Portugal approves new Madeira tax benefits’ regime through 2027

Executive summary

Following the recent European Union (EU) Commission's decision to extend the Madeira tax regime through 2027, the new rules applicable to the Madeira International Business Centre (MIBC) were approved and published in the Portuguese Official Gazette on 1 July 2015.

The approved tax regime will apply to entities licensed to operate in the MIBC until 31 December 2020, although the tax benefits will apply until 2027. In addition, the MIBC tax regime is sanctioned and approved by the EU Commission and therefore provides a stable tax environment for the next twelve years.

Detailed discussion

MIBC background

The MIBC was created in 1980 and established in the Island of Madeira. Madeira (and therefore companies incorporated and licensed to operate in MIBC) has full EU membership, including access to all EU directives. It also benefits from the Portuguese Double Tax Treaty network, with limited exceptions provided in certain treaties signed between Portugal and the US, Canada and Brazil. The MIBC comprises an industrial free zone, an international services center and an international shipping register and, as from 2015, an air transport register.

The MIBC has been created with the main goal of attracting foreign direct investment in order to diversify and modernize the island’s economy. It has been conceived as a program of regional development and it is a regime of State Aid fully approved and supported by Portugal and the EU.
The MIBC has been created with the objective of providing investors with a unique package of benefits, offering a wide range of options to enhance the efficiency and performance of various forms of investment. The wide scope of activities which may be carried out, ranging from manufacturing and trading or commercial activities to shipping and e-business activities, and the various synergies which can be found among them, demonstrate that the MIBC has been carefully structured to serve investors with a global package.

Such fact, coupled with the MIBC’s full integration in the Portuguese and EU legal systems, has made the MIBC not only an efficient investment location, but also a well-regulated business center recently regarded by the Organisation for Economic Co-operation and Development (OECD) as a model to follow.

The MIBC consists of a center where entities incorporated and licensed until 31 December 2020 may benefit from a special tax regime, under which entities will be subject to a reduced corporate income tax (CIT) rate of 5% until the end of 2027. This regime is also available for entities licensed by 31 December 2014, for which the tax regime was available through 31 December 2020.

**Snapshot of MIBC proposed tax regime as from 1 January 2015**

A new regime applies for companies licensed to operate under the MIBC regime from 1 January 2015 through 31 December 2027. The main features of this regime are summarized as follows:

- **Reduced CIT rate:** A 5% rate applies through the end of 2027. The application of this reduced tax rate is limited to the following ceilings of taxable income (associated with the number of existing jobs in the relevant year):

<table>
<thead>
<tr>
<th>Taxable income</th>
<th>Number of jobs</th>
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<tbody>
<tr>
<td>€2.73 M</td>
<td>1 to 2</td>
</tr>
<tr>
<td>€3.55 M</td>
<td>3 to 5</td>
</tr>
<tr>
<td>€21.87 M</td>
<td>6 to 30</td>
</tr>
<tr>
<td>€35.54 M</td>
<td>31 to 50</td>
</tr>
<tr>
<td>€54.68 M</td>
<td>51 to 100</td>
</tr>
<tr>
<td>€205.5 M</td>
<td>&gt; 100</td>
</tr>
</tbody>
</table>

- Income above the noted taxable income ceilings is subject to the standard Portuguese CIT rate of 21%.
- Industrial entities licensed as from 2015 can benefit from a 50% tax relief, which may result in an effective CIT rate as low as 2.5%, provided certain conditions are met.
- Dividends (except in very few circumstances) and interest paid out of shareholder loans derived by foreign shareholders are exempt from tax. In some cases, resident shareholders may also benefit from a tax exemption on these incomes.
- Withholding tax exemptions on qualifying income paid to nonresidents are available, including interest, royalty and provision of services.
- Entities operating in the MIBC benefit from relief, up to 80%, on several other taxes and surcharges applicable in Portugal, namely, Stamp Duty, Property Transfer Tax, Municipal Property Tax, Regional and Municipal Surcharges.
Substance requirements: A company operating in MIBC is required to create one to five jobs during the first six months of activity and make a minimum investment of €75,000 on the acquisition of tangible or intangible fixed assets during the first two years of activity, or, alternatively, create six or more jobs within the first six months of activity.

The overall tax benefits granted to companies licensed to operate in the MIBC are however capped at one of the following amounts:

- 20.1% of the annual gross value-added
- 30.1% of the total annual labor costs
- 15.1% of the annual turnover

Capital gains: Nonresident shareholders of MIBC companies are exempt from capital gains tax on the disposal of the shares in the Madeira subsidiary, except if the shareholders are (i) located in a tax haven or (ii) are controlled, directly or indirectly, at least 25% or more by Portuguese resident entities. If more than 50% of the MIBC company’s assets are, directly or indirectly, composed of Portuguese immovable property or rights attached thereto, the capital gains tax exemption will also not apply. Nevertheless, capital gains tax may be avoided in accordance with double tax treaties.

Other considerations
Income that is not within the scope of the MIBC tax regime is taxed at the CIT rate of 21%.

It is possible to apply for (and obtain in a short time frame) advance binding rulings from the Madeira tax authorities, which should provide for further certainty and security.

As a rule, installation and annual operating fees payable to SDM (the MIBC management company) are €1,000 and €1,800, respectively.

For holding companies, the annual operating fee is increased by 0.5% of the previous year’s taxable profit exceeding €1,000,000, with a ceiling of €30,000. Industrial entities pay an operating fee calculated according to the area (square meters) required. Annual fees also will be imposed on registered vessels.

Entities incorporated in Madeira and benefiting from the MIBC regime qualify under all EU Directives adopted by Portugal and for purposes of most of the double tax treaties (treaties) signed by Portugal. It is important to note that some treaties signed by Portugal (e.g., treaties with Germany and Italy) provide tax sparing or matching credit provisions, which may be used in combination with the withholding tax exemptions available under the MIBC tax regime.

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

Ernst & Young, S.A., Lisbon

- Antonio Neves +351 21 791 2249 antonio.neves@pt.ey.com
- Pedro Fugas +351 22 607 9698 pedro.fugas@pt.ey.com
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