

**TAX and LABOR & EMPLOYMENT LAW ALERT**  
**February 5, 2010**

**NEW PUERTO RICO SUPREME COURT DECISION ADDRESSES TAX  
CONSEQUENCES OF SEVERANCE PAYMENTS UNDER ACT NO. 80**

On December 18, 2009, the Puerto Rico Supreme Court issued its decision in the case of Orsini García v. Secretario de Hacienda, 2009 T.S.P.R. 191. The Court held that severance payments made to discharged employees pursuant to Act No. 80 of May 30, 1976 (“Act No. 80”) are not subject to Puerto Rico income tax, and as such, not subject to Puerto Rico income tax withholding.

After several years of employment, Orsini was discharged by his Employer. The Employer offered Orsini an amount in exchange for his signing of a release agreement, which Orsini accepted. The Employer withheld Puerto Rico income tax from the payment, and reported the payment and tax withheld to the Puerto Rico Treasury Department (the “Department”).

Orsini originally included the payment in his Puerto Rico income tax return as taxable wages. He subsequently filed an amended tax return to exclude said amount from income and request a refund of the tax withheld, on the basis that the severance payment did not constitute taxable wages. The Department denied the refund requested.

Orsini filed a claim before the Puerto Rico Court of First Instance against the Department alleging that the amount received did not constitute taxable wages, as it was not remuneration for work performed or services rendered, nor was it a substitute for his salary. Orsini argued that the payment was for damages. On the other hand, the Department alleged that the payment was not one under Act No. 80, but a separation payment and, as such, it was a payment of wages subject to Puerto Rico income tax.

Eventually, the matter reached the Supreme Court of Puerto Rico. The Court concluded that payments received under Act No. 80 are not subject to Puerto Rico income tax and, therefore, not subject to Puerto Rico income tax withholding. The Court took into account the fact that the amount received by Orsini was the same amount as the severance payment he would have received under Act No. 80. Furthermore, the Supreme Court concluded that the separation payment received by an employee as a result of a dismissal is not subject to Puerto Rico income tax because the purpose of said payment is to compensate for the damages caused to the employee by the loss of employment.

This case may have serious consequences in relation to separation payments, separation programs, settlement agreements, and the withholding and reporting obligations under various statutes. Thus, we recommend employers to discuss this matter further with legal counsel.

If you have any questions regarding the employment law implications of this case, or wish additional information regarding this matter, please contact any of the following attorneys of our **Labor & Employment Law Practice Group**:

Alfredo M. Hopgood-Jovet	(787) 250-5689	<a href="mailto:ah@mcvpr.com">ah@mcvpr.com</a>
Jorge A. Antongiorgi-Betancourt	(787) 250-5659	<a href="mailto:jab@mcvpr.com">jab@mcvpr.com</a>
María Antongiorgi	(787) 250-2624	<a href="mailto:maj@mcvpr.com">maj@mcvpr.com</a>
Francisco Chévere	(787) 250-5615	<a href="mailto:fc@mcvpr.com">fc@mcvpr.com</a>
Maggie Correa Avilés	(787) 250-5621	<a href="mailto:mc@mcvpr.com">mc@mcvpr.com</a>
Anita Montaner Sevillano	(787) 250-5652	<a href="mailto:ams@mcvpr.com">ams@mcvpr.com</a>
James D. Noël III	(787) 250-5673	<a href="mailto:jdn@mcvpr.com">jdn@mcvpr.com</a>
Miguel Palou Sabater	(787) 250-5686	<a href="mailto:mps@mcvpr.com">mps@mcvpr.com</a>
Radamés (Rudy) A. Torruella	(787) 250-5679	<a href="mailto:rat@mcvpr.com">rat@mcvpr.com</a>

If you have any questions regarding the tax implications of this case, or wish additional information regarding this matter, please contact any of the following attorneys of our **Tax Practice Group**:

Carlos E. Serrano	(787) 250-5698	<a href="mailto:ces@mcvpr.com">ces@mcvpr.com</a>
Juan Luis Alonso	(787) 250-5655	<a href="mailto:jla@mcvpr.com">jla@mcvpr.com</a>
Ariadna Alvarez	(787) 250-2602	<a href="mailto:aar@mcvpr.com">aar@mcvpr.com</a>
Rubén Muñíz	(787) 250-2623	<a href="mailto:rm@mcvpr.com">rm@mcvpr.com</a>

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