Labornet No. 1481

How Is Seniority Pay Taxed?

Important Ruling Sets New Limits to Confiscation

Dear All,

In the matter of Gelfman, the Plaintiff is a top-level Director and Executive Employee, i.e. the Company's General Manager, who questions his income tax overwithholding based on the new regulations in force at the time of his termination.
The agreed amount in the settlement agreement at SECLO [Mandatory Settlement Office for Labor Disputes] is exempt from income tax. Tax liabilities.
A court ruling analyzes income tax for executives and resolves that the agreed amount under a settlement agreement at SECLO as a result of an employment termination is exempt from Income Tax, and releases the company from acting as a withholding agent.

"Employment ends at the Company's discretion (Section 245 LCT and agreement at SECLO). The Department of Labor approves the agreement reached between the parties. The former senior employee and director claims income tax overwithholding, and challenges the constitutionality of the current tax framework, arguing that the Defendant should not have acted as a withholding agent, but rather paid him the agreed amount in its entirety."

"The Court states that confiscation occurs ***when taxpayers are taxed more than they should be based on the ability-to-pay principle."***

The Company should not always act as a withholding agent, even though it is a legal obligation, when employees' income is affected.

I. How Is Seniority Pay Taxed? Income tax has new limits to "confiscation", and here we analyze the supporting arguments

- (i) The passage of Act No. 27430, Executive Order No. 976/2018 and AFIP General Resolution 25 No. 4003-E put employees who pay income tax in the 4th bracket in a particular legal situation;
- (ii) Employers have the legal obligation to withhold income tax from the amounts that exceed the statutory seniority pay calculated based on the Supreme Court precedent in re Vizzotti, Carlos v AMSA SA on Employment Termination, for Directors and Managers who perform executive functions;
- (iii) Considering the position of Director that the Employee held upon termination, and given that the settlement offer made by the Company and accepted by the Employee is **a gross amount**, the Company should act as a withholding agent and make the relevant deductions for the items subject to income tax.
- (iv) It is particularly interesting to see that this is not what the reform of Act No. 27430 says. It does not make any reference to the Vizzotti case. On the contrary, the text of the reform acknowledges that the amounts paid as a result of an employment termination are severance pay in nature.
- (v) The Plaintiff explained that he expressed his opposition to the provision **added after Clause VII, whereby with the agreed payment under the agreement reached at SECLO, "he shall have nothing further to claim against the Company about the payment of taxes, social security contributions and/or any other liabilities in connection with his employment, with the exception set forth in the previous clause about withholdings by the Company from the agreed amount in the SECLO AGREEMENT"**. Clearly, the Plaintiff expressed an unequivocal disagreement with the alleged withholdings, saying "this would be grounds for a claim against the Company" and "such a claim gave rise to this action". He said "the Defendant was determined to deduct income tax" even though he was against it.

II. The agreement was approved at SECLO. The nature of the payment agreed at SECLO. Taxable base

- 1. The Plaintiff bases his claim on the argument that "it is not taxable income", and "income tax withholding requires a necessary correlation

between the taxable event, as defined in the Income Tax Act (hereinafter LIG, for its acronym in Spanish), and the de facto situation that leads to the payment from which the deduction will be made".

- 2. Section 2 LIG states that "for the purposes of this law, and regardless of the specific provisions for each bracket and even if they are not explicitly mentioned, income means: 1) profits, gains or earnings with such a frequency of payment that it implies a regular permanent source from which they derive". 2) Section 2 refers to profits, gains or earnings that meet or do not meet the conditions set in the previous paragraph, made by taxpayers under Section 73 and companies or sole proprietorships, except in the case of taxpayers under Section 73, who engage in activities under paragraphs f) and g) of Section 82, which are not supplemented by a business, in which case the provisions of the previous paragraph shall be applicable. 3) The results from the sale of depreciable movable property, whatever taxpayers' classification. 4) The results derived from the sale of shares, securities and certificates of deposit of shares and other securities, quotas and shares — including shares of mutual funds and participation certificates of financial trusts and any other trusts or otherwise, digital currencies, securities, bonds and other securities, whatever taxpayers' classification. 5) The results derived from the sale of real estate and the transfer of rights over real estate, whatever taxpayers' classification".
- 3. Consequently, the Plaintiff "bases his action on the nature of the amount established in the agreement approved at SECLO, whose origin is the damages suffered as a result of his wrongful termination". "Both parties make reciprocal concessions to avoid the risks of a lawsuit (...) and voluntarily agree to determine the amount of reparation in a lump sum", compensation that is compatible with the legal concept of income under Section 2 LIG for two reasons: "first, it is not yield, profit, benefit, earning or the result of any sale" but rather **"reparation for damages suffered by the employee, whose amount has been established in the law" and "there is no frequency of payment that may mean a regular permanent source of income (Section 2 paragraph 1), rather "it is a one-off and final payment".**
- 4. The Plaintiff says that "the amounts paid as compensation for employment termination and damages (...) are not 'profit', 'income', 'benefit' or 'earnings', or the result of a sale, since they are paid as 'reparation' and **"not all profits, gains or earnings are taxable income but only those that meet the conditions in Section 2 LIG, i.e. a frequency of payment that implies a regular permanent source".**

- 5. Consequently, he understands that "it is equally ridiculous to claim that compensation for the wrongful termination of a Director is subject to Income Tax 4th Bracket because the law has included it in this category, but actually the nature of this payment should be enough grounds to classify it as non-taxable income".
- 6. He also says that "the taxable event described under LIG about employment (Section 2 paragraph 1) requires a frequency of payment that implies a regular permanent source of income, which is not the case of severance pay".
- 7. He says that "it is reasonable to think that the Defendant may want to avoid any AFIP's claim for the withholding of amounts owned" to the Plaintiff "no matter how absurd or illegal the regulations supporting this withholding may be". "It is always much easier to pass the problem onto the employee than to deal with the tax collection agency" although "the Defendant acting in compliance with the liabilities imposed by the Tax Authority is violating constitutional rights.
- 8. He says that "to justify the withholding of such a big portion of the agreed amount (which in this case means a 33.70% deduction), the Defendant argues that Act No. 27430 amended LIG in such a way that severance pay for employees holding managerial and executive positions in public or private companies is now considered a 'taxable event'.
- 9. He says that this is not the case since "the text of Section 2 LIG, which **defines 'taxable event'**, says that "*it is clearly and conclusively stated that the definition of taxable income is not the one that arises from the provisions that describe each of the four income tax brackets, as wrongfully suggested by the amendment of Section 79 LIG (today Sections 82, as per the consolidated text in 2019), but the definition provided in the five subsections of Section 2 LIG, which were not amended*". In other words, 'taxable event' means exclusively those mentioned in Section 2 regardless of whether or not they are mentioned in the provisions describing the four brackets that the law establishes for other purposes, and not to define "taxable event".
- 10. The Plaintiff says that "Section 47 of Act No. 27430 added the second paragraph of Section 79 LIG after the list in subsections a, b, c, d, e, f, and g, which describe income tax 4th bracket, establishing that: '*Despite the other provisions of this law, for those who hold managerial and executive positions in public or private companies, as provided by the regulations, the amounts paid exclusively due to employment termination, whatever their name, that exceed the*

minimum statutory severance pay under the applicable labor law are subject to Income Tax.

- **11. In the event that these amounts are agreed by mutual consent (termination by mutual agreement or employee buyout program, among others), Income Tax shall be imposed on the amounts above the minimum statutory severance pay under the applicable labor law for termination without cause.**
- 12. The Plaintiff says that "first it is relevant to analyze the opening phrase: 'Despite the other provisions of this law', as if with this expression any contradictions in the added text may be cured, when "it actually highlights its incongruity".
- 13. He understands that **"just as the Defendant cannot be required by the AFIP to act as a tax withholding agent for taxes without a specific law (...) the Defendant cannot dispose of his 'personal service' - in this case for the benefit of the tax collection agency - because he is deprived of his property (Section 17 National Constitution, CN for its acronym in Spanish). It is absolutely necessary to have a specific law or a well-founded court order to do so. No inhabitant of the Nation shall be obliged to perform what the law does not demand nor deprived of what it does not prohibit (Section 19 CN)"**. He says that "even if eventually the employer must act as a withholding agent on the compensation that the employee frequently receives during employment based on certain regulations (unconstitutional for sure), such as Executive Orders or even worse, AFIP resolutions, which do not rank as laws, in constitutional terms, the truth is also that under no law his former employer was designated as a withholding agent for the severance pay he received upon his employment contract termination".
- **13. He insists that "the tax law expressly exempts severance pay and interest for amounts awarded in labor disputes (Section 26 subsection i) LIG consolidated text in 2019 Executive Order No. 824/2019, text currently in force).** "Section 131 LCT expressly provides that: **'no amount can be deducted, withheld or offset if it reduces employee compensation'" and Section 132 LCT "establishes the only acceptable exceptions, which do not include Income Tax".**
- 14. He highlights that "AFIP, as part of the Executive, cannot establish tax liabilities because it is directly and expressly forbidden in the National Constitution" and that "there is no reason for that. It can establish, though, advanced tax liabilities (whether or not they are calculated as advance

payments), but it must observe the principles of legality and reasonableness, which is not the case here. It is high time that the Judiciary enforces the protection provided by the Constitution, which is repeatedly overridden by the Tax Authority".

- 15. He claims the unconstitutionality of Act No. 27430, specifically the reform introduced by Act No. 27430 through the paragraph added to Section 79 LIG (currently Section 82, as per the consolidated text in 2019) since its language violates the right to equality before the law under Section 16 CN to the detriment of the Plaintiff and confiscates his assets (33.70%), which is also contrary to Section 17 CN".
- 16. He says that "the paragraph added to Act No. 27430, Section 79, today Section 82, with the aim of taxing the amounts paid upon employment termination without a regular frequency of payment, means taxes are levied without a taxable event as defined in the law (Section 2 LIG)".
- 17. He also claims that "the contested rule unjustifiably transfers taxation to the employee" because nowadays "due to the effects of the reform of Act No. 27430, severance pay is now subject to taxation but curiously enough this only applies to a certain group of employees who hold managerial or executive positions who lose their jobs and their sources of income". He understands that "this legal and constitutional system ends up distorting the protective principle of labor laws and leaves a certain group of employees in the hands of a voracious tax authority that in the name of a financial emergency and in an attempt to reduce public spending justifies this withholding".
- 18. He emphasizes that "the reform of Act No. 27430 was a real setback in case law because if severance pay is taxable no matter the reason for termination (dismissal, resignation, termination by mutual agreement, increased compensation), now it refers to management or senior staff only, which is an act of discrimination. So this rule is unconstitutional because the severance pay for a Director is also a one-off reparation for his employment termination, just like for any other ordinary employee who does not hold a managerial position."
- 19. He points out that "the differential treatment for his senior position entails a different protection - against wrongful termination- and goes against the right to equal treatment that all employees enjoy". "His position or responsibilities in isolation cannot be considered as a relevant element to determine his ability to pay."

- 20. He also makes reference to the grounds put forward by the Supreme Court in re Vizzoti and to the fact that "for the Supreme Court a tax is confiscatory when it absorbs a substantial portion of the taxpayer's income or capital (Judgments: 242:73 and its citations; 268:56; 314:1293; 322:3255 among many others)"
- 21. But **"confiscation also occurs when the application of the tax goes against the ability-to-pay principle, reducing taxpayers' assets". This clashes with "the Plaintiff's constitutional right to property**, as a considerable sum of money is deducted from his reparation for the damage suffered".

III. Analysis of the Tax Law. A brief account of the events

1. (a) Claim description: "The Defendant raises the defense of lack of jurisdiction as a pretrial motion in the understanding that the Judge "is not the natural judge to rule on the constitutionality of the tax law; the matter should be resolved by the Administrative Contentious Court instead". This claim is rejected, page 161 (Lex 100).
2. (b) Alternatively, the Defendant raises a motion for lack of standing to be sued because the employee "should have filed the action against the Tax Authority", the tax collection agency that received the withheld amount, and not against the Company "who just acted as a withholding agent in compliance with the tax law currently in force".
3. (c) Curiously enough, the Plaintiff "does not claim he is not subject to Income Tax but rather challenges the constitutionality of the law". It goes without saying that "he should have filed his claim against the relevant tax collection agency, AFIP in this case, and not against his employer, who just acted as a withholding agent in accordance with the tax law currently in force" because "income tax on employees' salaries is paid through employer withholding, in compliance with AFIP specific rules".
4. (d) The Defendant insists that the Company "did not withhold the amounts in question for its own benefit but in its capacity as withholding agent for AFIP". The Defendant "was legally obliged to withhold the tax for its employee, who is also an Income Tax taxpayer". **If the Plaintiff "thinks that the withholding is unconstitutional, he should sue AFIP and seek a refund of the amounts paid" because "Diaverum's obligation was to withhold Income Tax in compliance with the law or otherwise face severe penalties under the tax regulations".**

IV. Background information and an account of the events The Company as a withholding agent and the disproportionate impact on employee's income.

The Defendant explains that the Plaintiff "was a senior employee" of the company, "one of the top-level authorities in the group", because of his managerial and organizational powers. The Company decided to terminate his employment and paid him a full and final settlement, adjusted for his accrued and earned salary, within the statutory time-frame. It is worth mentioning that the Plaintiff "did not question his final pay".

The Defendant says the Plaintiff "does not ignore the fact that due to his senior position he is subject to Income Tax 4th Bracket. Instead, he challenges the constitutionality of Diaverum's withholding, for which he seeks a refund".

VI. Circumstances and context at the time of signing the agreement at SECLO. Important steps that companies should take

- According to the Defendant, the Plaintiff "had the assistance of counsel at all times when signing the agreement". The Company agreed to "pay the gross amount stipulated in the agreement, and indicated that all relevant income tax withholdings would be made in its capacity as withholding agent for AFIP" because "the Plaintiff in his capacity as senior employee, **one of the top-level authorities in the business group, was subject to income tax as a result of the amendment of Section 79 of the Income Tax Act".**

- The Defendant says this fact is not denied by the Plaintiff, who "on the contrary, emphasizes he held his senior position and was the company's legal representative, but questions the constitutionality of the law".

- The Defendant says the Plaintiff "*entered into the agreement freely, willingly and knowingly*". *He did not sign "under duress*". *And "he was a well-known professional and an employee with a long track record at the company*" so "he was not a simple worker with basic training". "As described in the complaint, it was a lengthy negotiation, where **the Plaintiff played an active role and had the assistance of counsel.** He now questions the role played by Diaverumh as a withholding agent" and "under no circumstances could it be thought that there was any kind of deceptive maneuver by the Company, because the text of the agreement contains the gross and net amounts to be

paid with the respective income tax withholding, and "the agreement even specified the reasons why such withholding was made".

- The Defendant says that the Company "always acted as an Income Tax withholding agent for all personnel and under the leadership of Gelfman himself" because he "was a top-level authority and had consented to these withholdings for years".

- The Defendant explains that "case law refers to Income Tax 4th Bracket in those cases where the relevant capital factor has completely disappeared, or gained secondary importance, because income mainly derives from personal services, whether under an employment relationship or the performance of trades and crafts, professional services or freelance activities". And "in particular, Section 79 of the Income Tax Act establishes that: 'Income Tax 4th Bracket means: (...) b) profit from work under an employment relationship. The law says the 4th bracket income includes cash and in-kind compensation. *It is worth mentioning that while undoubtedly any amount paid to employees as a result of employment is taxed,* the discussion centers on those payments due to employment termination, and whether they are subject to Income Tax according to the text in force before the reform introduced by Act No. 27430".

- The Defendant recognizes that there is much debate about the items paid as a result of employment termination, and whether they are subject to Income Tax and withholding by the employer". **"There are those who claim the amounts paid as a result of employees' termination in the portion exceeding compensation for seniority calculated based on Section 245 LCT (or Vizzoti Judgment, if applicable) are subject to Income Tax" while "others say these payments, regardless of their amount, must be considered exempt under Section 20 subsection i) of the Income Tax Act, which exempts seniority pay in cases of termination".**

- **Finally, "there is a third position, accepted by the Supreme Court of Justice of Argentina, whereby these payments should not be subject to Income Tax because with the termination of employment the source of income disappears. <u>Therefore, they are not included as a taxable event and there should not be any tax liability or withholding by the employer".</u>**

- "These three interpretations (...) refer to the interpretation of the scope of the law: the definition of 'taxable event' and tax exemption under Section 20 subsection i)."The constitutionality of the law or the possibility of withholding income upon termination are not questioned. Instead, the question is whether the source of income still stands or not in accordance with the legal text in force before the reform".

- However, "the legal relationship under analysis here between Gelfman and the National State and its tax collection agency is not governed by the Income Tax Act according to its text before the reform. On the contrary, it is governed by the scheme that includes the amendment introduced by Act No. 27430 to the Income Tax Act" taking into account that "the situation has changed after the reform, except now there are two universes of employees, whose income derived from their employment termination will be taxed differently: **those who hold a managerial or executive position and whose salary is higher than fifteen minimum living wages - like the Plaintiff - and those who do not.**

- While for those who do not hold a managerial or executive position, the application of the precedents by the Supreme Court in re 'De Lorenzo', 'Cuevas' and 'Negri' could be sought at Court; for those who hold a managerial or executive position, the amounts paid as a result of their employment contract termination in the portion that exceeds the minimum statutory severance pay under the applicable labor law, are subject to income tax ".

- As a matter of fact, "Section 47 of Act No. 27430 (Official Gazette dated December 29, 2017) added a new paragraph to Section 79 of the Income Tax Act. This new paragraph establishes: *'Despite the other provisions of this law, for those who hold managerial and executive positions in public or private companies, as established by the regulations, the amounts paid exclusively as a result of their employment termination, whatever their name, that exceed the minimum statutory severance pay under the applicable labor laws are covered by this Section.*

- **Whenever these amounts are paid as a result of a termination agreed by the parties (termination by mutual agreement or employee buyout program, among others) they will be subject to Income Tax if they exceed**

the minimum statutory severance pay under the applicable labor laws in case of termination without cause".

"The express inclusion of this second paragraph in Section 79 of the Income Tax Act has substantially changed the legal system used by the Supreme Court of Justice of Argentina in previous cases. "With the passage of Act No. 27430, the amounts paid as a result of the employment termination of employees holding executive and managerial positions, if they exceed the minimum statutory severance pay under the applicable labor laws, have been expressly included in the Income Tax 4th Bracket. So it is irrelevant to discuss whether such amounts keep their source of income or not". "The prevailing rule in Supreme Court precedents in re 'De Lorenzo', 'Cuevas' and 'Negri' is clearly non-applicable when analyzing the tax treatment of income according to the new paragraph included in Section 79 of the Income Tax Act.

- "The Plaintiff, in his complaint, does not ignore the fact that he is subject to Section 79 of the Income Tax Act and Regulatory Executive Order No. 976/2018. He does not claim that due to his role and tasks he should be excluded from such a group of employees. Instead, he bases his claim on precedents issued within a different regulatory framework and on ill-founded grounds for unconstitutionality". **"Under the agreement at SECLO the Plaintiff recognized that he met the objective and subjective conditions to consider his role as a managerial or executive position in the terms of the second paragraph of Section 79 of the Income Tax Act and Executive Order No. 976/2018. But he does not question this in his complaint".** There is no discussion about the fact that the Plaintiff "held a managerial and executive position. His claim is based on a personal analysis about the hypothetical administration of justice or tax inequality when taxing the payments received as a result of his employment contract termination".

- So as explained, "it is made clear that the amounts paid by the Company are subject to Income Tax", and the Company "has the legal obligation to act as a withholding agent".
- This "marks a difference with the cases governed by the Income Tax Act according to the text in force before the reform" because before "what was the object of significant debate was whether the legal requirements were

met to consider that the income derived from a contract termination was actually included in the definition of 'taxable event' for Income Tax.

- ❖ In other words, and as explained above, the question used to center on whether or not the source of income continued and whether or not such income was exempt from taxation". Now "this debate within the current regulatory framework applicable to managerial and executive positions, is no longer relevant, since there is no doubt - beyond the out-of-context citation by the Plaintiff regarding the Supreme Court rulings - that income earned upon employment termination in excess of the minimum statutory severance pay under the applicable labor laws is included in the definition of 'taxable event' under the Income Tax Act".

VI – The Tax Authority (AFIP)

The Tax Authority is involved in this matter as a third party but "it shouldn't be involved because there is no employment relationship between the Tax Authority and the parties" and "based on the outcome of this lawsuit, they may collect their amounts awarded following the appropriate procedure and before the competent court having jurisdiction".

- If the Plaintiff "disagreed" with "the withholding, he should have filed an administrative claim based on Act No. 11683 (Section 81 and related provisions) with the Federal Administrative Contentious Court".
- "The Defendant is obligated to pay the relevant taxes to the tax collection authorities in compliance with Act No. 11683, in its capacity as tax withholding agent". So AFIP's involvement as a third party "does not make any sense and so its summons is an absolutely unnecessary waste of time and resources (...) in an attempt to elude the correct procedure to resolve the matter".
- As the discussion about "whether or not income tax should be withheld from severance pay is heard by a Labor Court", actually “if the final ruling is contrary to the employer's claim, and the company is ordered to return the amounts withheld, the employer is entitled to file an action for recovery against the tax agency”.
- "Only the Defendant is a party to this process, regardless of an eventual recovery action that it may bring". "With regard to the Defendant's lack of standing to be sued, many precedents say that the liable person for eventual reimbursement is the withholding agent who, as appropriate, may file a recovery action against the Tax Authority".

- "The withholding agent is the one who handles taxpayers' money because he is a debtor or because of the public role he plays, his activity, craft or trade, or profession, and consequently he is required to take a portion and pay it to the Tax Authority in the name of the creditor". In the case of "employment contracts, the source of income is automatically the employment relationship and any resulting payments are subject to taxation". Please note "Section 26 of the Tax Act (consolidated text in 2019 according to Executive Order No. 824/2019) makes a detailed list of Income Tax exemptions, including "seniority pay" under subsection i); that's why "the other items in case of termination are therefore subject to taxation".
- "Even though such items may be considered 'taxable events', because of the regular permanent source of income, the truth is that in this particular case, income is explicitly subject to Income Tax 4th Bracket under Section 82 of the Tax Act (although the Plaintiff ignored the fact that Section 79, which he repeatedly mentions and of which he seeks the declaration of unconstitutionality, was amended around four years ago). **The second paragraph of Section 82 (consolidated text in 2019 according to Executive Order No. 824/2019) explicitly states that the amounts resulting from an agreed termination ('termination by mutual agreement or employee buyout program, among others') shall be taxable in the portion that exceeds the minimum statutory severance pay under the applicable labor laws in the case of termination without cause, as established by the regulations".**
- The Plaintiff cites precedents but "there is no point because they do not help decide cases like this. "Both the 'Negri' and 'Bogado' rulings on which he bases his claim were issued before the tax reform of Act No. 27430. As a matter of fact, the Recitals refer to the definition of income according to the regular permanent source of income (compliance with legal requirements under subsection 1 of Section 2 of the Income Tax Act)".
- "As a result, the main line of argument and the legal sources on which the entire claim is based are wrong, ignoring that the taxable events mentioned in the Income Tax Act are broadly described (a regular permanent source of income for individuals, and profits in the balance sheets for legal entities) under Section 2 of its text, and in particular (without the need to prove the circumstances in the previous case) in each of the Sections about income in each Bracket (in this case, the explicit inclusion for the purpose of Income Tax arises from Section 82, 4th Bracket Income).

- It is particularly striking that "the Plaintiff recognizes that the case under subsection b) is applicable here. He is classified as a 'director'", which "is also proved by the answer to the complaint by the former employer". "However, the Plaintiff files an action because he argues that such regulation is arbitrary and contrary to the principle of legality, indicating that the role of Manager, in reality, does not match the tasks that he effectively performed for the Company".
- He explains that "the withholdings in dispute here were made when he was paid severance pay as a result of his employment termination by mutual agreement under Section 15 LCT before a mediator at SECLO. "This agreement is particularly relevant because it was signed by both parties to terminate employment". "This agreement was accepted by both parties. The Defendant agreed to deposit the income tax withholding from the agreed amount of ARS 28,550,227.00 and undertook to hand in Form 984 - certificate of Income Tax withholding-VI and VII of the agreement" within 30 days following execution of the agreement. And the Plaintiff accepted the agreed amount and stated that he would have nothing further to claim in this regard". "The agreed amount is not broken down but totals ARS 28,550,227.00 in a lump sum", as agreed between the parties. "The complaint and the answer to the complaint contain transcripts showing the Plaintiff recognized that he held a managerial position at the Company and that his salary was subject to Income Tax in the same exact amount that he now inconsistently claims."
- "The free will of the Plaintiff and the Defendant does not seem to be compromised". The Plaintiff "had the chance of going over and challenging the settlement offer, and yet accepted it without reservation". "The agreement does not in any way indicate that the payment would be exempt from income tax; on the contrary, the text shows without a shadow of a doubt that certain items would be subject to Income Tax, even specifying the amounts in question". So now with this contradictory attitude, the Plaintiff now seeks refund of the withheld amounts". "The Plaintiff cannot seek refund of the withheld amounts when he expressly has consented to them".
- The Court found:

I- As shown in the records of these proceedings, Diaverum Argentina SA hired Rubén Eduardo Gelfman. He had worked for the Company for more than 22 years. At the time of termination he was "Chairman of the Board and General Manager",

until his employment ended on the date of termination under Section 245 LCT. The termination agreement was entered into at SECLO and approved by the Department of Labor. Clause IV reads: "**The Company states that in its capacity as withholding agent for AFIP it will withhold Income Tax from the agreed payment and pay the net amount in a lump sum by bank transfer once the agreement is duly approved".**

Based on a reasonable interpretation of the letter and the spirit of the employment contract and the termination agreement, the Plaintiff's seniority and the subsequent compensation shall be subject to Section 79 of the Income Tax Act.
It is worth mentioning that based on the legal employment relationship between employer and employee, the Company must fulfill its obligation as a withholding agent, as provided by the law.

According to the Plaintiff's seniority, the Court should determine the admissibility of the application of Section 47 of Act No. 27430, in force since January 1, 2018, which reads **as follows: "The following text is hereby added as the second paragraph of Section 79 of the Income Tax Act, consolidated text in 1997, as amended: 'Despite the other provisions of this law, for those who hold managerial and executive positions in public or private companies, as established by the regulations, the amounts exclusively connected with their employment termination, whatever their name, that exceed the minimum statutory severance pay under the applicable labor laws are covered in this Section.**
In the event that these amounts are agreed by mutual consent (termination by mutual agreement or employee buyout program, among others), they shall be subject to Income Tax in the portion that exceeds the minimum statutory severance pay under the applicable labor laws in the case of termination without cause.

As per case law and scholars' opinions, the parties may establish greater benefits for employees than those contained in the law or in the applicable collective bargaining agreement. In other words, the goal of the Employment Contract Act is to protect employees' rights in that they cannot be reduced at the employer's discretion. In addition, the Income Tax Act does not suggest, let alone stipulate, that the tax exemption for this type of severance pay refers only to the minimum amount that the employer must pay when employees are terminated without cause.

It is reasonable to challenge the interpretation of the tax law made by the Plaintiff when he understands that he is not obligated to pay Income Tax on the amounts received, and entitled to claim full severance pay in the agreed amount.

From this standpoint, these amounts cannot be below the minimum statutory payments, since these are public order provisions. The claim cannot seek a transfer of the tax obligations imposed by law.

But since severance pay can be greater than the minimum statutory amount, the portion in excess of the minimum legal severance pay is subject to taxation.

The Supreme Court of Justice of Argentina in the matter of Vizzoti, Carlos Alberto v AMSA SA dated September 14, 2004 **declared the unconstitutionality of the caps under Section 245, paragraph 2 of the Employment Contract Act. Paragraph #11 of the Recitals reads "... it is not reasonable, fair or equitable that the salary base provided for in the aforementioned Section 245, paragraph 1 of the Employment Contract Act, i.e. 'the highest regular usual monthly salary received in the last year or during the time-period of the provision of services, if shorter', be reduced by more than 33%, by application of paragraphs #2 and #3. This guideline, by the way, makes reference to the Court's well-known precedents whereby confiscation occurs when the tax burden exceeds the aforementioned percentage** (Judgments: 209:114, 125/126 and 210/310, 320 paragraph #6, among many others)...". And along this line of thinking, the prevailing rule in such cases helps the Court to solve this matter in that "... as this is a ruling by the Highest Court and for brevity's sake and to avoid unnecessary cost, the tax collection agency should take the criterion used by the Court in re Vizzoti, Carlos Alberto v AMSA SA, when declaring the unconstitutionality of Section 245 of the Employment Contract Act about the caps, thus broadening the scope of the tax exemption under Section 20, paragraph i) of the Income Tax Act".
This ruling dealt with the principle of non-confiscation to reduce the cap on severance pay when taxation means more than 33%, determining the nature of the severance pay items that exceed that cap. And when dealing with tax regulations for matters governed by labor laws, this criterion for interpretation means severance pay above such caps is also protected by the exemption under Section 20, paragraph i) of the Income Tax Act.

… "*The public order provisions for labor matters should be interpreted as a threshold in favor of employees, and not as a ceiling or limitation that leads to dividing the tax treatment of severance pay, a solution that the letter of the tax law does not establish...*"

Consequently, withholding is confirmed. Note that the declaration of unconstitutionality is always a last resort. The judge must rule in this respect when the law in question is contrary to the spirit of the Magna Carta, which is not the case here, because the fundamental rights have not been affected and so the claim for unconstitutionality should not be sustained.

Please feel free to contact us for further information.

Best regards,

Natalia de Diego

Senior Consulting Team - Labor and Employment Law

Leading Law Firm - de Diego & Asociados [These reports are prepared by the Senior Labor Consulting Team, a sophisticated team of specialized lawyers with more than 40 years of solid experience serving clients with the latest trends, carefully selecting topics for Human Resources executives.]