Global Tax Alert

EU Commission approves enhancements to Madeira International Business Center Tax Regime

Executive summary

On 2 July 2013, the EU Commission issued a decision allowing Portugal to increase (by 36.7%) the taxable income ceilings to which the reduced 5% Corporate Income Tax (CIT) rate should apply. This amendment shall enter into force and apply for fiscal years 2014-2020.

In addition, the Portuguese CIT law is under a deep reform (with the aim to make the Portuguese tax system more competitive for both inbound and outbound investment), and several proposed changes may have a very positive impact for multinational companies with a presence in the Madeira International Business Center (MIBC).

Background

The MIBC regime from 1 January 2012

A new regime (Regime III) applies for companies operating under the MIBC from 1 January 2012 through 31 December 2020. The main features of this regime, which excludes financial and insurance activities, as well as intra-group services activities (namely, coordination, treasury and distribution center), can be summarized as follows:

- Reduced CIT rate: 5% until the end of 2020. This reduced rate applies on taxable income ceilings, which are associated with the number of jobs: the ceilings currently vary between €2,000,000 (one to two jobs) and €150,000,000 (more than 100 jobs), with any excess taxable income taxed at 25%.

- Substance requirements: creation of one to five jobs during the first six months of activity and a minimum investment of €75,000 on the acquisition of tangible or intangible fixed assets during the first two years of activity, or, alternatively, creating of six or more jobs within the first six months of activity.
Currently, the MIBC tax regime also provides for several withholding tax exemptions on payments to nonresidents, including:

- Interest on borrowings for investments and for the normal functioning of the company within the MIBC
- Royalties for the temporary use of industrial property rights, including technical assistance thereof, provided the use of such rights is related to the activity carried out within the MIBC
- Services

MIBC entities also benefit from a full stamp duty exemption on documents, books, papers, contracts, transactions, acts and products, provided no Portuguese entities (including permanent establishments of foreign companies), outside the MIBC are involved.

The increase of the taxable income ceilings and respective approval by EU Commission

On 30 December 2011, the Portuguese Tax Authorities notified the EU Commission of their intention to amend the existing aid scheme relating to the MIBC tax regime.

The Portuguese Tax Authorities notified the EU Commission of a 36.7% increase of the ceilings relevant to the annual base of taxable income. The method of adjustment takes into account two factors: (i) the rate of inflation for years 2007-2013 and (ii) the impact of the raise of the general CIT rate applicable in Madeira from 20% to 25% (which, in relation to MIBC entities, shall only apply to non-licensed income or to taxable income exceeding the applicable ceiling) since January 2012. The current applicable and proposed amended ceilings are indicated in the table below:

<table>
<thead>
<tr>
<th>Current ceiling (Regime III)</th>
<th>Proposed ceilings</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of jobs created</td>
<td>Tax base ceiling (Eur mio)</td>
<td>No. of jobs created</td>
</tr>
<tr>
<td>1 - 2</td>
<td>2</td>
<td>1 - 2</td>
</tr>
<tr>
<td>3 - 5</td>
<td>2,6</td>
<td>3 - 5</td>
</tr>
<tr>
<td>6 - 30</td>
<td>16</td>
<td>6 - 30</td>
</tr>
<tr>
<td>31 - 50</td>
<td>26</td>
<td>31 - 50</td>
</tr>
<tr>
<td>51 - 100</td>
<td>40</td>
<td>51 - 100</td>
</tr>
<tr>
<td>&gt; 100</td>
<td>150</td>
<td>&gt; 100</td>
</tr>
</tbody>
</table>

The new proposed taxable income ceilings should enter into force for fiscal year 2014 and should be in place until the end of 2020.

The EU Commission issued a decision on 2 July 2013\(^1\) where it was decided that the notified amendment to the ZFM scheme is compatible with the internal market in accordance with Article 107(3)a) TFEU. This means that Portugal has now received approval from the EU Commission to amend the MIBC tax regime and increase the taxable income ceilings for fiscal years 2014-2020.

Other relevant proposed changes with positive impact on MIBC entities

In January 2013, the Portuguese Government appointed an independent Commission to perform a study and propose changes to the country’s CIT law. Drivers of the CIT reform are (i) review and simplification of the CIT law and tax obligations, and (ii) a restructuring of the international tax policy to be more competitive both for inbound and outbound investment.
On 30 July 2013, the Commission released its proposals. Public comments are requested by the end of September. The proposed changes to the CIT law, if approved, are expected to be enacted in 2014. The main proposed changes with a positive impact on entities licensed to operate in the MIBC are summarized below.

**Withholding tax exemption on outbound dividends**
In addition to the existing exemption on outbound dividends paid to EU, European Economic Area (EEA) member-states with a tax cooperation agreement, and Switzerland, the proposed changes expands the regime to tax treaty countries with tax cooperation agreements.

The existing minimum holding requirements for the EU/EEA (direct shareholding of 10% and one year holding period) are greatly reduced. Under the proposal, the shareholding requirement is reduced to 2% (including indirect holdings through eligible companies) and although the minimum period of holding is maintained it can be met after the dividend distribution. Companies outside the EU/EEA must be subject to CIT at a minimum legal rate of 10%.

**Participation exemption**
The existing full participation exemption regime for EU/EEA dividends is proposed to be significantly amended, as follows:

- Reduction of the minimum holding percentage from 10% to 2%. This holding percentage can be met indirectly via holdings of eligible companies.
- The subsidiary can be located in any country, except a tax haven territory, provided that it is subject to one of the taxes listed in the EU Parent-Subsidiary Directive or to a minimum CIT legal rate not lower than 10% (and this can be waived if the dividends are from an entity which derives more than 50% of its income from an active business activity or if its assets are not composed more than 50% by (i) shareholdings of less than 2%, (ii) shareholdings in tax haven entities, (iii) other financial assets and (iv) Portuguese real estate).
- Application of the regime to the amortization of shares without a share capital reduction.

The regime should not apply if the dividend is tax deductible for the entity making the distribution. On the other hand, it is proposed to eliminate the specific anti-abuse provision that currently requires that the dividends are distributed out of income that has been effectively taxed.

**Capital gains and losses on shareholdings and other equity instruments**
A full participation regime is proposed for capital gains and losses on shareholdings held for at least 12 months (no minimum holding percentage requirement) provided the remaining conditions for the dividends participation regime are met. This applies to gains and losses from onerous transfers of shares and other equity instruments (namely, supplementary contributions), capital reductions, restructuring transactions and liquidations.

**Exemption regime for foreign permanent establishment (PE) profits**
The proposal includes the possibility for resident taxpayers (such as an entity incorporated in Madeira and licensed to operate in the MIBC) to opt for an exemption regime for foreign PE profits, in which case foreign PE losses are also not deductible, provided the PE is subject to one of the taxes listed in the EU Parent-Subsidiary Directive or to CIT at a legal rate of no less than 10% and the PE is not located in a tax haven territory.

The transactions between the head-office and the foreign PE should respect the arm's length principle and the costs related to the PE should not be allowed as a deduction for the head-office. Recapture rules are also introduced, as follows:

- PE profits should not be exempt up to the amount of PE losses deducted by the head-office during the 15 previous years.
- In the case where the PE is incorporated, subsequent dividends and capital gains from shares should not be exempt up to the amount of PE losses deducted by the head-office during the 15 previous years.
- Whenever the exemption regime ceases to apply, the PE losses and capital losses from shares (if the PE is previously incorporated) are not deductible up to the amount of the PE profits that were tax exempt during the previous 15 years.
**IP regime**

The proposed changes include an intellectual property (IP) regime that provides for a 50% exclusion from the taxable basis in relation to income derived from contracts of transfer or of temporary use of patents and industrial designs or models. This proposed change, combined with the MIBC regime, could reduce the nominal CIT rate to 2.5% for qualifying income.

Several conditions apply to be able to benefit from the IP regime and it should only apply to patents and industrial designs or models registered on or after 1 January 2014.

---

**Impact**

Multinationals with a presence in the MIBC should closely monitor the proposed increase of the taxable income ceilings and the proposed changes presented by the Commission. These new rules shall have a positive impact in the MIBC structures and, therefore, multinationals with a presence in the MIBC should reconsider and reorganize its group structures and transactions to take advantage of the new proposed rules.

---

**Endnote**


---

For additional information with respect to this Alert, please contact the following:

**Ernst & Young, S.A., International Tax Services, Lisbon**

- António Neves +351 21 791 22 95 antonio.neves@pt.ey.com
- Pedro Fugas +351 22 607 96 98 pedro.fugas@pt.ey.com
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2013 EYGM Limited.
All Rights Reserved.

EYG No. CM3778

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com