met:

a the individual has not been tax resident in Spain during the last 10 tax years prior to his or her transfer to Spain;

b the individual does not receive any business or professional income that could be considered obtained through a Spanish permanent establishment for tax purposes; and

c the reason for the transfer to Spain is one of the following circumstances:
- to enter into an employment relationship with a Spanish employer;
- the individual's employer decides to transfer him or her to Spain, which must be duly set out in a transfer letter; or
- to become a company director provided that the individual is not shareholder of the company, or if the individual is shareholder, his or her stake does not mean that he is a 'related party' for corporate income tax purposes.[8]

The taxpayer would need to expressly choose this tax regime upon being transferred to Spain. Once he or she has opted to apply this tax regime, it will start to apply in the year in which he or she obtains his or her Spanish tax residence and for five years after that.

This special tax regime may appeal to executives as income obtained in Spain will be taxed by applying the NRIT regulations for non-residents without a permanent establishment in Spain, subject to specific rules which can be summarised as:

a all worldwide employment income obtained by the individual would be taxed in Spain;

b income will be subject to taxation on an accumulated basis and losses cannot be offset;

8 An individual and an entity are deemed to be related parties when the shareholder holds a minimum share of 25 per cent in the company.

c the first €600,000 of income will be taxed at a tax rate of 24 per cent, and income exceeding that amount at a tax rate of 45 per cent; and
d only Spanish-source dividends, interest and capital gains would be taxed.

This special tax regime also applies to net wealth tax, and even though the executive would be considered tax resident in Spain, he or she would only be taxed on assets located in Spain and thus not on his or her worldwide assets.

v Reduction for irregular income

Remuneration generated during a period exceeding two years and that is generated irregularly as established by law and paid in one tax period can apply a 30 per cent reduction on the amount paid. In other words, the executive will only have to pay PIT on 70 per cent of the income received.

This reduction only applies when the taxpayer has not applied it in the preceding five years. In addition, it is capped at €300,000. However, when applied to severance payments between €700,000 and €1,000,000, the limit for applying the reduction (i.e., €300,000) will be reduced by the difference between the payment received and €700,000. Therefore, no reduction applies to severance payments of €1 million or higher.

vi The regional regulations in the Basque Country and Navarre on carried interest

The Basque Country and Navarre have authority to enact their own PIT rules and have recently established some tax benefits for carried interest payments.

While in the rest of Spain carried interest is in principle taxed for PIT purposes as regular employment income, the Basque Country and Navarre have introduced tax benefits for carried interest payments subject to strict requirements.

In this regard, two provinces in the Basque Country have introduced a 50 per cent exemption on the amount of qualified carried interest. However, the other province in the Basque Country and Navarre have opted to consider qualified carried interest as dividends, which are taxed at a maximum PIT rate of 25 per cent.

IV EMPLOYMENT LAW

i Non-compete obligations

Under Spanish employment law, non-compete obligations differ depending on whether they apply while the employment relationship is in force or after its termination. These obligations are as follows.

Non-compete during the term of the employment contract

Ordinary employees can work for other companies unless to do so qualifies as unfair competition, or the parties have reached an exclusivity arrangement. Therefore, if exclusivity has not been agreed to in the employment contract, an ordinary employee may work for another company provided that in doing so he or she would not be unfairly competing with the work performed for his or her employer.

In relation to executives, unless the company has stated otherwise in writing, they have a total exclusivity obligation and cannot work for other companies, regardless of whether or not this would amount to unfair competition.

An executive does not have to be compensated financially for an exclusivity obligation. However, if the employee with an exclusivity obligation is an ordinary employee, he or she must be financially compensated for it to be valid. The amount paid to the employee as compensation must be 'adequate'. There is no express provision under Spanish law that clarifies when compensation is 'adequate'; however, 10 per cent of the fixed remuneration received by the employee is normally considered sufficient.

Post-contractual non-compete obligation

The employer must have an effective industrial or commercial interest in the employee not competing with it after the termination of his/her employment contract: this could be defined as the interest that an employer has in preventing a well-trained ex-employee (often at its expense) from taking advantage of the know-how acquired while working for it to perform competing activities. This industrial or commercial interest is also defined as an interest in protecting information about 'sensitive' corporate matters: methods of production, commercialisation and organisation systems and, in general, information that is useful for the correct performance of the business (relationships with clients, suppliers, etc.).

Therefore, in order to determine whether or not a company has an effective industrial or commercial interest in an employee not competing with it, the specific functions and duties of the employee must be analysed: if during his or her employment, the employee has performed duties that are closely related to, for example, the business' strategy, clients, suppliers or know-how, the company would have an effective industrial or commercial interest in the employee not competing with it. If the employee has not performed any activities or duties related to these aspects of the company (for example, if the employee has only performed general administrative tasks), imposing a non-compete obligation on that employee would probably be considered unenforceable because the company lacks an effective interest in it.

The employee must receive a financial compensation from the employer that is adequate: however, the Statute of Workers does not define 'adequate compensation'. Whether the compensation agreed is 'adequate' for the purposes of the Statute of Workers is again analysed on a case-by-case basis, in terms of factors such as: (1) the employee's chances of finding a new non-competing job; (2) the geographical scope of the prohibition; and (3) the length of the obligation.

There is no general rule regarding the method of payment of compensation for non-compete obligations: the most common methods of payments are the following: (1) a monthly payment during the term of the non-compete obligation beginning at the end of the employment relationship; (2) a lump sum at the end of the employment relationship that compensates the entire non-compete period; or (3) a monthly payment during the employment relationship.

A post-contractual non-compete obligation cannot last longer than two years for technical employees or executives and six months for other employees. To determine whether or not an employee can be considered a technical employee, the following issues would have to be taken into account:

a the company's professional categories;

b the specific duties performed by the employee in question; and

c the employee's specific knowledge of the company's know-how, strategy, clientele and techniques.

Although damages are not specifically regulated for this purpose, penalty clauses linked to the breach of a non-compete obligation are acceptable. It is advisable that the penalty to be paid for a breach does not exceed the financial compensation agreed for the non-compete obligation. Otherwise, evidence of the harm suffered is required to make a penalty clause enforceable.

Unlike other jurisdictions, unilateral waivers of non-compete obligations are not acceptable when their terms have been agreed by both parties. Therefore, clauses that allow the employer or the employee to unilaterally waive the fulfilment of the obligation once it has been entered into are null and void.

It should not be forgotten that this non-compete obligation is linked to the termination of the employment relationship, and consequently it is not triggered (1) during garden leave, where the commitments of non-compete during the term of the employment contract still apply; or (2) after a transaction affecting the ownership of the company, where a different non-compete obligation might be agreed for the sellers.

Finally, although non-solicitation covenants are not specifically regulated in Spanish employment law, the above-mentioned rules for non-compete obligations are applicable.

Terminations

An employment contract may be terminated on the following grounds:

- *a* mutual agreement of the parties;
- *b* valid reasons previously identified in the employment contract;
- *c* upon the expiration date or completion date for the contracted job or service;
- *d* the employee's resignation.
- *e* death or permanent disability of the employee;
- *f* the employee's retirement;
- *g* death, retirement or permanent disability of the employer;
- *h* *force majeure*;
- *i* collective redundancy based on economic, technical, organisational or production reasons;
- *j* by the employee because of a breach of contract by the employer;
- *k* disciplinary dismissal;
- *l* dismissal for objective reasons; and
- *m* by a female employee who is forced to leave her job because she has been a victim of domestic violence.

Collective redundancies must be based on economic, technical, organisation or production reasons. An individual dismissal for objective reasons may be based on: (1) the employee's incapacity to perform the job; (2) the employee's failure to adapt to technical changes to his or her job; (3) the employee's continuous and unjustified absences; or (4) economic, technical, production or organisational grounds. Employees whose employment contracts are terminated as part of a collective redundancy or as a result of an individual dismissal for objective reasons have the right to a statutory severance payment equivalent to at least 20 days of salary per year of service, up to a maximum limit of 12 months of salary.

Employees may be dismissed as a result of a serious and wilful breach of their duties (disciplinary dismissal) (for instance, a lack of discipline or insubordination towards the employer or other employees, or a continuous and voluntary decrease in efficiency).

An employee dismissed for objective or disciplinary reasons may file a claim before the labour courts, which must then determine whether the dismissal was fair, unfair or null. If the dismissal is declared unfair, the employer may choose between (1) reinstating the employee; or (2) paying the statutory compensation for unfair dismissal, which is 33 days of salary per year of service up to a maximum of 20 months of salary. The employer must also pay the employee the salaries accrued between the date of the dismissal and the notification of the judgment if it the employee in question is an employee representative. If the dismissal is declared null and void, the employer must reinstate the employee and pay the back-dated salary from the date of dismissal until the date of reinstatement.

A company transaction itself is not a valid ground for dismissal and that the purpose of the transfer of undertakings regulations is to guarantee the stability of employment relationships in the framework of the transfer of a business. However, it is possible and common that, after a transfer, there are grounds to carry out a collective redundancy (e.g., duplicate posts after a merger).

In addition, the grounds for terminating ordinary employment relationships also apply to executive employment contracts, and the severance payment corresponding to unfair dismissals is 20 days of gross salary in cash per year of service, up to a maximum of 12 months of salary.

In the case of executive relationships, the contract may also be terminated by both parties by giving a minimum of three months' prior written notice. This minimum period may be extended up to six months, if so agreed by the parties, in the case of executive employment contracts of indefinite duration or with a fixed duration of more than five years. The company may also withdraw from the contract by paying the executive the contractual severance payment or, failing that, the equivalent of seven days of gross salary in cash per year of service, up to a maximum of six months of salary. The same severance payment is payable to an executive who terminates his or her employment contract in the event of a transfer of undertaking or significant changes in the company's ownership that bring about changes in its governing bodies or main activity.

V SECURITIES LAW

According to Spanish legislation, a prospectus is not required for private offerings (for instance, when shares are offered to fewer than 150 investors per EU Member State, other than qualified investors, or when the face value of the securities is at least €100,000).

In addition, according to EU and Spanish regulations, the obligation to publish a prospectus does not apply to a public offering of securities to existing or former directors or employees by their employer or by a group company, provided that (1) the securities to be granted are of the same class as securities already listed on the same regulated market, and (2) a document is made available containing information on the number and nature of the securities offered and the reasons for and details of the offer.

VI DISCLOSURE

i Disclosure in the company's articles of association

The directors' remuneration system must be set out in the company's articles of association, as is further explained in Section VII.

ii Annual public reports in listed companies

In accordance with articles 540 and 541 of the SCL, listed companies must publish on an annual basis:

A corporate governance report, to be submitted to the Spanish Securities Market Authority (CNMV) as a relevant fact, that includes, among other information, details of the directors' remuneration and agreements concluded between the company and its senior officers or employees whenever those agreements foresee compensation to be paid upon the termination of the contractual relationship as a result of an unfair dismissal, voluntary resignation or termination caused by a public offering; and

A directors remuneration report (DRR) to be prepared by the board of directors and approved by the general meeting as a separate point of the agenda on a consultative basis.

The DRR must be reported to the Spanish Securities Market Authority (CNMV) as a relevant fact simultaneously to the corporate governance report and detail the remuneration received by the directors in their capacity as such and for their executive functions, setting out complete and clear information on the directors remuneration policy for the current year, a brief summary of the application of the remuneration policy in the previous year, as well as a breakdown of the individual remuneration received by each director for any and all concepts.

iii Publication on listed companies' websites

Listed companies must publish on their corporate websites the information and documents to be approved – such as the DRR and DRP – prior to the relevant general meeting.

VII CORPORATE GOVERNANCE

i Non-listed companies

Under Spanish law, the governing body of a non-listed company can be a sole director, a number of joint directors or joint and several directors, or a board of directors.

When the governing body is structured as a board, directors may be vested with executive powers (e.g., a managing director), in which case the SCL differentiates between the remuneration paid to directors in their capacity as such and what they receive for their executive functions.[9]

Remuneration of directors in their capacity as such

These provisions are applicable to sole directors, joint directors, joint and several directors and directors which are members of the board of directors in their capacity as such, that is, for those functions which are inherent to their position as directors (such as deliberative functions), other than executive functions.

There is a *iuris tantum* (rebuttable) presumption that the office of director is not remunerated, which can be rebutted by setting out the remuneration system in the company's articles of association.

The remuneration system must be proportionate to the company's financial situation, market standards and the size of the company, and must be guided by the company's long-term profitability and sustainability.

9 Directors' remuneration in non-listed companies is regulated in articles 217 to 219 and 249 of the SCL.

The SCL sets out an open list of remuneration elements such as fixed and variable remuneration, attendance allowances, remuneration linked to corporate benefits, remuneration systems based on company shares, termination compensation, and such like.

Regardless of the remuneration system established, the total maximum annual amount to be paid to the directors in their capacity as such must first be approved by the general meeting and, unless provided otherwise, the distribution of the amounts to the directors (except in the case of a sole director) must then be approved by the directors themselves. As a general rule, when there is a board of directors, it must unanimously approve the distribution of the total amount to all directors taking into account the functions and duties corresponding to each director.

Whenever the remuneration is linked to corporate benefits, the articles of association determine the specific amount or the maximum percentage of the corporate benefits to be paid as directors' remuneration. If a maximum percentage is established, it is the general meeting that sets the applicable percentage within the permitted maximum.

When the remuneration system includes the delivery of shares or stock options, or remuneration referenced to the value of the shares, express provision in the articles of association and approval by the general meeting are required, including the maximum amount of shares to be allocated to directors each year, the value of the stock options or the calculation method applied, the reference value of the shares and the term of the plan.

Remuneration of members of the board of directors for their executive functions

Whenever a member of the board of directors is vested with executive powers, either as managing director or under a different title, a contract between the executive director and the company must be concluded, with the prior approval of two-thirds of the members of the board of directors (excluding the executive director who is a party to the agreement). The agreement must be consistent with the directors remuneration policy (DRP), if any.

Any amount to be received by such director for executive functions – regardless of whether or not the office of director is remunerated – must be set out in the agreement, specifying the concepts for which the executive director can be remunerated for the performance of executive duties, compensation for early termination, if any, and all other amounts to be paid as insurance premiums or saving systems.

According to a landmark ruling of the Spanish Supreme Court, the remuneration system of directors for their executive functions must comply with the same corporate governance rules as those applicable to the remuneration of directors in their capacity as such, that is, inclusion in the articles of association, approval of the total maximum annual amount that could be paid to the directors for their executive functions and distribution of the total amount to the directors vested with executive powers by the board of directors.

Non-director executives

The remuneration of non-director executives reporting directly to the board of directors must be approved by the board of directors.

ii Listed companies

Under Spanish law, listed companies must always be governed by a board of directors.[10] There is a iuris tantum presumption that the office of director is remunerated, which may be rebutted in the company's articles of association.

As a general rule, the remuneration of executive and non-executive directors, including amounts received upon ceasing to be a director, must comply with the DRP approved on a triannual basis by the company's general meeting, based on a proposal from the board of directors accompanied by a report of its appointment and remuneration committee. These two documents must be available to shareholders on the company's website as from the date the general meeting is called.

The SCL distinguishes between:

a remuneration of directors in their capacity as such: the remuneration system must be set out in the company's articles of association and the DRP must set out the maximum total annual amount that can be distributed to the directors in their capacity as such. The board of directors distributes the total amount among directors according to their duties and other specific circumstances; and

b remuneration of directors for their executive functions: the board of directors determines the remuneration and must approve the contract concluded between the company and the executive directors in accordance with the DRP – which must set out the fixed annual remuneration, the variable remuneration criteria and the main terms of the directors' contracts, such as term, early termination compensation, ordinary termination, exclusivity and post-contractual non-compete commitments.

VIII SPECIALISED REGULATORY REGIMES

A reduced number of sectors have specialised remuneration regulations (mainly, credit entities, closed-end investment companies, and collective investment institutions).

The Credit Institutions Solvency Law (Law 10/2014) includes provisions of the EU regulations relating to the obligation for credit institutions to put in place remuneration policies that are consistent with their risks. These policies apply to executives, employees who assume responsibilities, have a position of responsibility, and any employee whose remuneration is similar to that of an executive.

The main factors to be considered are the following:

a Fixed and variable components of the overall remuneration must be appropriately balanced. The fixed component must represent a sufficiently high proportion of the overall remuneration.

b The remuneration policy applicable to members of the board of directors of a credit institution is subject to the approval of the general meeting or equivalent body under the same terms as those applicable to listed companies.

c Specific principles limiting the amount, the composition, the payment date and explicit *ex post* risk adjustments (*malus* and clawback arrangements) apply.

d Credit institutions must form a remuneration committee.[11]

10 Directors' remuneration in listed companies is regulated in articles 529 *sexdecies* to *novodecies* of the SCL.

11 *The Banking Regulation Review.* Spain. Juan Carlos Machuca and Alfonso Bernar.

IX DEVELOPMENTS AND CONCLUSIONS

The rapid escalation of the public health crisis caused by the covid-19 pandemic has created an unprecedented situation that poses innumerable legal challenges, both on a national and international scale.

Since the World Health Organization declared this situation to be a public health emergency on an international scale on 30 January 2020, the situation has gradually worsened, and there are now numerous countries, including Spain, that have taken measures to restrict citizens' freedom of movement, limiting or restricting the entry of people travelling from countries with major covid-19 outbreaks, and approved various types of measures with the dual aim of protecting public health and mitigating the economic consequences of this situation.

In this context, many companies are seeking alternatives to reduce costs and avoid lay-offs. One option is to amend remuneration policies (altering fixed and variable elements) and impose salary reductions. In Spain, this is considered a substantial modification of working conditions that must be justified on serious economic, technical, production or organisational grounds. Although it must be analysed in a case-by-case basis, the covid-19 pandemic might represent sufficient economic, technical, production or organisational grounds to justify such a modification.

Appendix 1

ABOUT THE AUTHORS

RAÚL BOO

Uría Menéndez Abogados

Raúl is a lawyer in Uría Menéndez's Valencia office, where he manages the employment team. He was appointed counsel in 2016.

Raúl has a great deal of experience in employment-related issues in national and international M&As, private equity and structured, acquisition and project finance. In this area, he advises top hotel firms on transfers of undertakings and managerial remuneration packages.

Raúl has extensive experience in representing clients in the courts and in out-of-court settlements. He is also frequently asked to carry out labour audits on companies and issue the corresponding due diligence reports.

During the recent pandemic, he has directly advised on relevant temporary lay-offs affecting more than 2,000 workers in different sectors (e.g., HORECA, furniture and chemicals, tiles).

He lectures at several prestigious institutions and is a regular speaker and commentator at law seminars and conferences on executive remuneration issues. From 2016 to 2020, he was a lecturer at Universidad Cardenal Herrera.

MIGUEL PÉREZ

Uría Menéndez Abogados

Miguel Pérez joined Uría Menéndez in 2013 and he has been an associate of the firm since 2017. From January to March 2020, he was seconded to the Frankfurt office of Hengeler Mueller.

Miguel has more than seven years of experience advising domestic and foreign companies on M&As, corporate restructuring transactions for corporate groups, real estate transactions and due diligence processes both of asset deals and share deals. He also advises in tax procedures and to family groups and high-net-worth individuals.

He obtained a law and a business management and administration degree from the University of Valencia. He also holds a master's degree in tax law from the Centro de Estudios Financieros.

AINA VALLS

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Aina joined Uría Menéndez in 2011. Between January and July 2016, she worked at the firm's London office. Aina has over nine years of experience advising domestic and foreign companies on corporate, financing and M&As.

She has advised on many different types of transactions, including acquisitions and real estate transactions, financing agreements and debt restructuring, both bilateral and syndicated, corporate acquisitions and joint ventures; mergers and the restructuring of corporate groups; corporate transactions and contracts in general.

She has been non-executive vice-secretary to the board of several companies.

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