

The headache of the social treatment of severance indemnities

Reminder of applicable legislation and outline of the more stringent rules introduced by the amended finance bill for 2012

Up to 2011, it is true that exemption ceilings have been repeatedly decreased but at least the exemption principles remained a reality.

At a time the government strives to reduce the available social-related contribution exemptions in a difficult economic and social climate, the following elements – that come in addition to the drastic reduction of the exemption ceilings applicable to severance indemnities – should be outlined:

- **Since January 1, 2011:** the social and tax treatment of severance indemnities have been disconnected;
- **Since January 1, 2011:** the full exemption from social-related contributions of (i) mandatory dismissal indemnities provided for by law or applicable collective bargaining agreements and (ii) indemnities awarded by French labor courts in employment termination related disputes has been suppressed;
- **Since January 1, 2012:** the 3% rebate for professional expenses applied to the calculation of the CSG-CRDS (social taxes) has been simply and purely abolished for severance indemnities; the applicable CSG-CRDS tax rate for such indemnities is thus 8%;
- **Since September 1, 2012:** a further measure has impacted so-called “golden parachutes”: when the cumulated severance indemnities reach the threshold of 10 times the annual social security ceiling (hereinafter the “ASSC”), i.e. 363,720 Euros in 2012, such indemnities are subject to the CSG-CRDS taxes as from the first Euro.

1. New provisions introduced by the Amended Finance Bill for 2012^[1] : golden parachutes have definitively lost some of their attractiveness...

In 2009^[2], in the midst of the economic and financial crisis, the first – quite legitimate – sledgehammer blow to the social treatment of golden parachute payments had been widely commented. Specifically such payments became fully subject to social-related contributions and CSG-CRDS taxes as from the first Euro if their amount exceeded 1 million Euros^[3].

In 2012, the new reduction of the exemption ceiling almost goes unnoticed. Yet, even though such reduction can be deemed necessary as the French Social Security Administration is actively seeking to shore up its permanent deficit, it is in no way insignificant: effective as from September 1, 2012, indemnities paid in relation to a dismissal or forced termination of a corporate mandate are fully subject to social-related contributions and CSG-CRDS taxes as from the first Euro if their cumulated amount exceeds 10 times the ASSC^[4], i.e. 363.720 Euros for 2012.

The various indemnities affected by this new provision are as follows: severance indemnities paid following a termination at the initiative of the employer within or outside the framework of a redundancy plan (*Plan de Sauvegarde de l'Emploi* or hereinafter "PSE"), forced retirement indemnities, indemnities paid following the forced termination of a corporate mandate as legal representative or company officer, clientele allowance paid to so-called *voyageurs de commerce, représentants et placiers* (a specific status as sales representatives), voluntary termination indemnities paid in the framework of a PSE or a so-called GPEC agreement (i.e. a collective agreement concerning the management of employees' jobs and skills) as well as the indemnities paid in the framework of the so-called "*rupture conventionnelle*", i.e. a contractually negotiated termination.

It should be noted that when executive employees, specifically at the end of their career, negotiate a termination with their company, the amount of indemnities provided for under certain industry-wide collective bargaining agreements (e.g. Metallurgy, Bank & Insurance, etc.) are so significant that the above-mentioned ceiling may in fact be attained or exceeded fairly quickly.

It is therefore important to keep in mind the amount of this new maximum ceiling that can change many things when negotiating a termination with (senior) executives (and no longer only with managing or top executives).

The new social treatment of severance indemnities introduced by the Social Security Finance Bill for 2012^[5]

The Social Security Finance Bill for 2012 not only confirmed the disconnection between the tax and social treatment of severance indemnities but it also introduced (as did the Social Security Finance Bill for 2011) a transitional regime for 2012 while a definitive regime should come into force only as from January 1, 2013 (save any further amendments under the forthcoming Social Security Finance Bill for 2013...).

- Preliminary issue: what type of severance indemnities are affected by this new social treatment?

In fact, all severance indemnities that benefit from a full or partial exemption from income tax, as set forth in Article 80 *duodecies* of the French Tax Code (Article L. 242-1 §12 of the French Social Security Code), are affected by this new social treatment.

Specifically, these indemnities are as follows:

- Indemnities paid in relation to a dismissal held abusive, unfair or void pursuant to a court decision;
- Mandatory dismissal indemnities paid within or outside the framework of a PSE;

- Voluntary termination indemnities paid within the framework of a PSE;
- Settlement indemnities negotiated between the employee and the company;
- Forced retirement indemnities;
- Indemnities paid further to the so-called *rupture conventionnelle* to employees who have not reached the age required to benefit from a retirement pension (60 years raised to 62 years);
- Indemnities paid in relation to the forced termination of a corporate mandate as legal representative, corporate officer and other positions listed in Article 80 ter of the French Tax Code^[6]

The other sums paid in relation to the employment termination, in particular sums considered as remunerations (pay in lieu of notice, pay in lieu of vacation, non-compete indemnity, indemnity paid for the premature termination of a fixed-term employment contract) as well as voluntary termination indemnities paid outside the framework of a PSE, etc. are subject to social-related contributions from the first Euro.

In order to determine the applicable regime, all indemnities must of course be aggregated, even if the dismissal indemnities are paid by several companies.

- Reduction of the social-related contribution and CSG-CRDS exemption ceiling (disconnection with the applicable tax treatment)

While the social-related contribution and CSG-CRDS exemption ceiling had already been reduced by the Social Security Finance Bill for 2011^[7], it has been further lowered by the Social Security Finance Bill for 2012.

Effective from January 1, 2013 (and save any further reform), this exemption ceiling will be reduced from three ASSC to **two ASSC** (as a reference only: 72,744 Euros in 2012).

In other words, any Euro paid as severance indemnity above that threshold will be subject to social-related contributions and CSG-CRDS.

As such, a generous mandatory dismissal indemnity paid under an applicable collective bargaining agreement that used to be fully exempt from social-related contributions will henceforth be subject to such contributions for its portion in excess of 72,744 Euros.

Until January 1, 2013, the following transitional regime shall apply:

- Indemnities paid in 2012 in relation to a termination notified or taking effect in the framework of a contemplated collective dismissal plan for economic reasons notified to the employees' representatives on or before December 31, 2011, shall benefit from an exemption within the limit of three ASSC (i.e. 109,116 Euros).
- The social treatment of indemnities paid in 2012 in relation to a termination notified or taking effect in the framework of a contemplated collective dismissal plan for economic reasons notified to the employees' representatives in 2012 will depend on the amount of the mandatory dismissal indemnity provided for by the collective bargaining agreement (multi-branch agreement, branch agreement,

industry-wide, company-wide or site-wide collective bargaining agreement) applicable as of December 31, 2011, or in the absence of such agreement, the amount of the mandatory dismissal indemnity provided for by law:

- If the amount of the mandatory dismissal indemnity provided for by the collective bargaining agreement or by law exceeds three ASSC (i.e. 109,116 Euros), the exemption ceiling is set at this amount of 109,116 Euros;
- If the amount of the mandatory dismissal indemnity provided for by the collective bargaining agreement or by law is between two ASSC (72,744 Euros) and three ASSC (109,116 Euros), the exemption ceiling is equal to the amount of the dismissal indemnity provided for by the applicable collective bargaining agreement or by law;
- If the amount of the mandatory dismissal indemnity provided for by the collective bargaining agreement or by law is below two ASSC (72,744 Euros), the exemption ceiling is equal to this amount of 72,744 Euros.

The tax exemption ceiling remains fixed at 6 ASSC (i.e. 218,232 Euros in 2012).

Important: These ceilings are of course applicable only if they do not result in an exemption that is more favorable than that applicable for the determination of the amount exempt from income tax.

- The basic rules, that are identical to that used for the determination of the amount exempt from income tax, remain applicable

The exemption ceilings provided for under Article L. 242-1 of the French Social Security Code and Article 80 *duodecies* of the French Tax Code to be applied for the determination of the amount exempt from income tax remain fully enforceable to dismissal indemnities paid outside the framework of a PSE, indemnities negotiated between the employee and the company, forced retirement indemnities, indemnities paid further to a so-called *rupture conventionnelle* to employees who have not reached the age required to benefit from a retirement pension and indemnities paid in relation to the forced termination of a corporate mandate.

As such, the above-mentioned severance indemnities are in fact exempt from social-related contributions **up to the highest** of the following amounts:

- For employees^[8]: the amount of the dismissal indemnity provided for by the applicable collective bargaining agreement (industry-wide collective bargaining agreement, etc.) or, in the absence of such agreement, the amount of dismissal indemnity provided for by law;
- Twice the annual gross remuneration received by the employee during the calendar year preceding the termination;
- Half of the severance indemnity paid;

and, in any event, within the limit of two ASSC (or for 2012 the ceiling set forth under the transitional regime).

NB: For the indemnities paid in the framework of a PSE and the indemnities paid in relation to a dismissal held abusive, unfair or void pursuant to a court decision, only the exemption ceiling corresponding to two ASSC (or for 2012 the ceiling set forth under the transitional regime) shall apply.

- The CSG-CRDS treatment

As indicated, the CSG-CRDS rate applicable to severance indemnities since January 1, 2012 is 8% (there is no longer any rebate for professional expenses).

Apart from the aforementioned indemnities paid in relation to a dismissal held abusive, unfair or void pursuant to a court decision, all other aforementioned severance indemnities are **exempt from CSG-CRDS** up to:

- Either the fraction of the aggregate severance indemnities corresponding to the the amount of the mandatory dismissal indemnity provided for by the applicable collective bargaining agreement or, in the absence of such agreement, the amount of dismissal indemnity provided for by law, insofar as such indemnity is fully exempt from social-related contributions (any amount paid in excess of this indemnity is subject to CSG-CRDS even if it remains exempt from social-related contributions);
- Or, in any event, the fraction of the aggregate severance indemnities that is not taking into in the social-related contribution calculation basis.

The underlying rule is indeed that the amount of CSG-CRDS exemption may not exceed the amount of social-related contribution exemption (Article L. 136-2, II 5° of the French Social Security Code).

Concerning the indemnities paid in relation to a dismissal held abusive, unfair or void pursuant to a court decision, it should be noted that the fraction of such indemnities in excess of the amount set forth by law is subject to CSG-CRDS (the amount set forth by law is one month's salary if the dismissal procedure has not been complied with, 6 months' salary if the dismissal is without cause, 12 months' salary if the dismissal procedure governing dismissals on economic grounds has not been complied with and 2 months' salary if the company has not complied with its re-hiring priority obligation – *the employer has indeed the obligation to inform the dismissed employee of any job vacancy corresponding to his/her skills and competences*).

In conclusion, besides the fact that the social treatment of severance indemnities has become particularly complex (not to say a real headache), it is undisputedly clear that the available exemptions are shrinking away... and yet, given today's economic climate, there is absolutely no guarantee that the forthcoming Social Security Finance Bill for 2013 will not introduce further amendments to the currently applicable regime.

If that were the case, let's hope that the changes will focus on simplifying things (e.g. by suppressing the various currently applicable ceilings and setting forth once and for all a single and unchanging ceiling). In any case, there are not many alternative solutions for severance indemnities to be fully exempt from social-related contributions and social taxes: only damages awarded by a labor court pursuant to Article 1382 of the French Civil Code, i.e. damages paid as compensation for

a distinct loss, seem to remain fully exempt... but until when?

[1] Article 30 of the Law n°2012-958 of August 16, 2012 amending Articles L. 242-1 §12 and L. 136-2, II of the French Social Security code

[2] Social Security Finance Bill for 2009 dated December 17, 2008

[3] 30 times the annual social security ceiling, i.e. 1,060,560 Euros in 2011

[4] In 2012, the ASSC is set at 36,372 Euros

[5] Law n°2011-1906 of December 21, 2011

[6] In the event indemnities are simultaneously paid for the termination of an employment agreement and the forced termination of a corporate mandate, all such indemnities must be aggregated.

[7] Law n°2010-1594 of December 20, 2010 : the ceiling was brought back from 6 ASSC to 3 ASSC

[8] Excluding holders of a corporate mandate

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