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Soulhier Bunch, Cabinet d'avocats d'affaires basé à Paris et Lyon

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Are the benefits of settlement agreements questioned by the new limits on tax and social exemptions?

As from January 1, 2006, the exemption caps on indemnities paid upon the termination of employment agreements were considerably decreased. Specifically, for indemnities paid upon a dismissal, any amount below 186,408 € is exempt from income tax and social contributions (which is six times the annual limit set forth by the Social Security Administration), and for indemnities paid upon forced retirement, any amount below 155,340 € is exempt (which is five times the annual Social Security limit). However, in 2005, the exemption cap was 366,000 €.

CSG and CRDS social contribution rules remain unchanged. Please find below the rules applicable to social contributions and to income taxes:

The indemnities paid upon termination of employment agreements to employees or legal representatives are exempt from social contributions and income taxes to the following extent:

- 2 times the amount of the gross annual salary paid during the calendar year preceding said termination, or
- 50% of the total indemnities.

The higher of the two is applied, but up to the limit of the new cap which is applicable to terminations notified as from January 1, 2006, i.e. 186,408 € or 155,340 € depending on the situation. Please note that these caps apply also to the forced termination of a corporate mandate for retirement or any other reasons.

However, please be reminded that the severance pay as per the French labor code and/or the applicable national collective bargaining agreement is still completely exempt from social contributions and income taxes, even if the amount exceeds the aforementioned caps.

In other words, the new caps apply to all severance paid because of the termination of the employment

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agreement or corporate mandate. The severance paid under an employment preservation plan is the only thing excluded.

As such, to determine this threshold, total indemnities are taken into account: severance pay as per the French labor code and the applicable national collective bargaining agreement and the settlement indemnity.

Therefore, it seems as if the settlement indemnity paid to employees, who receive a certain level of remuneration and benefit from a higher severance pay (because of a payment scale and/or seniority), has only a small part which may be exempt, if any.

The company, which hopes to end a litigation arising from the termination of an employment agreement or of a corporate mandate, must take into account these new provisions, which may increase the settlement indemnity by a significant amount and notably when it has to make a choice between a settlement agreement and litigation.

Please be reminded that the damages awarded by the labor courts remain completely exempt from social contributions. Additionally, only the amount over 6 months' salary of said damages is subject to CSG/CRDS charges.

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