



EUROPEAN COMMISSION

Brussels, 6.07.2018
C(2018) 4149 final

PUBLIC VERSION

This document is made available for
information purposes only.

**Subject: State Aid SA.21259 (2018/NN) (ex 2016/EO; ex 2015/MX) – Portugal
Zona Franca Madeira (ZFM) – Regime III**

Sir,

The Commission wishes to inform Portugal that, having examined the information supplied by your authorities on the implementation of the aid scheme referred to above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union.

1. PROCEDURE

- (1) Within the context of the 2015 ex post monitoring cycle ("2015 Monitoring")¹, on 12 March 2015 the Commission asked information from Portugal in view of examining whether the Zona Franca Madeira aid scheme ("ZFM scheme") approved by the Commission as compatible regional aid, respected the applicable rules and in particular the Commission decisions of 27 June 2007² ("2007 Commission decision"), applicable from 1st January 2007 until 31 December 2012, and 2 July 2013³ ("2013 Commission decision"), applicable from 1st January 2013 to 31 December 2013. In the context of the 2015 Monitoring, at a first stage the Commission asked information on the legal basis of the scheme and at a second stage it examined its implementation by choosing a sample of 26 beneficiaries that benefited from the ZFM scheme in years 2012 and 2013.

¹ In monitoring, the Commission examines whether Member States correctly apply the State aid provisions at the level of the legal basis and the implementation i.e. the individual aid awards. In the 2015 Monitoring the period during which individual aid awards were verified, is 2012-2013.

² C(2007)3037 final in case N 421/2006, OJ C 240 of 12.10.2007, p.1.

³ C(2013) 4043 final in case SA.34160 (2011/N), OJ C 220 of 1.08.2013, p. 1.

S. Ex.^a o Ministro dos Negócios Estrangeiros
Augusto Santos Silva
Largo do Rilvas
P – 1399-030 - Lisboa

- (2) Portugal submitted information on 4 May 2015. The Commission services requested additional information on 5 June 2015, to which Portugal replied on 6 July 2015. On 1 October 2015 the Commission sent another request for information to which Portugal replied on 29 October 2015. On 29 February 2016 the Commission services requested additional information to which Portugal replied on 1, 8 and 12 April 2016. Following the Commission services' requests for supplementary information on 29 March 2017 and 11 August 2017, Portugal submitted information on 2 May 2017 and 11 September 2017 respectively. Following a conference call it had with the Portuguese authorities on 26 October 2017, the Commission sent to Portugal another request for information on 27 October 2017, to which Portugal replied on 21 and 22 November 2017. Following a meeting between the Commission and the Portuguese authorities on 4 December 2017, Portugal requested a delay extension in order to submit the missing information until the end of December 2017. On 7 December 2017, the Commission services sent to the Portuguese authorities the questions on which replies were still expected. Portugal submitted information on 2 February 2017. Following the request of Portugal, another meeting took place on 27 March 2018.

2. DESCRIPTION OF THE MONITORED AID SCHEME

2.1. Zona Franca Madeira aid scheme under the 2007 Commission decision

- (3) Following notification submitted by Portugal, the Commission approved in 2007 the ZFM scheme ("Regime III"⁴) for the period from 1 January 2007 until 31 December 2013, on the basis of the Regional Aid Guidelines applicable for the period 2007-2013⁵ (hereinafter "2007 RAG"). The companies registered and authorised under the scheme before 31 December 2013⁶ would benefit from the fiscal benefits involved until 31 December 2020.
- (4) The Commission approved the ZFM scheme as compatible operating aid aiming at the promotion of regional development and diversification of the economic structure of Madeira. As Madeira was an outermost region on the basis of Article 299(2) of the EC Treaty (now Article 349 of the TFEU), it was eligible for regional operating aid under Article 87(3)(a) of the EC Treaty (now Article 107(3)(a) of the TFEU), intended to offset the additional costs arising in the pursuit of economic activity of undertakings in that region, due to the regions structural handicaps⁷.

⁴ The ZFM scheme was first approved in 1987 (Regime I) by Commission decision of 27.05.1987 in case N 204/86; it was then prolonged in 1992 by Commission decision of 27.01.1992 in case E 13/91 and 1995 by Commission decision of 3.02.1995 in case E 19/94 and its successor schemes were approved by the Commission in 2002 (Regime II) by Commission decision of 11.12.2002 in case N222a/2002, 2007 (Regime III) by Commission decision of 27.06.2007 in case N 421/2006, in 2013 (amendment of Regime III) by Commission decision of 2.07.2013 in case SA. 34160 (2011/N) by Commission decision of 26.11.2013 in case SA. 37668 (2013/N) and in 2014 (prolongation of Regime III until end 2014) by Commission decision of 8.05.2014 in case SA. 38586 (2014/N).

⁵ Guidelines on national regional aid for 2007-2013, OJ C 54, 4.3.2006, p. 13.

⁶ Following the two prolongations authorised by the Commission decisions mentioned in footnote 4, this expiry date was extended to 31 December 2014.

⁷ Remoteness, insularity, small size, difficult topography and climate, economic dependence on few products.

- (5) The ZFM scheme as approved by the Commission in 2007 authorised aid in the form of reduced corporate income tax⁸ on profits resulting from activities effectively and materially performed in Madeira, exemption from municipal and local taxes, as well as exemption from transfer tax payable on immovable property for setting up of a business in ZFM, up to maximum aid amounts based on maximum taxable base ceilings placed upon the beneficiaries' annual taxable base. These ceilings were set out on the basis of the number of jobs the beneficiary would hold each fiscal year, as follows:

Number of jobs/year	Max. taxable base ceilings in EUR	Maximum aid amount in EUR
1-2	2,000,000	420,000
3-5	2,600,000	546,000
6-30	16,000,000	3,360,000
31-50	26,000,000	5,460,000
51-100	40,000,000	8,400,000
>100	150,000,000	31,500,000

- (6) Under certain conditions⁹, companies registered in the ZFM could benefit from a further 50% tax cut.
- (7) The access to the ZFM scheme was restricted to activities in a list included in the 2007 Commission decision, on the basis of the statistical nomenclature of economic activities in the European Community, NACE Rev. 1.1¹⁰ : agriculture and animal production (Section A, codes 01.4 and 02.02), fisheries aquaculture and related services (Section B, code 05), manufacturing industry (Section D), production and distribution of electricity, gas and water (Section E, code 40), wholesale trade (Section G, codes 50 and 51), transport and communication (Section I, codes 60-64), activities relating to immovable property, leasing and services to companies (Section K, codes 70-74), higher education and/or adult education (Section M, codes 80.3 and 80.4), other collective services activities (Section O, codes 90, 92 and 93.01). Should there be any changes to the list, given that classification systems of this type are liable to develop further, the Portuguese authorities committed to duly notify them to the Commission.
- (8) All activities involving financial intermediation, insurance and auxiliary financial and insurance-related activities (Section J, NACE codes 65-67), as well as all intra-group service activities (coordination, treasury and distribution centres) which could be carried out under Section K, code 74 (services provided mainly to companies) were excluded from the application of the scheme. The 2007 Commission decision also included the commitment of the Portuguese authorities to exclude enterprises in the financial sector and enterprises carrying out intra-

⁸ 3% from 2007 to 2009, 4% from 2010 to 2012, 5% from 2013 to 2020.

⁹ At least two of the following: a) modernisation of the regional economic fabric through technological innovations relating to products, manufacturing or business methods; b) diversification of the regional economy, particularly through the introduction of new activities with high added value; c) employment of highly qualified human resources; d) improvement of environmental conditions; and e) creation of at least 15 new jobs to be kept for a minimum of five years.

¹⁰ Commission Regulation (EC) No 29/2002 of 19 December 2001 amending Council Regulation (EEC) No 3037/90 on the statistical classification of economic activities in the European Community, OJ L 6, 10.1.2002.

group services from the application of the scheme and provide to the Commission the names of the companies that have been refused for registration in the ZFM explaining the reasons for their refusals.

2.2. Zona Franca Madeira aid scheme under the 2013 Commission decision

- (9) Following notification from Portugal, the Commission authorised in 2013 a 36.7% increase of the maximum base ceilings on which the income tax reduction would apply. Thus from year 2013 the maximum taxable base ceilings and maximum aid amounts were as follows:

No of jobs created/ maintained	Maximum taxable base ceilings in EUR (2013-2014)	Maximum aid amount in EUR (2013-2014)
1-2	2,730,000	546,000
3-5	3,550,000	710,000
6-30	21,870,000	4,374,000
31-50	35,540,000	7,108,000
51-100	54,680,000	10,936,000
>100	205,500,500	41,100,000

- (10) Under the notification that led to the 2013 Commission decision, the Portuguese authorities indicated that all the other conditions of the scheme as approved in 2007 remained the same.

2.3. The ZFM scheme put in place by Portugal and preliminary position of the Portuguese authorities

- (11) The information provided by Portugal in the context of the 2015 Monitoring had the following results.

2.3.1. Origin of the profits benefiting from the income tax reduction

- (12) According to Commission decisions of 2007 and 2013, the tax reduction allowed under the scheme applies only to "*profits resulting from activities effectively and materially performed in Madeira*".
- (13) In this respect, Portugal indicates that as far as corporate income tax is concerned, taxable persons with their head office or place of effective management in Madeira will be taxed there on all of their earnings, irrespective of whether their activity generates earnings, uses inputs and/or incurs costs in a different location to that of their head office or place of effective management, as long as said earnings, inputs and costs are received, allocated and borne by the undertaking and they are linked to its activity. These earnings will all be obtained inside or outside Portuguese territory, and provided that they are generated by activities that are authorised within the ZFM and carried out by entities with their head office or place of effective management in Portugal, these earnings will be declared and taken into account for the calculation of the tax base and the amount to which the relevant tax rate will be applied.
- (14) To ensure that earnings are declared correctly for tax purposes, the ZFM scheme requires separate accounting between earnings considered as generated in Portuguese territory, which are subject to the normal income tax, and earnings considered as generated outside Portuguese territory, which are subject to the reduced income tax rate of the ZFM scheme. The former consist in earnings the

ZFM beneficiaries gain from transactions with residents in Portuguese territory, or in its geographical area, which includes the Autonomous Region of Madeira, but excludes the Madeira Free Zone itself. The latter consist in earnings ZFM beneficiaries obtain from their transactions with entities not resident in the national territory as well as those generated in the ZFM itself.

- (15) Portugal argues that in view of the NACE codes authorised within the scope of the ZFM and the predominantly international nature and scope of the activities carried out in the ZFM, the requirement that activities are carried out effectively and materially in Madeira, does not mean, nor could it mean, that the activities must be restricted, geographically speaking, to Madeiran territory and earnings obtained solely in that geographical area. Thus the Commission's "restrictive interpretation" fails to reflect the current situation and is not consistent with the purpose of schemes for outermost regions, which is to attract investment from inside and outside the single market, but also the EU's fundamental freedom of establishment and free movement of goods, people, services and capital. As the lack of competitiveness of Regime III as compared to other jurisdictions competing with Madeira was one of the reasons why the Commission approved the increase of the ceilings of the scheme in 2013, shows that attracting international and not only regional undertakings is very important for the development of outermost regions.
- (16) Moreover, although Portugal admits that in line with EU case law, the activity can be considered as being effectively and materially carried out in the Autonomous Region of Madeira if it is actually performed there and if the company has a proper office, adequate staff and resources and an actual, effective decision-making centre there, it also argues that this does not mean that all of the company's human resources need necessarily carry out all of their tasks there or that its activity must be solely restricted to the geographical area of Madeira.
- (17) Furthermore, Portugal indicates that the annual tax declarations, on the basis of which the tax due and the tax reduction are determined, are based on the beneficiaries' self-assessment; the statements of the beneficiary companies are presumed to be true and correct by the tax authorities and are subsequently validated at central level by the Tax and Customs Authority. In case of doubts, this presumption ceases, allowing the tax authorities to request additional information to assess whether the revenues liable for the reduced rate actually involve transactions with non-residents. However, Portugal did not provide any evidence on the said control conducted by the competent authority.
- (18) Finally, Portugal indicates that controls have been carried out by means of tax inspections in case of doubt as to whether the activity is genuine and actually taking place and that international cooperation is in place with other tax authorities, and information is exchanged in this respect.

2.3.2. Job creation/maintenance in the region

- (19) The ZFM scheme as authorised by the Commission set out the number of jobs created and maintained in the region by the beneficiaries as one of its fundamental compatibility criteria, linking the maximum allowable aid to the contribution of regional development.

- (20) During the implementation of the ZFM scheme, Portugal informed that it considered as valid jobs created any type of working relation foreseen by the national Labour Code, according to which the employment relationship may be established in any of the forms provided by the law¹¹. On this basis, it has accepted as valid jobs for the purposes of the application of the ZFM scheme any employment of whichever legal nature irrespective of the number of hours, days, months of active labour per year. As board members and part time work is allowed by national law, the posts of part time employees (of whatever type) and board members that were reported as being occupied in more than one beneficiary companies, were taken into account as valid jobs for each beneficiary company that declared them.
- (21) Thus, for the purposes of the calculation of the fiscal benefit of ZFM beneficiaries it did not consider, nor checked the full time equivalents ("FTEs")¹², but only the number of jobs the company declared by the beneficiaries in their annual tax declarations ("Modelo 22"), and in certain cases, in the declarations submitted by the beneficiary companies relevant to withholding tax on their employees' income (Modelos 10, 30 or DMR¹³), which may allow cross-checking with the information on declared jobs in Modelo 22. These declarations are presumed to be true within the meaning of article 75 of the General Tax Law. Should the entities not comply with their declaration obligations, either by failing to submit them or by submitting incorrect information, the penalties set out in the General Law of tax offences apply.
- (22) As from 2013 that the DMR included monthly statements, Portugal indicated that it only took into account the number of jobs declared in December of each year, regardless of whether the relevant employees worked or not in the company for the full year. When requested to provide calculations of the number of jobs as FTEs according to the 2007 RAG definition, Portugal argued that this definition of employment does not apply to regional operating aid but only to investment aid schemes approved under the 2007 RAG, as it is not included specifically in the operating aid part of the 2007 RAG but in the investment aid part. It also argued that the definition of staff headcount included in article 5 of Annex I of the General Block Exemption Regulation No 800/2008 ("2008 GBER")¹⁴ only relates to the definition of SMEs within the scope of the 2008 GBER that does not apply to Regime III. Portugal also argued that the main purpose of the approved ZFM scheme was not the creation of jobs or compensating wage costs,

¹¹ Including fixed term contract, teleworking, contract of indefinite duration, deployment/posting, loaning, temporary work, part time work, intermittent work, secondment, occasional assignments, contract with several employers etc.

¹² On the basis of the definition set out in paragraph 58 and footnote 52 of the 2007 RAG.

¹³ Modelo 10 is submitted by companies to declare annual taxable, exempt and non-taxable income earned by taxable persons (company's employees) subject to income tax at source, which are Portuguese residents for tax purposes. Modelo 30 is the same type of tax declaration but for income of taxable persons (company's employees) that are not resident in Portugal. The monthly salary statement ("DMR") which came into effect from the 2013 tax year (Ministerial Implementing Order No 6/2013 of 10 January 2013) has the same function but only for income deriving from dependent work and on a monthly basis. All these declarations are considered by the tax authorities as ancillary obligations as they do not give rise to tax assessment.

¹⁴ Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty, OJ L 214 of 9.08.2008, p. 3

but rather the promotion of the economic, social and territorial cohesion in an outermost region through the modernisation and diversification of its economy. Thus it refused to provide any calculations on this basis, but they only provided an indication of the number of employees whose salary was below the minimum wage foreseen under Portuguese law.

- (23) Following the Commission services' request to provide the social security number of all employees employed by the ZFM beneficiaries in years 2012 and 2013 in order to check possible job double counting, although Portugal provided the relevant numbers, it indicated that they were not relevant for the purposes of the application of the ZFM scheme.
- (24) In addition, Portugal indicated that the beneficiary companies do not have to provide to the Tax Administration any evidence on the employment relationship they have with the employees declared, as the tax assessment is made on the basis of the tax declarations (Modelos) mentioned above. Such information may only be requested by the Tax Administration in case it has information that leads on suspicions for errors, omissions, inaccuracies etc. However, they did not provide any proof in this respect. Article 16 of the Labour code foresees the protection of the privacy of personal life, which does not allow access to personal data which are not documents of a tax or accounting nature. Moreover, according to articles 59(2) and 75(1) of the General Tax Law, the taxpayers are deemed to act in good faith; thus the declarations they submit, as well as the data and assessments of their accounts or bookkeeping are presumed to be true and conducted in good faith.
- (25) Moreover, Portugal submitted information demonstrating that part of the jobs for which tax benefits have been granted were located outside Madeira (some even outside the EU). Portugal indicated that for the purposes of the application of the ZFM scheme, it took into account jobs created inside or outside the Madeira region; as long as the jobs were created by the company registered within ZFM, it was not necessary that they are located in the region. As the companies and the employees are free according to Portuguese law to contractually define the place where the employee will provide its services, for the purposes of the application of the ZFM scheme the workplace can be located anywhere; even outside Madeira and Portugal. Moreover, according to Portugal, the employees of beneficiary companies working on a permanent basis outside Portugal are objectively paid employees of the beneficiary company and contribute through their work to the generation of revenue for the beneficiary company and thus they must be counted as "jobs created and maintained" for the purposes of the application of the ZFM scheme. Following the Commission services' request to indicate the place of effective activity of each employee declared as employed in ZFM, Portugal only provided the address of the companies established in Madeira, as place of effective activity, without indicating the place where the beneficiaries' employees were occupied.
- (26) Concerning the controls conducted by the Portuguese authorities as regards the number of jobs created and maintained by the ZFM beneficiaries, Portugal indicated that in case of discrepancies between the information on the different declarations, it is the Modelos 10 and 30 as well as the DMR (as of 1st January 2013) that take precedence over Modelo 22. Following the Commission services' request on several discrepancies that have been detected, Portugal indicated that

Modelo 22 enables quantification only for the posts generating withholding tax that are created and maintained during the relevant period; this could result in discrepancies with the other Modelos, in particular in the case of employees' income below a certain threshold that does not generate withholding tax. Moreover, Portugal informed that the tax authorities asked the relevant companies to correct the number of jobs declared in their annual tax declarations, without the actual proof of the existence of the jobs ever being put into question. All proof provided by Portugal as regards controls referred only to the discrepancies between the different tax declarations of the same beneficiary that were raised by the Commission in the context of the 2015 monitoring exercise and only involved corrections of the number of jobs within the annual tax declaration without any action as regards reimbursement of possible aid unduly granted.

- (27) Portugal also indicated that in the course of application of Regime III, even in case the beneficiaries omitted to declare the number of jobs created in the region, the annual tax declarations were considered as validly submitted and consequently the assessment of the tax due and the tax benefit was not affected.
- (28) Finally Portugal indicated that, for a specific type of holding companies¹⁵, the scheme did not require the creation of jobs in order for these companies to benefit from the ZFM tax reductions. Finally, Portugal maintained that the job creation requirement laid down in the scheme did not apply to this specific category of holding companies benefiting from the scheme. According to Portugal, the waiver of the job creation requirement for SGPS was included in the draft law¹⁶ attached to the notification. The Commission's approval decision of the scheme therefore implicitly approved it along with the other provisions of the same law.

3. ASSESSMENT

3.1. Lawfulness of the ZFM scheme implemented by Portugal under Article 108(3) TFEU

- (29) On the basis of the information provided by Portugal, the Commission has reached the following preliminary conclusions regarding the compliance of the ZFM scheme implemented by Portugal with Article 108(3) TFEU.

3.1.1. Origin of the profits benefiting from the income tax reduction

- (30) The Commission notes that it authorised the ZFM scheme on the condition that the income tax reduction allowed would be applied to profits resulting from activities effectively and materially performed in the Madeira region. This compatibility criterion stems from the *raison d'être* of regional operating aid for outermost regions, i.e. the compensation of the additional costs companies incur in these regions due to their handicaps, such as remoteness, insularity, small size, difficult topography and climate, economic dependence on few products, as enshrined in Article 349 of the TFEU. This is also the reason why the compatibility assessment that led to the 2007 Commission approval, was based on the study on the additional costs companies incur in the outermost region of

¹⁵ The so called "Sociedades Gestoras de Participações" ("SGPS").

¹⁶ Article 36(8) of the EBF.

Madeira. Thus the Commission considers that if the companies do not conduct their activities in Madeira, they do not incur any additional costs due to their activity in an outermost region. Consequently they cannot be considered as valid beneficiaries of the approved ZFM scheme and they are not entitled to regional operating aid.

- (31) Portugal indicates that the beneficiaries of the scheme do not necessarily have to conduct their activity in the region. In addition Portugal seems to have consistently granted the income tax reduction to revenues generated from operations of the beneficiaries with entities outside Portugal and inside the ZFM itself, but not to revenues generated in the region as such. Moreover, Portugal did not provide any evidence on possible controls the relevant tax authorities have conducted as regards the origin of the revenues declared and subject to the income tax reduction. On the basis of the information available, the Commission preliminarily considers that Portugal applied a tax reduction the terms of which go against the 2007 and 2013 Commission decisions.
- (32) Moreover, in the course of the notification that led to the 2007 Commission Decision, the Commission services requested from Portugal to introduce a clause in the draft law submitted by Portugal, establishing that the tax reductions foreseen in the scheme would be restricted to activities carried out in Madeira¹⁷. Following this request, Portugal confirmed that the fiscal reductions foreseen in the scheme would only apply to activities performed in Madeira, but that such a clause was not necessary as this fact derived from the ZFM law in general¹⁸. However, given the replies submitted by Portugal in the context of the 2015 monitoring exercise, Portugal seems to have consistently applied the scheme during its whole duration in a manner that runs counter to its commitment, the compatibility criteria foreseen in the 2007 and 2013 Commission decisions and consequently the 2007 RAG.
- (33) The Commission further notes that the objective of regional development that justifies regional operating aid for companies in outermost regions may be pursued, among others, through the attraction of foreign investments in the region, as stated by Portugal. However, this means that the investments have to be conducted within the region and not outside. If the foreign investments are made outside the outermost region by a company established in the region, then it is not the outermost region that will benefit from such investments, but only the company that has an office in the outermost region but real and effective activity in another region or State. Consequently this type of investments is not relevant for the purposes of regional development in general and of the outermost region of Madeira in particular. Thus they should not be benefiting from a scheme which is meant to promote regional development of outermost regions.

¹⁷ Request for information of 9 November 2006, D/59422.

¹⁸ Reply submitted by Portugal on 19 December 2006, registered by the Commission as SUB-A/40387. In the course of the 2002 approval of Regime II, Portugal had also indicated that the fiscal advantages of the scheme would be limited to activities effectively and materially realised in Madeira and the Commission had again based its compatibility analysis also on this fundamental condition. Thus the earlier and subsequent ZFM schemes have always been considered as generating effective activity in the region.

- (34) In addition, despite the Commission's request in the course of the 2015 Monitoring, Portugal did not submit information on the place of effective activity of each sample beneficiary of the scheme, but it only limited itself to submitting the address of the head office of the beneficiaries in Madeira. This being said, it explained that the taxation system put in place allows the Portuguese authorities to establish which income derives from foreign and which income derives from activities in mainland Portugal and in Madeira, but without indicating how this analysis was conducted per sample beneficiary. However, since it admitted that it is mainly the income deriving from activities outside Portugal that is subject to tax reductions, it has already indicated that the commitment relevant to the origin of the profits benefiting from the income tax reduction has not been complied with. Moreover, at this stage, the Commission has serious doubts concerning the effectiveness of the controls conducted by the tax authorities as regards the origin of the profits that benefited from the tax reductions.
- (35) Finally the preliminary results of the 2015 Monitoring relevant to the unverified creation of employment, i.e. the reported work of employees outside Madeira or even the EU¹⁹, or the inexistence of employees due to the high number of duplications provides also a strong indication that the tax benefits granted to ZFM beneficiaries may not relate to profits generated in the region.
- (36) Therefore, on the basis of the information available at this stage, the Commission has serious doubts concerning the implementation of the ZFM scheme as regards the compatibility criterion relevant to the origin of the profits benefiting from the tax reduction by Portugal throughout the whole period of the scheme, as it seems to have been implemented in a way running counter to the 2007 and 2013 Commission decisions.

3.1.2. Job creation/maintenance in the region

- (37) The Commission notes that the link of the aid ceilings to the number of jobs created and maintained was one of the fundamental compatibility criteria of both Commission decisions ensuring proportionality of the aid that would be granted under the approved ZFM scheme. In its decisions, the Commission considered that the scheme contributed in a proportional way to the regional development and the diversification of the economic structure of Madeira, as one of its conditions for the companies to benefit from the scheme was to create and maintain the employment created in the region.
- (38) However, on the basis of the information provided by Portugal in the context of the 2015 Monitoring, the Commission's preliminary view is that the compatibility criterion relevant to job creation/maintenance has been applied for the whole duration of the scheme, in a manner which is contrary to the objective of the approved scheme, as well as to the compatibility criteria laid down in both Commission decisions.
- (39) Following the Commission services' request, Portugal provided the complete list of employees employed by ZFM companies in years 2012 and 2013. An analysis of the names and status of individuals employed by ZFM beneficiaries in years 2012 and 2013 leads to the following conclusions: (i) about 40% (in 2012) and

¹⁹ See section 2.3.2 of this decision.

30% (in 2013) of the jobs for which tax benefits were granted refer to board members that may simultaneously hold functions in many other ZFM companies which each appear to receive tax benefits on their account; (ii) only 65% of the jobs reported for 2012 and 2013 are occupied by individuals whose names appear uniquely associated with the respective beneficiary companies; (iii) employees that have worked only for a small fraction of the entire fiscal year were taken into account as fully occupied employees for the purposes of establishing the number of jobs giving rise to tax benefits.

Definition of number of jobs created

- (40) The Commission considers that, as the approval of the ZFM scheme was based on the 2007 RAG, the definitions, conditions and principles set out in the 2007 RAG should apply. The notion of "job creation" set out in paragraph 58 of the 2007 RAG corresponds to "*a net increase in the number of employees directly employed in a particular establishment compared with the average over the previous 12 months. Any jobs lost during that 12 month period must therefore be deducted from the apparent number of jobs created during the same period*". Moreover in the sense of the 2007 RAG, "*the number of employees means the number of annual labour units (ALU), namely the number of person employed full time in one year, part-time and seasonal work being ALU fractions*"²⁰.
- (41) The Commission does not deny that the said definition has not been included in the Commission approval decisions, and that it is not included in the operating aid part of the 2007 RAG. However, this definition is used in the Commission's practice for the purposes of the assessment of all regional aid cases and given that it is clearly set out in the 2007 RAG, the relevant Commission decisions do not necessarily need to include it in their text. The reasoning of Commission decisions can be shorter when part of such reasoning can be derived from the relevant guidelines. Moreover, the fact that the definition is set out in the investment aid part of the RAG does not mean that the Commission would consider a different definition for the purposes of operating aid, as the said definition aims at defining the notion of "job" in an objective manner so that abuses are avoided. A differentiated job definition for regional operating aid would not be justified by the very purpose of regional aid, which is related to an important extent to the creation of real employment in the region. The operating aid part of the 2007 RAG does not include any different and special definition of "job". Furthermore, the same definition relevant to annual labour units (ALU) is also set out in article 5 of the Commission Recommendation of the SME definition²¹, which is of general application of all EU legislation and in particular of EU State aid rules, as the said Recommendation was consistently included as Annex I in the 2008 GBER, as well as the 2014 GBER²². Although the 2008

²⁰ See footnote 52 of the 2007 RAG.

²¹ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.5.2003, p. 36. In this Recommendation the ALU is mentioned as annual working units (AWU).

²² Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, OJ L 187, 26.6.2014, p. 1, as amended by Commission Regulation (EU) 2017/1084 of 14 June 2017 amending Regulation (EU) No 651/2014 as regards aid for port and airport infrastructure, notification thresholds for aid for culture and heritage conservation and for aid for sport and multifunctional recreational

GBER indeed did not apply to the ZFM scheme, this does not mean that the staff headcount should be determined in a different manner for the purposes of regional operating aid schemes approved under the 2007 RAG, depending on the interpretation Member States see fit. Therefore it is the Commission's preliminary view that the said method to calculate the jobs created and maintained is the one that should apply for the purposes of application of State aid rules in general, including the ones of regional operating aid. On this basis, board members and normal employees should have been taken into account for the job creation/maintenance compatibility criterion of the ZFM scheme, only in proportion to the number of hours worked and the duration of their effective activity within the respective company. This is also evident in order to avoid discrimination between beneficiaries that do not effectively make an equivalent contribution to employment in Madeira, and which therefore should not receive the same level of aid.

- (42) Given that the number of jobs is crucial for the determination of the maximum allowable tax benefit, precise calculations on the basis of reliable and easily identifiable data are necessary for the correct implementation of the ZFM scheme. Although the different tax declarations provide an indication of the employees that companies may occupy each year, they are not conclusive as regards the corresponding ALU, as these declarations include employees' revenues only and the amount of these revenues may differ a lot even for the same type of job depending on the contract/agreement the employee has with the company. Thus in the Commission's preliminary view, all these tax declarations cannot be used as a basis for an accurate calculation of the number of jobs held by each ZFM beneficiary and certainly cannot be considered as a valid alternative of the definition of jobs in the sense of the 2007 RAG.

Jobs located outside Madeira region

- (43) It derives from the information provided that Portugal consistently did not make any distinction between jobs created in and outside the region, even outside Portugal and the EU, in order to determine the maximum allowable tax benefit. However, the 2007 Commission decision explicitly indicates that "*the recipient of the aid can benefit from a reduction in the rate of tax on profits resulting from activities effectively and materially performed in Madeira*". Thus in the Commission's preliminary view, activities performed by employees outside the region, cannot be considered to be materially and effectively performed in Madeira, even though the revenues generated may be allocated to companies located in ZFM. The creation of jobs by the beneficiary company outside the region cannot serve any purpose of real economic development of the Madeira region, as, first, it is not related to the beneficiaries' additional costs due to structural disadvantages of the region, and, second, it may only generate positive benefits/externalities for the regions in which these jobs would be created. In the Commission's preliminary view, this is clearly contrary to the job creation/maintenance compatibility criterion and the regional objective of the ZFM scheme as approved by both Commission decisions.

infrastructures, and regional operating aid schemes for outermost regions and amending Regulation (EU) No 702/2014 as regards the calculation of eligible costs, OJ L 156, 20.6.2017, p. 1.

Controls of the job creation and maintenance

- (44) Portugal admitted that the respect of this compatibility criterion was based mainly on the number of jobs declared by the beneficiaries in their annual tax declarations and not on controls conducted for each beneficiary before and/or after receiving the relevant tax benefits. This being said, it also indicated that the omission to declare a number of employees in these declarations did not affect the assessment of the tax due and tax benefit. The information submitted on the controls conducted by the tax authorities, only concerned the beneficiaries for which the Commission detected possible errors. Thus Portugal did not provide any proof that it conducted any controls outside the scope of the Commission services' monitoring cycle. In addition, these checks were conducted through a comparison of Modelo 22 to Modelos 10, 30 and the DMR, the submission of which consists in an "ancillary obligation" that according to Portugal, does not give rise to tax assessment. Thus it is not clear how Portugal established each time that the beneficiary companies indeed had the right to receive the aid. In addition, Modelo 30 includes solely income of employees employed outside Portugal that in the Commission's preliminary view should not be taken into account in the calculation of the number of jobs, as explained above. Moreover, Portugal indicated that the beneficiary companies were not under the obligation to submit proof on the employment relationship they had with the employees declared, in view of the protection of privacy of personal life. Finally concerning the discrepancies the Commission detected between the number of jobs declared in the different types of tax declaration, Portugal only requested from the beneficiaries to correct the number of jobs declared in their initial tax declaration indicating that this was the way to control the respect of the said compatibility criterion. At the same time, 35% of all employees declared as employees of ZFM beneficiaries for years 2012 and 2013, were counted as working in more than one ZFM beneficiary company for the purposes of establishing the tax reduction from which the aid beneficiaries would benefit.
- (45) In the Commission's preliminary view, all these elements provide a strong indication that Portugal in practice has granted fiscal benefits to the ZFM beneficiaries without ensuring or conducting any effective control in this respect at any stage of the implementation of the ZFM scheme. In addition it seems that it never imposed on the beneficiary companies any obligation to provide at any time proof demonstrating that they indeed complied with the compatibility criteria in the Commission decision, although the grant of aid should necessarily entail the said obligation.

Lack of maintenance of the jobs created

- (46) The DMR, in which since 2013 companies have to declare the income of their employees for which withholding tax is held, demonstrates a very important fluctuation of the employees that are occupied each month by the beneficiaries. This in practice means that the employees did not necessarily work for the ZFM beneficiaries on a stable basis, as required by the compatibility criteria in the 2007 and 2013 Commission decisions which related to creation and maintenance of the jobs by the beneficiary companies. In the Commission's preliminary view, the creation of employment that is not necessarily maintained would undermine the very purpose of the scheme which is regional development.

- (47) In view of the above, the Commission has serious doubts as regards the implementation of this job creation/maintenance compatibility criterion on behalf of Portugal throughout the duration of the scheme, entailing a systematic misapplication of the scheme that cannot be considered to be covered by the 2007 and 2013 Commission decisions. Moreover, given that in 2007 and 2013 the Commission linked the authorisation of the tax benefit to job creation and maintenance without making any distinction between different types of companies, the Commission's doubts as regards the implementation of this compatibility criterion concerns all types of ZFM beneficiary companies, irrespective of their form or type.

3.1.3. Conclusion

- (48) In view of the above, the Commission has serious doubts whether the ZFM scheme has been applied in conformity with the 2007 and 2013 Commission decisions and more in particular whether it has not been systematically in breach of the basic compatibility criteria set out in these decisions. Therefore, the scheme as implemented by Portugal appears different from the scheme authorised by the Commission and, as a result, it seems to be outside the scope of approval of the 2007 and 2013 Commission decisions. Consequently, the scheme implemented by Portugal constitutes unlawful aid, as it was put into effect in contravention of Article 108(3) of the TFEU²³. In any event, even if the Portuguese authorities had implemented the ZFM scheme as approved in the 2007 and 2013 Commission decisions (*quod non*), the above circumstances indicate at least misuse of aid since the beneficiaries have used the aid in contravention of the compatibility criteria of those two decisions.
- (49) As explained in the following sections, the Commission has serious doubts regarding the compatibility of such aid unlawfully granted by Portugal.

3.2. Existence of aid

- (50) Article 107(1) TFEU defines State aid as any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods in so far as it affects trade between Member States. Therefore, in order to determine whether the measure at stake constitutes State aid within the meaning of Article 107(1) TFEU, all the following conditions have to be met. Namely, the measure has to a) be granted through State resources, b) confer an economic advantage to an undertaking, c) be selective, d) distort or threaten to distort competition and affect trade between Member States.
- (51) The measure involved is decided by the State and is imputable to it. By allowing companies registered in ZFM to enjoy a specific tax treatment, in the form of reduced corporate income tax on profits²⁴, Portugal foregoes State resources that it would have obtained if it had not enacted the alleged advantageous fiscal

²³ In accordance with Article 1(f) of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, OJ L 248, 24.9.2015, p. 9.

²⁴ 3% from 2007 to 2009, 4% from 2010 to 2012, 5% from 2013 to 2020, instead of 29% in 2007 20% from 2008 to 2011, 25% from 2012 to 2014;

provisions. Hence the measure at issue involves loss of State resources and it can be considered as granted through State resources.

- (52) According to constant case law, in order to determine whether a State measure constitutes State aid, it is necessary to establish whether the recipient undertakings receive an economic advantage that they would not have obtained under normal market conditions, i.e. in the absence of State intervention²⁵. The notion of aid encompasses not only positive benefits, but also measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without being subsidies in the strict meaning of the word, are similar in character and have the same effect²⁶. With regard to taxes, the Court of Justice has made clear that a measure by which the public authorities grant certain undertakings a tax exemption which places the recipients in a more favourable position than other taxpayers amounts to State aid within the meaning of Article 107(1) TFEU. Likewise, a measure allowing certain undertakings a tax reduction of tax normally due can amount to State aid²⁷. Thus the measure under examination confers an advantage to the companies established in ZFM. Given the sectoral and geographical scope of application of the measure, the measure under examination is selective, as it is only available to the companies registered in the limited Free Zone of Madeira. Portugal never argued that this measure is not selective, that it is justified by the logic of the tax system, or that it does not constitute State aid. Thus the Commission considers that the measure under examination entails a selective advantage for the companies registered in ZFM that cannot be justified by the logic of the tax system.
- (53) A measure that constitutes a selective advantage may constitute State aid if it distorts or threatens to distort competition and in so far as it affects trade between Member States. According to settled case law, a selective advantage granted by the State is considered to distort or threaten to distort competition when it is liable to improve the competitive position of the recipient compared to other undertakings with which it competes²⁸. This is the case here. To the extent that the companies registered in ZFM carry out activities that are open to international competition, the measure at stake improves their competitive position and thus may affect trade between Member States and distort competition.
- (54) In view of the above, the Commission considers that the measure implemented by Portugal in favour of ZFM companies constitutes State aid.

3.3. Compatibility of the aid

- (55) The authorisation of Regime III was based on 2007 RAG. However, the scheme as implemented by Portugal is in breach of the Regime III as authorised by the

²⁵ Case C-39/94 SFEI and Others [1996] ECR I-3547, paragraph 60; Case C-342/96 Spain v Commission [1999] ECR I-2459, paragraph 41.

²⁶ Cases C-143/99 Adria-Wien Pipeline [2001] ECR I-8365, paragraph 38; C-387/92 *Banco Exterior de España* [1994] ECR I-877, paragraph 13; and Case C-200/97 *Ecotrade* [1998] ECR I-7907, paragraph 34 .

²⁷ Case C-222/04 Cassa di Risparmio di Firenze and others, [2006] ECR I-289, paragraph 132.

²⁸ Case 730/79 Philip Morris [1980], ECR 267, paragraph 11, joined cases T-298/97, T-312/97, T-313/97, T-315/97, T-600/97 to 607/97, T-1/98, T-3/98 to T-6/98 and T-23/98, Alzetta Mauro and others v. Commission, [2000] ECR II-2325, paragraph 80.

Commission. The compatibility criteria of the 2007 and 2013 Commission decisions which have been breached in the scheme as implemented by Portugal (see section 3.1 of the present decision) reflect fundamental conditions for the approval of operating aid under 2007 RAG. Therefore, the Commission has strong doubts as to its compatibility with 2007 RAG.

- (56) As the scheme implemented by Portugal does not seem to be compatible under the 2007 RAG, the Commission has to examine whether individual awards under that scheme could, nevertheless, be deemed compatible²⁹ if they were block-exempted by the General Block Exemption Regulation (2014 GBER)³⁰, which may apply retroactively to individual aid granted before the respective provisions of the 2014 GBER entered into force, provided the relevant conditions are complied with³¹. It has to be noted that according to Portugal, the scheme does not fall under the 2014 GBER, as, according to Portugal it is covered by the 2007 and 2013 Commission decisions.
- (57) According to Article 15(4) of the 2014 GBER, *"in outermost regions, the operating aid schemes shall compensate for the additional operating costs incurred in those regions as a direct result of one or several of the permanent handicaps referred to in Article 349 of the Treaty, where the beneficiaries have their economic activity in an outermost region provided that the annual aid amount per beneficiary under all operating aid schemes implemented under this Regulation does not exceed any of the following percentages: (a) 35 % of the gross value added annually created by the beneficiary in the outermost region concerned; (b) 40 % of the annual labour costs incurred by the beneficiary in the outermost region concerned; (c) 30 % of the annual turnover of the beneficiary realised in the outermost region concerned"*. Moreover, according to Article 13(d) of the 2014 GBER, the regional aid section shall not apply to: *"regional operating aid granted to undertakings whose principal activities fall under Section K "Financial and insurance activities" of the NACE Rev. 2 or to undertakings that perform intra-group activities whose principal activities fall under classes 70.10 "Activities of head offices" or 70.22 "Business and other management consultancy activities" of NACE Rev. 2."*
- (58) The Autonomous Region of Madeira is an outermost region designated by Article 349 of the TFEU. Therefore, on the basis of Article 15(4) of the 2014 GBER, it is eligible for regional aid under the derogation foreseen in Article 107(3)(a) of the TFEU, provided that (i) the beneficiaries have their effective activity in the outermost region, (ii) the annual aid amount of aid does not exceed a maximum percentage of annual gross value added, or annual labour costs or annual turnover

²⁹ The Commission does not consider it necessary to conduct an analysis of the aid character of the scheme, given that Portugal never argued that the scheme as implemented fell out of the scope of the application of State aid rules.

³⁰ Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, OJ L 187, 26.6.2014, p. 1, as amended by Commission Regulation (EU) 2017/1084 of 14 June 2017 amending Regulation (EU) No 651/2014 as regards aid for port and airport infrastructure, notification thresholds for aid for culture and heritage conservation and for aid for sport and multifunctional recreational infrastructures, and regional operating aid schemes for outermost regions and amending Regulation (EU) No 702/2014 as regards the calculation of eligible costs, OJ L 156, 20.6.2017, p. 1.

³¹ In accordance with Article 58 of the 2014 GBER.

of the beneficiary incurred/realised in the region, (iii) the beneficiaries do not conduct excluded activities, such as financial and insurance activities, as well as intragroup activities.

- (59) The measure implemented consists in tax benefits which have the effect of reducing the expenses that companies would have to bear as part of their business activities. Therefore it constitutes operating aid in favour of the companies that may benefit from it in ZFM.
- (60) However, on the basis of the information provided by Portugal, it seems that the beneficiaries of the scheme implemented by Portugal do not necessarily have their effective activity in Madeira. Moreover, it seems that the aid amounts involved are not necessarily related to gross value added, labour costs or turnover generated in Madeira. Finally the results of the monitoring exercise seem to indicate that Portugal has granted aid to companies that conduct excluded activities, such as financial and insurance activities, as well as intragroup activities.
- (61) Therefore, as regards the elements on which the Commission raises serious doubts in the present decision, the respective individual aid awards would not comply with the provisions of the 2014 GBER.
- (62) Furthermore, in view of its preliminary conclusions cited above, the Commission considers that the scheme implemented by Portugal cannot be considered compatible directly on the basis of Article 107(3)(a) of the TFEU, according to which, may be considered to be compatible with the internal market aid to promote the economic development of the regions referred to in Article 349, in view of their structural, economic and social situation. Portugal seems not to have granted the tax reduction on income deriving from activities in the region. In addition the aid has not necessarily been linked to the generation of employment in the region, and certain beneficiary companies seem to have conducted activities for which they did not incur additional costs due to the structural handicaps of the region. Therefore, the scheme implemented by Portugal seems to have been applied in a manner that did not address the structural handicaps companies may effectively incur in their activity in Madeira. Therefore, at this stage, the Commission has strong doubts as regards the compatibility of the scheme implemented by Portugal with the internal market.

4. CONCLUSION

- (63) In view of the above, the Commission considers at this stage that the scheme implemented by Portugal is not covered by the 2007 and 2013 Commission decisions, having authorised Regime III. Therefore, it preliminarily concludes that the scheme implemented by Portugal constitutes unlawful aid that may not be considered compatible with the internal market on the basis of Article 107(3)(a) of the TFEU. In particular the Commission has serious doubts as regards:
- a) The application of the income tax exemption to income deriving from activities effectively and materially performed in the region;
 - b) The link of the aid amount to the creation and maintenance of real jobs in Madeira.

- (64) In the light of the foregoing considerations, the Commission requires Portugal, within one month of receipt of this letter, to provide all documents, information and data needed for assessment of the compatibility of the aid/measure, and in particular:
1. Complete list of all the companies registered in ZFM for all the years of duration of the scheme, i.e. between 2007 and 2014, indicating the amounts of aid received each year. This information should be provided in an excel sheet.
 2. Complete list of the largest 25 aid beneficiaries in years 2007, 2008, 2009, 2010, 2011 and 2014 under Regime III. This list should also indicate the aid amounts received the same years and the number of employees taken into account for the grant of the tax reduction and should be provided in an excel sheet. Relevant proof on all these aspects should also be submitted. To this end, a table should be provided in which your authorities will indicate for each sample beneficiary the reference to the relevant document that has been used as documentary evidence ;
 3. Proof on the origin of the income all sample ZFM beneficiaries selected in the course of the monitoring cycle for years 2012 and 2013, as well as those selected in point 2 above. To this end, a table should be submitted in which your authorities will indicate for each sample beneficiary the reference to the relevant document that has been used as documentary evidence;
 4. Proof on the effective place of activity of the employees of all sample ZFM beneficiaries selected in the course of the monitoring cycle for years 2012 and 2013, as well as those selected in point 2 above . To this end, a table should be submitted in which your authorities will indicate for each sample beneficiary the reference to the relevant document that has been used as documentary evidence;
 5. Calculation of the number of employees of all sample ZFM beneficiaries selected in the course of the monitoring cycle for years 2012 and 2013, as well as those selected in point 2 above, in full time equivalents on the basis of the definition set out in paragraph 58 and footnote 52 of the 2007 RAG, accompanied with concrete documentary evidence. To this end, a table should be submitted in which your authorities will indicate for each employee the reference to the relevant document that has been used as documentary evidence;
 6. Complete list of all employees employed by companies registered in ZFM each year of the duration of the scheme (2007 to 2014), in an excel sheet.
 7. Argumentation that has not been provided before as regards the compatibility conditions of the scheme implemented by Portugal on the basis of the 2014 GBER, or Article 107(3)(a) of the TFEU.

Otherwise the Commission will adopt a decision on the basis of the information in its possession. It requests your authorities to forward a copy of this letter to the potential recipients of the aid immediately.

The Commission wishes to remind Portugal that Article 108(3) of the Treaty on the Functioning of the European Union has suspensory effect, and would draw your attention to Article 16 of Council Regulation (EU) 2015/1589, which provides that any unlawful aid which is found to be incompatible may be recovered from the recipient.

The Commission warns Portugal that it will inform interested parties by publishing this letter and a meaningful summary of it in the Official Journal of the European Union. It

will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the Official Journal of the European Union and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

If this letter contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of this letter. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Fax No: +32 2 29 61242

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission