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**Subject: State aid SA.34160 (2011/N) – Portugal – Amendment of Zona Franca da Madeira scheme N 421/2006**

Sir,

**1. PROCEDURE**

- (1) On 30 December 2011, the Portuguese authorities notified to the Commission their intention to amend the existing aid scheme relating to the Madeira free zone (Zona Franca da Madeira)<sup>1</sup> ("the ZFM scheme"). The Commission registered the notification under case reference SA.34160 (N/2011).
- (2) On 29 February 2012, the Commission services sent a request for information, to which the Portuguese authorities replied on 16 April 2012 after having been given an extension of the deadline on 30 March 2012 following their request of 28 March 2012.
- (3) On 26 June 2012, the Commission services sent a request for information, to which the Portuguese authorities replied on 24 July 2012.

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<sup>1</sup> Commission decision of 27 June 2007 in case SA.21259 (N 421/06) Zona Franca da Madeira, OJ C 240, 12.10.2007, p. 1.

S. Ex.<sup>a</sup> o Ministro dos Negócios Estrangeiros  
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- (4) On 4 October 2012, the Commission services sent a request for information. On 31 October 2012, the Portuguese authorities asked for an extension of the deadline to which the Commission services agreed on 5 November 2013. On 19 November 2012 the Portuguese authorities replied to this request for information. On 18 January 2013, the Portuguese authorities submitted further additional information.
- (5) On 19 March 2013, the Commission services sent another request for information, the Portuguese version of which reached the Portuguese authorities on 2 April 2013. The Portuguese authorities replied on 30 April 2013.

## 2. DESCRIPTION OF THE ZONA FRANCA DA MADEIRA SCHEME ("ZFM SCHEME") AND THE NOTIFIED AMENDMENTS

- (6) The ZFM scheme, which was first approved by the Commission in 2007<sup>2</sup>, consists of operating aid in the form of various fiscal advantages, notably a reduced rate of corporate taxation applicable to companies licensed to operate in the Zona Franca da Madeira (ZFM). The ZFM scheme currently in force is the 3rd subsequent aid scheme in favour of companies licensed to operate in the ZFM that was approved by the Commission (Regime III). Regime I was authorised in 1987<sup>3</sup> and companies could benefit from it until 31 December 2011, while Regime II was authorised in 2002<sup>4</sup> and companies could benefit from it also until 31 December 2011. As from 1 January 2012, the companies registered under Regime II can only benefit from the provisions of Regime III.
- (7) The ZFM scheme allows aid beneficiaries to apply a reduced rate of taxation to the profits resulting from activities effectively and materially performed in Madeira up to a maximum taxable base ceiling. According to the 2007 Commission decision, as amended for the period after 2013 and up to 2020, the aid beneficiaries which have established themselves in the ZFM until the end of 2013 can benefit from a preferential corporate tax rate of 5%, up to a ceiling calculated on the basis of their annual taxable income. This benefit will apply until 31 December 2020<sup>5</sup>.
- (8) In addition, companies that carry out industrial activities in the ZFM can benefit from a further 50% tax cut as long as they fulfil at least two of the following conditions<sup>6</sup>:

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<sup>2</sup> See Commission decision of 27.06.2007 in case N 421/2006 – Portugal – Zona Franca da Madeira, OJ C 240 of 12.10.2007, p. 1.

<sup>3</sup> Commission decision SG(87) D/6736 of 27 May 1987 in case N 204/86, prolonged by Commission decision SG(92) D/1118 of 27 January 1992 in case E13/91 and again prolonged by Commission decision SG(95) D/1287 of 3 November 1995.

<sup>4</sup> Commission decision of 11 December 2002 in case N 222a/2002, OJ C 65 of 19.3.2003, p. 23.

<sup>5</sup> See recital 23 of Commission decision of 27.06.2007 in case N 421/2006 – Portugal – Zona Franca da Madeira.

<sup>6</sup> The 50% tax cut is provided for registered companies having started their activities and only for those exercises in which the fulfilment of the mentioned conditions is verified.

- a. modernisation of the regional economic fabric through technological innovations relating to products, manufacturing or business methods;
  - b. diversification of the regional economy, in particular through the introduction of new activities with a high added value;
  - c. employment of highly qualified human resources;
  - d. improvement of environmental conditions;
  - e. creation of at least 15 new jobs with a minimum maintenance period of 5 years.
- (9) Moreover, the companies authorised to operate in the ZFM will also enjoy exemption from municipal and local taxes, as well as exemption from taxes payable on transfers of immovable property for the setting up of a business in the ZFM.
- (10) All these tax benefits will only apply up to the corresponding maximum taxable base ceilings. The ceiling placed upon the annual taxable base subject to the tax benefits of the scheme depends on the number of jobs created by the beneficiary (cf. table below).
- (11) The Portuguese authorities have now notified to the Commission a 36.7% increase of the ceilings relevant to the annual base of taxable income. The method of adjustment takes into account two factors; the rate of inflation for years 2007-2013 and the impact of the raise of the general Corporate Income Tax (CIT) rate applicable in Madeira from 20% to 25% since January 2012. The currently applicable and the notified amended ceilings are indicated in the table below:

**Proposed amendments to the ZFM scheme**

Current ceilings (Regime III)		Proposed ceilings		Difference
No of jobs created	Tax base ceiling (EUR mio)	No of jobs created	Tax base ceiling (EUR mio)	% increase
1-2	2	1-2	2.73	36.7%
3-5	2.6	3-5	3.55	
6-30	16	6-30	21.87	
31-50	26	31-50	35.54	
51-100	40	51-100	54.68	
> 100	150	> 100	205.5	

- (12) According to the Portuguese authorities, all the other conditions of the existing aid measure as approved by the Commission in 2007 remain unchanged.
- (13) Through the notified amendments to the existing aid measure, the Portuguese authorities aim to maintain the regional economic development achieved as a result of Regime I. Regime I was responsible for attracting the vast majority of beneficiaries into the ZFM and, according to the Portuguese authorities, most of the major beneficiaries of Regime I relocated at the expiry of that regime at the end of 2011, due to the lack of attractiveness of Regimes II and III.

- (14) The Portuguese authorities underline that, in addition to the structural handicaps to be supported by economic operators located in Madeira, the economic environment is particularly difficult given the on-going fiscal consolidation process in the context of "*Programa de Ajustamento Económico e Financeiro da Região Autónoma da Madeira*". The outflow of previous beneficiaries of the ZFM scheme would represent very important foregone tax revenues for Madeira that are essential to the economic development and growth strategy of the region.
- (15) Without the amendments, the ZFM scheme currently in force would have considerably limited impact on the diversification and modernization of the regional economy. The aim of the amendments is to recover the attractiveness of ZFM scheme in order to maintain its contribution to the economic regional development of Madeira.
- (16) The notified amendments to the maximum taxable base ceilings reflect the combined effect of inflation since 2007 and the impact of the increase in the general CIT rate that occurred in Madeira since 2012<sup>7</sup>. Moreover, the new structure of the ceilings only concerns the maximum allowable taxable base and not the number of jobs that has to be created accordingly.
- (17) The Portuguese authorities undertook to revise the current ZFM scheme for the period after 2014 and to notify a new regime in accordance with the Regional aid Guidelines for the period 2014-2020.
- (18) In particular they undertook to establish specific regular controls of the ZFM beneficiaries in order to ensure that companies conducting activities that involve financial intermediation, insurance and auxiliary financial and insurance-related activities, as well as intra-group service activities, are effectively not benefiting from the current regime. In this context they committed themselves to ensure that such companies will not obtain licenses to operate in ZFM, that the activities of companies already benefiting from the scheme will be regularly and effectively checked so as to prevent that companies which are *de facto* conducting the mentioned activities benefit from the scheme and that they will draw the consequences of State aid rules. The new draft legislation on the issue will be submitted to the Commission.
- (19) Moreover, the Portuguese authorities committed themselves to abolish any preferential treatment of entities, like the *Sociedades gestoras de participações sociais* ("SGPS"), as long as it is confirmed that their treatment in the ZFM indeed entails an advantage as compared to the general SGPS regime applicable in Portugal.
- (20) Finally they committed themselves to review all other tax exemptions applicable to ZFM beneficiaries, so as to ensure that they are included in the calculations and respect the maximum taxable amount ceilings.

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<sup>7</sup> Since January 2012 the corporate income tax rate applicable in Madeira has increased by 25%.

### 3. ASSESSMENT OF THE NOTIFIED AMENDMENTS

#### 3.1. *Legality*

- (21) By notifying the amendments of this scheme, Portugal respected its obligations under article 108(3) TFEU.

#### 3.2. *Existence of aid*

- (22) The Commission considers that the amended measure constitutes State aid within the meaning of article 107(1) TFEU. The involvement of State resources is demonstrated by the fact that the envisaged tax reductions constitute foregone revenue for the State budget. Moreover, given the sectoral and geographical scope of the measure, the Commission considers that it is selective in that it targets specific companies active in the ZFM. The measure confers an advantage to recipients by relieving them from charges they would normally have to bear, and therefore threatens to distort competition. To the extent that the activities carried out by these enterprises are open to international competition, they can also affect trade between Member States.

#### 3.3. *Compatibility*

- (23) As the objective of the notified amendment is the regional development of Madeira, the Commission has to assess its compatibility on the basis of the 2007-2013 Regional Aid Guidelines ("RAG").
- (24) In accordance with paragraph 17 of the RAG, the Commission takes note that in recognition of the special handicaps which they face by reason of their remoteness and specific constraints in integrating the internal market, the Commission considers that regional aid for the outermost regions covered by article 299(2) of the EC Treaty<sup>8</sup> also falls within the scope of the derogation in Article 87(3)(a) of the EC Treaty<sup>9</sup>. In this context and in accordance with the Portuguese regional aid map for 2007-2013, Madeira constitutes an outermost region fully eligible for regional aid under Article 107(3)(a) TFEU until 31 December 2013. Consequently the Commission has to assess whether the notified amendment meets the conditions of application of the derogation embodied in Article 107(3)(a) TFEU.
- (25) The Commission notes that the aid measure that is now being amended constitutes operating aid<sup>10</sup>. In accordance with paragraph 80 of the RAG, in the outermost regions this aid may be authorised in so far as it is intended to offset the additional costs arising in the pursuit of economic activity from the factors identified in article 349 TFEU, the permanence and combination of which severely restrain the development of such regions (remoteness, insularity, small size, difficult topography and climate, economic dependence of a few products).

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<sup>8</sup> Now Article 349 TFEU.

<sup>9</sup> Now Article 107(3)(a) TFEU.

<sup>10</sup> See paragraphs 39 and 40 of Commission decision in case N 421/2006 – Portugal – Zona Franca da Madeira, OJ C 240 of 12.10.2007, p. 1.

- (26) In its decision of 27 June 2007<sup>11</sup> the Commission assessed the appropriateness, necessity and proportionality of the scheme on the basis of paragraph 80 of the RAG. To that end it found that the scheme was compatible with the internal market pursuant to Article 107(3)(a), as it was targeted to address the specific handicaps of Madeira, as an outermost region, and was proportional, since its conditions had as a result that it would not lead to an overcompensation of the additional costs of the aid beneficiaries. Therefore the Commission considered that the scheme as designed indeed contributed to the regional development and to the diversification of the economic structure of Madeira.
- (27) The amendment notified by Portugal aims to adapt the ZFM scheme to the current situation in Madeira, by increasing by 36.7% the applicable maximum taxable base ceilings which can benefit from reduced taxation. The adaptation method takes into account two objective and quantifiable factors, i.e. the inflation that incurred between 2007 and 2012, as well as the increase of the CIT rate in Madeira since January 2012.
- (28) As all the other elements and conditions of the scheme remain unchanged and the Regional aid rules under which these conditions were assessed are still applicable, the conclusions of the Commission's assessment of these conditions contained in the 2007 decision remain valid.
- (29) As regards the notified amendments to the taxable base ceilings, the Commission notes that they are in line with the reasoning followed in its 2007 decision. Moreover, the increase in the maximum taxable base ceilings constitutes a mere adaptation of the ceilings authorised in 2007 to the inflation rate and to the higher CIT rate applicable in Madeira since 2012. Therefore, the Commission considers that the notified amendment does not include an additional undue advantage for the aid beneficiaries that will obtain a license until the end of 2013 in order to operate in the ZFM. Thus the amendments can be considered appropriate.
- (30) As this adaptation is justified by specific, identifiable and objective factors, and it is relatively limited, it does not alter the conclusion of the Commission in its 2007 decision that the ZFM scheme avoids overcompensation of the additional costs that it is intended to offset, at aggregated level, but also at the level of each beneficiary. Thus the notified amendment can be considered as limited to the minimum necessary and proportionate.
- (31) Moreover, the notified amendment will allow Regime III to become more attractive for companies to register in the ZFM. Given that these companies will still have to create and maintain employment in order to receive the aid benefits, the amendments can be considered a contribution to the regional development and the diversification of the economic structure in Madeira.
- (32) In view of the above and the fact that Portugal will review all conditions of the scheme for the period after 2014 in conformity with the Regional aid rules for the period 2014-2020, the Commission considers the notified amendment to be compatible with the internal market pursuant to Article 107(3)(a) TFEU.

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<sup>11</sup> See reference in footnote 1.

#### 4. CONCLUSION

The Commission has accordingly decided that the notified amendment to the ZFM scheme is compatible with the internal market in accordance with Article 107(3)(a) TFEU.

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Yours faithfully,  
For the Commission

*Joaquin Almunia*  
Vice President of the Commission