

# Tax treatment of exemptions under the Public Service of Justice (Efficiency Measures) Act

Here follows a critical analysis of the changes made by the Public Service of Justice (Efficiency Measures) Act to the regulation of three of the exemptions provided for in Article 7 of the Personal Income Tax Act that seek to favour the implementation and promotion of non-court appropriate dispute resolution procedures.

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**W**ith effect from 3 April 2025, the fourteenth final provision of the Public Service of Justice (Efficiency Measures) Act 1/2025 of 2 January (LOMMESPJ), introduces changes to three of the exemptions set out in Article 7 of the Personal Income Tax Act 35/2006 of 28 November (LIRPF).

The first change affects Article 7(d) LIRPF, which regulates the exemption of damages arising from civil liability. The aim of this is, as stated in section IV of the lengthy preamble to the LOMMESPJ (the Preamble), to favour the ‘implementation and promotion of non-court appropriate dispute resolution procedures’ - in civil and commercial matters - thus helping to reduce conflict and the workload of the courts

of justice. The other two changes affect the exemptions provided for in the same legal provision for employment payouts (Article 7(e)) and child support (Article 7(k)) and share the objective of clearing up interpretative doubts about their application when compensation is the result of any appropriate dispute resolution procedure provided for by law.

### 1. Exemption of damages arising from civil liability

Article 7(d) LIRPF provides for the exemption of “damages arising from civil liability for personal injury, in the amount established by law or a court of law”. With regard to this first exemption, which does not undergo any change, it should be noted that, according to the administrative interpretation of the provision, the expression *judicially recognised* is not limited to quantification by means of a court decision, but also covers those cases where there is a voluntary approximation of the parties in conflict, provided that there has been some kind of judicial intervention, such as conciliation, admission, abandonment, discontinuance and settlement (Directorate-General for Taxation, answer to query no. V2847-20 of 22 September).

However, the fourteenth final provision of the LOMMESPJ incorporates a second exemption, through the introduction of a new second paragraph in Article 7(d) LIRPF, with the aim, as stated in the Preamble, that the exemption “may be applicable when, without the amount being fixed by law or by a court of law, compensation is paid by the insurer of the physical or psychological injurer in compliance with a mediation agreement or any other appropriate dispute resolution procedure provided for by law”.

In view of the Preamble and the very wording of the new exemption, its scope seems more limited than that provided for in the exemption established in the first paragraph of Article 7(d) LIRPF, since it only covers compensation for pain and suffering. All the same, regardless of the type of exemption that applies, compensation for financial losses or material damage is excluded in all cases.

Moreover, the application of the new exemption requires the simultaneous fulfilment of three requirements that considerably reduce its potential. According to the Preamble, these requirements are intended to “ensure the application of the exemption to real situations, avoiding abusive situations”:

- From this anti-avoidance understanding, the first of the requirements is illogical, according to which the exemption is only applicable if the compensation is paid “by the insurer of the injurer”. Consequently, the exemption will not be applicable if the payment of the compensation is made directly by the injurer, even if the reality of both the harm caused and the payment are proven and the rest of the requirements demanded by the legislation are met.
- As a second requirement, the compensation must derive from “a mediation agreement or any other appropriate dispute resolution procedure provided for by law, provided that a neutral third party has been involved in reaching the agreement by such procedure”. Therefore, for tax purposes, it is not enough for the compensation to be the result of any non-court appropriate dispute

resolution procedure (in accordance with the definition set out in Article 2(1) LOMMESPJ), but such must be established by virtue of one of the instruments provided for in Chapter I of Title II in which a neutral third party intervenes, such as mediation (Art. 14), conciliation (Arts. 15 and 16) and independent expert opinion (Art. 18). Furthermore, in principle, there are no obstacles to recognising the exemption when the compensation is determined within a collaborative law process, provided that neutral third parties are involved (Art. 19).

On the other hand, compensation agreed directly by the parties and that reached by virtue of a confidential binding offer are excluded from the exemption (Art. 17). In the same vein, given that the recognition of the exemption is conditional on the

prejudice to the fact that, in certain cases - for example, compensation awarded by the Insurance Compensation Consortium - the exemption provided for in the first paragraph of Article 7(d) LIRPF may apply to damages arising from civil liability for personal injury, in the amount established by law or a court of law (Directorate-General for Taxation, answer to query no. V1950/2008 of 28 October).

- As a third requirement, in order to benefit from the exemption, the agreement stating the compensation “must have been recorded in a public instrument”. Thus, it is not enough to formalise the agreement by means of a document stating the identity and address of the parties (and their lawyers) and of the neutral person who has intervened, the place and date on which it is signed and the obligations assumed by each party (Art. 12(1) LOMMESPJ). The formal requirements are intensified to the point of demanding that the agreement be put under seal in order to enjoy the exemption (Art. 12(3)). This is a requirement whose proportionality with respect to the intended purpose (avoiding situations of tax fraud) is debatable, especially when, in the absence of an agreement between the parties, notary fees are bound to be paid in most cases by the person who has suffered the harm (Art. 12(3))<sup>1</sup>.

## *The inflexibility of the new exemption of damages arising from civil liability reduces its effectiveness*

compensation deriving from one of the non-court appropriate dispute resolution procedures in which a neutral third party has intervened, it is understood that compensation awarded by public-sector entities is also outside the scope of application (Art. 3(2)), without

<sup>1</sup> In this regard, see Marín López, J. J., ‘La indemnización por daños físicos o psíquicos: su tratamiento en el IRPF tras la Ley Orgánica 1/2025, de 2 de enero’, *Economist & Jurist*, no. 286, 2025, pp. 62-69.

With regard to the amount of compensation that is considered exempt, the new second paragraph of Article 7(d) LIRPF limits it “up to the amount that results from applying, for the harm suffered, the system for the assessment of harm caused to persons in traffic accidents, incorporated as a schedule in the Recast version of the Civil Liability and Motor Vehicle Insurance Act approved by Royal Legislative Decree 8/2004 of 29 October”. In other words, to determine the maximum exempt amount of compensation, the amount that would be set according to the system for the assessment of harm caused to persons in traffic accidents will be taken as a reference. The part of the compensation that exceeds this maximum threshold will be subject to taxation.

The strictness of its scope and conditions of application casts some doubt on the capacity of the new exemption established in the second paragraph of Article 7(d) LIRPF to effectively fulfil the purpose of promoting out-of-court settlements for the fixing of damages arising from civil liability.

## 2. Exemption of employment payouts

The fourteenth final provision of the LOM-MESPJ also makes changes to the exemption provided for in Article 7(e) LIRPF for *employment payouts*. The material requirements and quantitative limits already known for the application of the exemption remain unchanged. However, together with some minor technical adjustments, the most significant change in the wording of the provision affects the nature of payouts not deemed established “by virtue of an agreement, pact or contract” and which, therefore, fall within the scope of the exemption.

In this regard, as a prerequisite for initiating employment proceedings, a new third paragraph is incorporated according to which “payouts agreed in conciliation before the administrative service referred to in Article 63 of the Employment Jurisdiction Act 36/2011 of 10 October, shall not qualify as payouts by virtue of an agreement, pact or contract”. Thus, in order to provide legal certainty, the interpretation that had already been embraced at the administrative and judicial level is ratified at the statutory level, recognising that the amounts agreed in conciliation, as long as they do not exceed the established statutory amount, are exempt from taxation.

The change made in the regulation of this exemption warrants two clarifications. Firstly, its practical effects will be felt in the field of compensation for unfair dismissals, since, according to the Directorate-General for Taxation, the exemption of employment payouts in the context of terminations by reasons of redundancy does not require conciliation or court decision (answer to query no. V2067-24 of 25 September). Secondly, the exemption provided for in Article 7(e) LIRPF shall not apply if, despite the payout having been formally established in a conciliation, it is clear from the circumstances of the case that the worker was not in fact dismissed, but rather his contract of employment was terminated by mutual agreement (judgments of the *Audiencia Nacional* of 3 July 2019, app. 144/2017, and of the Supreme Court of 20 April 2023, app. 2333/2021).

## 3. Exemption of child support

The fourteenth final provision of the LOM-MESPJ rewords the exemption contained

in Article 7(k) LIRPF, applicable to child support received by virtue of a “court decision”. Following the amendments made to the Civil Code by the Non-Contentious Jurisdiction Act 15/2015 of 2 July (LJV), this exemption was extended to child support agreed in a settlement agreement executed by the parents before a court clerk or as a deed before a notary referred to in Article 87 of the Civil Code (Directorate-General for Taxation, answer to query no. V2043-17 of 27 July 2017).

The changes made by the LOMMESPJ seek to dispel any doubts concerning the application of the exemption to “child support received under the settlement agreement referred to in Article 90 of the Civil Code, or under the equivalent settlement agreement provided for in the legal system of a devolved region, approved by a court or executed in solemn form before a court clerk or as a deed before a notary, regardless of whether or not said settlement agreement derives from any appropriate dispute resolution procedure provided for by law. Similarly, child support received by virtue of a court decision in cases other than those mentioned above is also considered exempt.

In line with the new regulation on the exemption of child support, the LOMMESPJ amends the reference to child support in Articles 64 and 75 LIRPF, articles that, from the payer’s perspective, take into account the payments made for the purposes of calculating the national and regional tax liability before allowances or credits.

This same clarifying objective would have advised, perhaps, the rewording of Article

55 LIRPF, which grants a deduction in the taxpayer’s tax base “for spousal and non-spousal maintenance, with the exception of child support, paid by virtue of a court decision”, especially when, following the amendments to the Civil Code by LJV, the administrative (Directorate-General for Taxation, answer to query no. V2043-17, of 27 July, and no. V2295-18, of 7 August) and judicial (Supreme Court Judgment of 25 March 2021, app. 1212/2020) view is that spousal maintenance (alimony) determined before a notary by mutual agreement or, under the same conditions, before a court clerk, meets the factual requirements of Article 55 LIRPF.

#### 4. Final thoughts

Beyond the LOMMESPJ’s fiscal effects, it is to be welcomed that our legal system provides for, “alongside the courts of law, non-court appropriate dispute resolution procedures, as an essential measure for the consolidation of a sustainable public service of justice’.

As already noted, according to the Preamble, “matters of any nature in which one of the parties is a public-sector entity, pending future regulation of these same appropriate dispute resolution procedures in the administrative sphere and in the judicial review jurisdiction under a differentiated legislative instrument” that reconciles appropriately the use of such dispute resolution procedures with “the public interest that underlies the intervention of all public-sector entities, as well as the public nature of the financing that supports their operation, the submission to the strict principle of legality as required by Article 103 of the Constitution and the presumed validity and

enforceability of administrative acts”, are not covered by the LOMMESPJ.

In this sense, fiscal non-derogability (Art. 18 of the Taxation Act [LGT]), a consequence of public bodies only doing what they are empowered or required to do by statute, does not *per se* prevent the application of transactional formulas for the prevention of conflict, especially in relation to questions of fact, valuation and even law (particularly in the presence of indeterminate legal

concepts), with the aim of mitigating the high level of conflict and litigation that currently exists in tax matters. This has been noted by the Spanish Taxpayer Protection Council in several recent reports, recommending the strengthening of agreement formulas within tax audits by extending the possibilities of assessments with the taxpayer’s agreement (Art. 155 LGT), the introduction of conciliation in tax proceedings and the application to these same proceedings of the pilot case mechanism.].