



# MADEIRA'S TAX GUIDE (2019)

## 1. INTRODUCTION

Situated off the coast of Portugal, Madeira is a Portuguese archipelago that is fully part of the EU and has the status of 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 tax incentives.

## 2. INTERNATIONAL BUSINESS CENTER (CINM)

Madeira's International Business Center ("CINM") was created in the 80s with the aim of attracting international investment

as well as boosting economic growth and social development in the region.

CINM consists of a variety of incentives, primarily tax benefits, with the aim of:

- i. modernizing, diversifying and internationalizing Madeira's production (goods and services);
- ii. counterbalancing inefficiencies and disadvantages that corporations established in Madeira would otherwise suffer due to the region's ultra-peripheral status.

This special regime was originally instituted as a State Aid program to develop the region, and it is fully authorized by the European Union.

One of the greatest advantages of the CINM regime is the wide list of tax benefits granted to corporations registered under this regime and their shareholders. These corporations 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 been registered at the CINM since 1 January 2015 or are **registered before 31 December 2020** and are **applicable until the end of 2027**.

#### i. MINIMUM REQUIREMENTS

In order to be entitled to the tax benefits stated above, the companies registered within the CINM regime shall meet one of the following requirements:

JOB CREATION	
<b>OPTION 1</b>	Creation of <b>one to five jobs</b> during the <b>first six months</b> of activity, as well as an <b>investment of minimum € 75,000</b> by the acquisition of fixed, tangible, or intangible assets during the first two years of activity
<b>OPTION 2</b>	Creation of <b>six or more jobs</b> during the <b>first six months</b> of activity

#### ii. ELIGIBLE TAXABLE INCOME

On the other hand, the application of a lower 5% CIT tax rate is limited to the following amounts of taxable income,

determined by the number of jobs created as follows:

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

#### iii. 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 the **annual gross value added**

**30,1%** of the **annual labor costs**

**15,1%** of the **annual turnover**

#### iv. INDUSTRIAL FREE TRADE ZONE

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

- contribution to the modernization of regional economy by technological innovation of products and manufacturing processes or business models;
- diversification of the regional economy by introducing new activities of added value;

- iii. fixation 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, under whose provisions import duties will be charged on the non-European Union incorporated raw materials and components only when the final products leave the **Industrial Free Trade Zone**.

#### **v. OTHER TAX BENEFITS**

In addition, companies registered under the regime are entitled to **80% exemption from stamp duty** on documents, contracts, and other operations requiring public registration, provided that other parties involved are not resident in Portuguese territory or are also companies operating within the legal framework of the International Business Centre of Madeira.

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

Thus, Madeira's International Business Centre provides a great platform for the successful application of the **wide network international double tax conventions concluded by Portugal** as well as the application of European Union directives, offering a great competitive advantage over other international markets.

#### **vi. EXEMPTION ON DIVIDENDS AND INTEREST PAID TO NON-RESIDENTS**

An IRS or IRC exemption regime on dividends and interest paid to natural or legal persons that are not tax resident in Portugal. Such benefit is applicable until 31 December 2027.

Particularly, shareholders of entities licensed to operate within the Free Zone of Madeira that are not resident in Portuguese territory (not including here the partners of entities licensed to operate in the Industrial Free Zone, or which continue to carry on maritime or air transport, as well as shareholders domiciled in countries, territories or regions with privileged taxation) for the following income:

- i. profits made available to them by such companies, including the amortization of shares without reduction and capital, in proportion to the results that benefit from the application of the reduced rate and,

even if they do not benefit, result from income obtained outside Portugal, with the exception of operations carried out with entities domiciled in countries, territories or regions with privileged taxation regimes;

- ii. interest and other forms of remuneration for supplies, allowances or additions of capital which the shareholders make to the company or due to the fact that they do not raise the profits or remunerations made available to them.

#### vii. JOINING CINM

Madeira's International Business Centre 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.

The permit can be requested by a company that already exists either in Portugal or abroad, as well as by a company that will be incorporated. In the latter case, the incorporation will be subject to same requirements and procedures that are applied to

Portuguese legal entities according to the law.

In case of a successful application, the license is deemed to be granted in favor of the company once the applicant furnishes proof of the creation and registration of such company.

Companies located in the CINM are subject to an establishment and operating fee. Therefore, service-oriented companies will be subject to an application fee of €1,000 and to an annual fee of €1,800.

Holding ("SGPS") companies 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, being the first 1 million euros exempt, for the subsequent years. This annual fee is restricted to a maximum of €30,000.

#### viii. RECENT DEVELOPMENTS

The need to adhere to the above mentioned **economic substance requirements** is reinforced by the European Commission announcement, on 6 July 2018, that it had opened an in-depth investigation into tax exemptions for companies carrying on activities in the Madeira Free Zone.



The European Commission raised a concern whether the Portuguese Tax Authorities may have failed to respect some of the basic conditions under the 2007 and 2013 decisions by which the European Commission had approved the extension of Madeira Free Zone regime under EU State Aid rules.

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

- i. the company profits benefitting from the income tax reductions originated exclusively from activities carried on in Madeira;
- ii. the beneficiary companies actually created and maintained jobs in Madeira.

The European Commission's enquiry does not negatively affect the existence of the special tax regime, but rather specific implementations that may have not fully adhered to the economic substance requirements.

In this context, the Portuguese Tax Administration itself has recently aligned its interpretation and legal application considering, for the purposes of applying the scheme, only the jobs related to Madeira.

It is also noteworthy that an overall **reform of the Statute of Fiscal Benefits** is pending by a Special Working Party, who is performing a legal and economic analysis of the fiscal benefits. The work is expected to be concluded during 2019.

However, it is expected that the principles of the previous tax regimes will remain applicable in order to prevail the stability of Madeira's international business center, which plays a key role for the economic and social development of the autonomous region.

Lastly, considering the International Shipping Register of Madeira as the fourth largest international shipping register of the European Union, with the largest number of vessels since its creation, it is worth mentioning the new Portuguese tonnage tax regime, enacted in 2018, which offers shipping companies the possibility to opt for an alternative taxable income determination regime.

In fact, such development is expected to boost even further the International Shipping Register of Madeira due to a special tax scheme proposed to enhance the maritime industry.

Company administrators and certain activities performed by employees and service providers that relocate to Portugal

may also benefit from the Non Habitual Resident tax regime, where a 20% flat rate tax on their employment income may apply.

### 3. MADEIRA'S INVESTMENT TAX CODE (RAM)

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

Madeira's Investment Tax Code encompasses **four special regimes**:

#### i. PRODUCTIVE INVESTMENTS

An investment may qualify for this category if the application is presented by 31 December 2020 and the investment project has a value of at least € 1,500,000 (Madeira island) or

€ 500,000 (Porto Santo island, an island in Madeira's archipelago).

The benefits under this regime may be enjoyed for a period of 10 years, and they include:

- i. Tax credit up to a value equivalent to 10% to 35% of relevant applications;
- ii. Exemption or reductions on the immovable property tax rate; and
- iii. Exemptions from the special tax applicable to transactions of immovable property as well as stamp duties.

The framework and the regime's uninterrupted application is subject to various objective and subjective conditions, and certain continuous requirements.

#### ii. INVESTMENT SUPPORT

In order to benefit from the RFAIRAM regime, the investments performed by corporate taxpayers must not only create jobs but also assure their preservation for a certain period of time. The required period coincides with the minimum maintenance period of assets subject to investment, i.e. three years in case of SMEs and five years in case of non-SMEs.

This regime allows the deduction of 35% from the investment in qualified assets up

to € 1,500,000, and deduction of 15% from the exceeding part.

Moreover, with regard to investments in immovable property, the taxpayer may benefit from exemptions from immovable property tax, property transfer tax, and stamp duties.

### **iii. RETAINED AND REINVESTED PROFITS**

This regime allows the taxpayer to deduct the corporate income tax payable up to 15% of retained earnings that are reinvested within two years in assets that meet the requirements. The amount of reinvested profits is limited annually to € 1,500,000. This deduction may not exceed 25% of corporate income tax.

### **iv. RESEARCH AND BUSINESS DEVELOPMENT**

As to the SIFIDE-RAM regime, the taxpayer may deduct at least 32,5% of the expenses incurred in research and development activities during the period in question, provided that it they meet the requirements. This benefit is applicable until 2020.

## **4. FINAL REMARKS**

With regard to the CINM, it is to be pointed out that the 5% CIT rate offered

in Madeira is the lowest one in all Europe.

Moreover, the CINM regime grants a wide list of tax benefits to shareholders of the authorized companies carrying out activities within Madeira Free Trade Zone, excluding income related to companies located in lower taxation jurisdictions, as well as benefits regarding profit distributions.

With regard to Madeira's new Investment Tax Code, it is a great tool to spur the development of commercial activities. However, its practical application demands a careful analysis and monitoring of the requirements, so that the investor and the taxpayer adequately mitigate any potential risk of failing to fulfil any of the requirements.

These new instruments further enable Portugal and, particularly, Madeira, to act as an investment platform. The four special tax regimes provided in the Investment Tax Code are in perfect harmony with Madeira's International Business Centre, and there are no restrictions on development of business operations installed in the free trade zone. Moreover, the new tonnage system provides shipping companies established in Madeira an alternative and potentially more favorable method to assess the taxable income of their shipping activities.

Hence, it is expected that a large number of companies opt to be registered under this new regime in the foreseeable future, leading to the consolidation of the current system.

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Rogério M. Fernandes Ferreira  
Jorge S. Lopes de Sousa  
Pedro Campos Peres





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