

MADEIRA'S TAX GUIDE (NEW DEVELOPMENTS 2021)

1. INTRODUCTION

At the end of 2020, the Portuguese Government proposed to Parliament an extension of the Madeira Free Trade Zone regime, foreseen in the Portuguese Tax Benefits' Code. This extension, along with other amendments to the regime, was approved on April 20th, 2021.

This new Law - Law no. 21 / 2021, of April 20th - extended the Madeira Free Trade Zone regime until December 31, 2021.

In addition to extending the deadline for accessing to the regime, changes were also made to address some concerns raised by the European Commission, particularly regarding the creation and maintenance of jobs.

2. GEOGRAPHICAL CONTEXT

Situated off the coast of Portugal, Madeira is a Portuguese archipelago that is part of the European Union (EU) and is officially qualified as an ultra-peripheral region. The special circumstances of its location and development enable the region to offer a variety of favorable tax regimes, namely free trade zones, lower tax rates and specific tax incentives.

3. INTERNATIONAL BUSINESS CENTER (CINM)

Madeira’s International Business Center (referred to as “CINM”) was created in the 1980’s, aiming to attract international investment as well as boosting economic growth and social development in the region.

CINM consists of a variety of incentives, primarily tax benefits, aiming to:

- i. modernize, diversify, and internationalize Madeira’s goods and services
- ii. allow companies established in the region to compensate and overcome structural inefficiencies and disadvantages derived from the region’s ultra-peripheral status

This special regime was originally established as a State Aid program to develop the region, fully authorized by the EU.

One of the greatest advantages of the CINM regime is the wide list of tax benefits granted to corporations and their shareholders. Corporations that are registered with CINM may benefit from a 5% corporate income tax (CIT) rate, as well as other tax benefits.

The current benefits provided by the regime apply to entities that have registered with CINM between January 1st, 2015, and December 31st, 2021. Once registered, the regime’s benefits may be applicable until the end of 2027.

MINIMUM REQUIREMENTS

To be entitled to these tax benefits, companies must be duly registered with CINM regime and meet one of the following requirements:

JOB CREATION

OPTION 1	Creation of one to five jobs during the first six months of activity, as well as a minimum investment of € 75,000 on fixed, tangible, or intangible assets during the first two years of activity
OPTION 2	Creation of six or more jobs during the first six months of activity

ELIGIBLE TAXABLE INCOME

On the other hand, the application of the 5% CIT tax rate is limited to the following amounts of taxable income, determined by the number of jobs created as follows:

NO. OF JOB CREATED	TAXABLE INCOME
1 to 2	€ 2,730,000
3 to 5	€ 3,550,000
6 to 30	€ 21,870,000
31 to 50	€ 35,540,000
51 to 100	€ 54,680,000
Over 100	€ 205,500,000

The renewed regime, in line with the concerns expressed by the European Commission, has introduced new criteria for job creation, namely:

- (i) the number of jobs is determined by the number of people who earn employment income paid or made available by the licensed entity, if they reside, for tax purposes, in Madeira, or if they are not Madeira residents, they carry out their activity therein or are workers or crew members of ships or pleasure boats registered in the International Shipping Registry of Madeira
- (ii) permanent employees, part-time employees, or intermittent employees, are considered proportionally to the full-time practice in a comparable situation, measured in number of work units per year

In this context, the following are excluded from the calculation of the number of jobs:

- (i) employees assigned by temporary employment agencies
- (ii) employees on a casual assignment regime
- (iii) employees under a multi-employer regime, when the employer that represents the others in the employment relationship is not licensed in the Madeira Free Trade Zone

The new amendment to the Madeira Free Trade Zone regime also specifies that, in order to be eligible under the CINM benefits, any income, expenses or losses must be attributable to the activity performed by the licensed entity through an appropriate business structure located in Madeira.

OVERALL ANNUAL LIMITATION

In addition, the overall tax benefits obtained by companies under this tax regime are limited to one of the following annual limits:

20,1%	of yearly gross value-added
30,1%	of yearly labour costs; or
15,1%	of yearly turnover

INDUSTRIAL FREE TRADE ZONE

In addition to the reduced rate of 5% until 2027, manufacturing companies in the Madeira Free Trade Zone may also benefit from a 50% reduction on their taxable income, provided that at least two of the following conditions are met:

- (i) contribution to the modernization of the region's economy through the technological innovation of products, manufacturing processes or business models
- (ii) diversification of the region's economy by introducing new high added-value activities
- (iii) attraction of highly qualified human resources
- (iv) contribution to the improvement of the environment
- (v) creation of 15 jobs for a minimum period of 5 years

Moreover, these companies will also benefit from a suspension regime, which states that non-EU incorporated raw materials and components will only be subject to import duties when the final product leaves the Madeira Free Trade Zone.

OTHER TAX BENEFITS

In addition, companies registered with CINM are entitled to 80% exemption from stamp duty on documents, contracts, and other operations requiring public registration, provided that other parties involved are not residents in Portuguese territory or are also companies operating within CINM's legal framework.

Companies under this regime are also granted an exemption of up to 80% of applicable to municipal real estate tax (RET) and real estate transfer tax (RETT), regional and municipal surtax, as well as any other local taxes.

Moreover, CINM also provides a great platform for the successful application of the wide network of international double tax conventions (DTT) signed by Portugal, as well as the application of EU directives, offering a great competitive advantage over other international markets.

It is also worth noting that an express rule was established to clarify that entities licensed with CINM are subject to a special advance payment of CIT, as well as autonomous taxation, assessed in proportion to the applicable CIT rate, except for:

- (i) autonomous taxation on non-documented expenses
- (ii) autonomous taxation on expenses corresponding to amounts paid or due, for any reason, to non-resident individuals or companies that are subject to a clearly more favorable tax regime, unless the taxpayer can prove that they correspond to real operations that are not of an abnormal or exaggerated amount.

JOINING CINM

CINM is available for any legal entity incorporated according to law.

Legal entities providing services shall apply for the permit jointly with the “*Sociedade para o Desenvolvimento da Madeira, S.A.*” (SDM), CINM’s managing entity.

This permit can be requested by a company that already exists either in Portugal or abroad, as well as by a soon-to-be-incorporated company. In the latter case, the same requirements and procedures foreseen for existing Portuguese legal entities will apply.

In case of a successful application, the license is granted once the applicant provides proof of the creation and registration of the company.

Companies registered with CINM are subject to an establishment and operating fee:

- (i) Services-oriented companies will be subject to an application fee of € 1,000 and to an annual fee of € 1,800

- (ii) Holding companies (SGPS) will be subject to an application fee of € 1,000 and an annual operating fee of € 1,800 for the first year, and € 1,800 plus 0,5% of the previous year's profit, with the first 1 million euros being exempt for the subsequent years. This annual fee is restricted to a maximum of € 30,000.

EUROPEAN COMMISSION'S POSITION

The need to adhere to economic substance requirements was reinforced by the European Commission's announcement in July 2018 that it had begun an in-depth investigation into tax exemptions granted to some companies doing business in CINM.

The aim of the European Commission was to determine whether some of the conditions set out in the decisions issued in 2007 and 2013 (approval of the extension of the CINM regime under EU state aid rules) were being respected.

More specifically, the European Commission questioned the compliance of the following requirements:

- (i) if the profits subject to income tax reductions were exclusively Madeira-sourced
- (ii) the benefitting companies have actually created and maintained jobs in Madeira

In this context, the Portuguese Tax Administration itself has recently changed its interpretation and legal application procedures to only consider jobs that are *de facto* created in Madeira as eligible under the CINM regime.

The European Commission's investigation did not negatively affect the existence of the special tax regime, as its purpose was merely verifying compliance with the economic substance requirements.

In fact, it is also worth noting that CINM was included, in 2017, in the general block exemption regulation, which means that application no longer depends on the approval of the European Commission, as it no longer qualifies as State Aid.

4. MADEIRA'S INVESTMENT TAX CODE

Additional contractual tax benefits were established in Madeira's Investment Tax Code with the aim of strengthening regional business and ensuring good market dynamics. This is achieved by introducing incentives to investment and capitalization, particularly in areas such as industry mining, manufacturing, tourism, computer activities and services, research and technology, environment, energy, telecommunications, and IT projects.

Madeira's Investment Tax Code encompasses four special regimes (however, the tax benefit regarding productive investment is only applicable to investment projects that have been carried out until December 31st, 2020, as detailed below).

PRODUCTIVE INVESTMENT

Investment projects, carried out before December 31st, 2020, for a period of ten years, whose relevant applications are equal to or greater than 1.5 million euros, in Madeira Island, and 500 thousand euros, in the case of developments in Porto Santo, are eligible to several benefits, including a tax credit of between 10% and 35% of relevant investments, as well as exemptions and reductions in RET or RETT rates and exemption from stamp duty.

The framework and maintenance of the regime are subject to several objective and subjective conditions and to certain ongoing obligations.

INVESTMENT SUPPORT

To benefit from tax incentives under the Investment Tax Code, CIT taxpayers, among other conditions, must make an investment that provides job creation and maintenance for a minimum maintenance period three years for small or medium enterprises, and five years for other entities.

This regime states that benefitting entities may deduct 35% of the relevant investments from their payable CIT (up to € 1.5 million), and 15% regarding the exceeding amount.

RETAINED AND REINVESTED PROFITS

The Deduction for Retained and Reinvested Profits Regime (Madeira's DLRR) allows the deduction from IRC collection of up to 15% of retained profits that are reinvested, within two

years, in relevant applications. This deduction can reach 25% of payable CIT, up to a maximum annual reinvested amount of € 1.5 million.

RESEARCH AND BUSINESS DEVELOPMENT

Finally, a deduction of 32.5% of the amount invested in research and development is allowed (with the possibility of a rate increase).

FINAL REMARKS

It should be noted that the 5% corporate tax rate foreseen in Madeira is the lowest in Europe.

On the other hand, the CINM grants a wide list of tax benefits to shareholders of registered companies, excluding income related to companies located in lower tax jurisdictions, as well as benefits regarding the distribution of profits.

As for the Madeira Investment Tax Code, it is a useful tool to stimulate the development of business activities. However, its practical application requires careful analysis and monitoring of compliance with applicable requirements, so that the investor and taxpayer can adequately mitigate any potential risk of non-compliance.

These instruments also allow Portugal (and particularly Madeira) to function as an attractive investment platform.

Furthermore, it should also be noted that the tonnage tax system provides shipping and maritime transport companies established in Madeira with an alternative and potentially more favorable method to determine the taxable income from their shipping activities.

Lisbon, September 6th, 2021

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International Tax Review – “Best European Newcomer” (shortlisted) 2013 / “Tax Controversy Leaders”, 2014, 2015, 2016, 2017, 2018, 2019, 2020 / “Indirect Tax Leaders”, 2015, 2016, 2017, 2018, 2019, 2020 / “Women in Tax Leaders Guide”, 2015, 2016, 2017, 2018, 2019, 2020 / “European Best Newcomer”, 2016 / “Tax Firm of the Year”, “European Tax Disputes of the Year” and “European Indirect Tax Firm of the Year”, (shortlisted) 2017

Best Lawyers – “RFF Tax Lawyer of the Year”, 2014 / “Recommended Lawyers”, 2015, 2016, 2017, 2018, 2019, 2020

Who’s Who Legal – “RFF Corporate Tax Adviser of the Year”, 2013, 2015, 2016 / “RFF Corporate Tax Controversy Thought Leader”, 2017 “Corporate Tax: Advisory and Controversy”, 2017, 2018, 2019

Legal Week – RFF was the only Portuguese in the “Private Client Global Elite Lawyers” 2018, 2019

STEP Private Clients Awards - RFF “Advocate of the Year 2019” (shortlisted)

IBFD Tax Correspondent Angola, Mozambique and East-Timor, 2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020

Bloomberg Tax and Accounting Author, 2020, 2021