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C(2020) 8550 final

COMMISSION DECISION

of 4.12.2020

**on aid scheme
SA.21259 (2018/C) (ex 2018/NN)
implemented by Portugal
for Zona Franca da Madeira (ZFM) – Regime III**

(Only the Portuguese text is authentic)

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<p>In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 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, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...]</p>		<p>PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to Article 108(2) of the Treaty on the Functioning of the European Union¹ and having regard to their comments,

Whereas:

1. PROCEDURE

- (1) By letter dated 12 March 2015, the Commission asked information from Portugal, in the context of the 2015 monitoring exercise ('2015 monitoring')², in view of

¹ OJ C 101, 15.3.2019, p. 7.

² Under Article 108(1) TFEU, 'the Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States'. See also Article 21(1) 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). To that end, the Commission examines regularly, based on a sample of schemes, whether Member States correctly apply the State aid rules both in terms of compliance of national legislation and in terms of the individual aid awards, the latter based on a sample of beneficiaries. The 2015 monitoring covered the years 2012 and 2013.

examining whether the Zona Franca da Madeira scheme ('ZFM scheme' or 'Regime III'), approved by the Commission as compatible regional aid, respected the applicable rules and, in particular, the Commission Decision of 27 June 2007³ ('2007 Commission Decision'), applicable from 1 January 2007 until 31 December 2013, and the Commission Decision of 2 July 2013⁴ ('2013 Commission Decision'), applicable from 1 January 2013 until 31 December 2013. In a first step, the Commission asked for information on the legal framework of the scheme⁵, and at a second step examined its implementation by choosing a sample of 26 beneficiaries that benefited from the ZFM scheme in the years 2012 and 2013.

- (2) Portugal submitted information on 4 May 2015. The Commission services requested additional information on 5 June, to which Portugal replied on 6 July. On 1 October 2015, the Commission sent another request for information to which Portugal replied on 29 October. 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 and 11 August 2017, Portugal submitted information on 2 May 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, 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 an extension of the deadline to submit the missing information until the end of December 2017. On 7 December 2017, the Commission services sent to the Portugal the questions on which replies were still expected. Portugal submitted information on 2 February 2018. Following the request of Portugal, another meeting between the Commission and the Portuguese authorities took place on 27 March 2018.
- (3) By letter dated 6 July 2018, the Commission informed Portugal that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union (TFUE) in respect of the ZFM scheme ('the Opening Decision')⁶.
- (4) By letter dated 30 July 2018, the Portuguese authorities noted that the complete text of the Opening Decision constituted, in their view, confidential information and requested the Commission to abstain from publishing that Commission Decision and only publish a succinct summary of it, the text of which they proposed.
- (5) By letter dated 11 September 2018, Portugal provided a list of all companies registered in the ZFM for the period of 2007 to 2014 and the list of the 25 largest aid beneficiaries in the years 2007 to 2011 and 2014, as requested in points 1 and 2 of paragraph 64 of the Opening Decision. Portugal further requested an extension of the deadline to submit the missing information until the end of September 2018. Portugal's comments on the opening procedure pursuant to Article 108(2) TFEU and

³ C(2007)3037 final in case N 421/2006 (OJ C 240, 12.10.2007, p. 1).

⁴ C(2013) 4043 final in case SA.34160 (2011/N) (OJ C 220, 1.8.2013, p. 1).

⁵ Article 36 of the Tax Incentives Statute (*Estatuto dos Benefícios Fiscais*, 'EBF') approved by Decree Law No 215/89 of 1 July 1989, as republished by Decree Law No 108/2008 of 26 June, and amended by Law No 83/2013 of 9 December. See also Decree Law No 165/86 of 26 June, as amended by Article 2 of Law No 55/2013 of 8 August, and Order No 46/2010 of 18 August of the Regional Secretariat for Finances (*Secretaria Regional do Plano e das Finanças*).

⁶ C(2018) 4149 final.

on the information requested in points 3 to 7 of paragraph 64 of the Opening Decision were submitted on 26 September 2018.

- (6) By letter dated 11 February 2019⁷, following extensive discussions with Portugal on issues of confidentiality relating to the Opening Decision and without an agreement on them, the Commission informed Portugal that it had decided to reject the confidentiality request presented by the Portuguese authorities and to publish the decision as adopted on 6 July 2018. Portugal abstained from introducing an action against the decision in the Union Courts and agreed with its publication by letter dated 5 March 2019.
- (7) On 15 March 2019, the Opening Decision was published in the *Official Journal of the European Union*⁸. The Commission invited interested parties to submit their comments on the aid scheme.
- (8) Following the request of Portugal, another meeting between the Commission and the Portuguese authorities took place on 10 April 2019. In the course of the meeting, Portugal was reminded to provide the missing information requested in paragraph 64 of the Opening Decision. Following that meeting, by letter dated 24 April 2019 Portugal provided data regarding tax controls conducted by national tax authorities on ZFM beneficiaries. In addition, Portugal provided, for the same period, data on divergences detected in ZFM companies' tax returns and additional elements on corrections on the tax due by ZFM taxpayers.
- (9) The Commission received comments from interested parties. By letters dated 23 May and 12 June 2019, the Commission forwarded them to Portugal, which was given the opportunity to react. Portugal's comments were received by letter dated 26 June 2019.

2. DETAILED DESCRIPTION OF THE AID SCHEME

2.1. The ZFM scheme under the 2007 Commission Decision

- (10) Following the notification submitted by Portugal, the Commission approved in 2007 the ZFM scheme⁹ for the period from 1 January 2007 until 31 December 2013, on the basis of the Guidelines on national regional aid for 2007-2013¹⁰ (Regional Aid Guidelines, '2007 RAG'). The companies registered and authorised under the

⁷ C(2019) 1066 final (not subject to publication in the Official Journal).

⁸ State Aid – Portugal, State Aid SA.21259 (2018/C) (ex 2018/NN) – Zona Franca da Madeira (ZFM) – Regime III (OJ C 101, 15.3.2019, p. 7).

⁹ The ZFM scheme comprises the International Business Centre of Madeira (IBCM), the International Shipping Register (MAR) and the Industrial Free Trade Zone (IFTZ). It was first approved in 1987 (Regime I) by Commission Decision of 27 May 1987 in case N 204/86 (SG(87) D/6736); it was then prolonged in 1992 by Commission Decision of 27 January 1992 in case E 13/91 (SG(92) D/1118) and in 1995 by Commission Decision of 3 February 1995 in case E 19/94 (SG(95) D/1287). Its successor scheme (Regime II) was approved by Commission Decision of 11 December 2002 in case N222/A/2002 (OJ C 65, 19.5.2003, p. 23). In 2007, a third successor scheme (Regime III) was approved by Commission Decision of 27 June 2007 in case N 421/2006 (OJ C 240, 12.10.2007, p. 1), which was amended in 2013 (amendment of Regime III) by Commission Decision of 2 July 2013 in case SA. 34160 (2011/N) (OJ C 220, 1.8.2013, p. 1). In 2013, its duration was prolonged until 30 June 2014 by Commission Decision of 26 November 2013 in case SA. 37668 (2013/N) (OJ C 37, 7.2.2014, p. 10) and in 2014 (prolongation of Regime III until the end of 2014) by Commission Decision of 8 May 2014 in case SA. 38586 (2014/N) (OJ C 210, 4.7.2014, p. 27).

¹⁰ OJ C 54, 4.3.2006, p. 13.

scheme before 31 December 2013¹¹ could benefit from a corporate tax reduction or other tax exemptions, as described in recital 12 of this Decision, until 31 December 2020.

- (11) 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 the Autonomous Region of Madeira ('ARM') is an outermost region defined by Article 299(2) of the Treaty establishing the European Economic Community ('EC Treaty') (now Article 349 TFEU), it is eligible for regional operating aid under Article 87(3)(a) of the EC Treaty (now Article 107(3)(a) TFEU). Regional operating aid is intended to offset, for undertakings pursuing their economic activity in that region, the additional costs arising from the outermost regions structural handicaps¹².
- (12) The ZFM scheme, as approved by the Commission in 2007, authorised aid in the form of reduced corporate income tax¹³ on profits resulting from activities effectively and materially performed in Madeira¹⁴, exemption from municipal and local taxes, as well as exemption from transfer tax payable on immovable property for setting up of a business in the ZFM¹⁵, up to maximum aid amounts based on maximum taxable base ceilings placed upon the beneficiaries' annual taxable base. These ceilings were set out based on the number of jobs the beneficiary would hold each fiscal year, as follows:

Number of jobs created/maintained/year	Maximum 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

- (13) Under certain conditions¹⁶, companies registered in the Industrial Free Trade Zone of the ZFM scheme could benefit from a further 50% corporate income tax cut.
- (14) The access to the ZFM scheme was restricted to activities in a list included in the 2007 Commission Decision, based on the statistical nomenclature of economic

¹¹ Following the two prolongations approved by the Commissions Decisions referred to in footnote 9, this expiry date was extended to 31 December 2014.

¹² Remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products.

¹³ 3% from 2007 to 2009, 4% from 2010 to 2012, and 5% from 2013 to 2020.

¹⁴ Paragraph 14 of the 2007 Commission Decision.

¹⁵ Paragraph 17 of the 2007 Commission Decision. See also Article 36(1) and (10) and Article 33(4) to (8) and (11) of the EBF.

¹⁶ 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 (paragraph 16 of the 2007 Commission Decision and Article 36(5) of the EBF).

activities in the European Community, NACE Rev. 1.1¹⁷: 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)¹⁸. Should there be any changes to the list, given that classification systems of this type are liable to develop further, the Portuguese authorities agreed to duly notify them to the Commission¹⁹.

- (15) 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 scheme²⁰. The 2007 Commission Decision also included the commitment of the Portuguese authorities to provide to the Commission the names of the companies that had been refused for registration in the ZFM scheme and the reasons for those refusals²¹.

2.2. The ZFM scheme under the 2013 Commission Decision

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

Number of jobs created/maintained/year	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

- (17) 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 same²².

¹⁷ 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, p. 3).

¹⁸ Paragraph 25 of the 2007 Commission Decision.

¹⁹ Paragraph 29 of the 2007 Commission Decision.

²⁰ Paragraph 26 of the 2007 Commission Decision.

²¹ Paragraph 32 of the 2007 Commission Decision.

²² Paragraph 12 of the 2013 Commission Decision.

2.3. The ZFM scheme put in place by Portugal and the views taken by Portugal in the 2015 monitoring

(18) The Regime III was monitored for the years 2012 and 2013 under the 2015 monitoring²³. The information provided by Portugal during the monitoring and the subsequent *ex officio* investigation ('2016 investigation') had the following results:

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

(19) As referred to in the 2007 and 2013 Commission Decisions, the tax reduction allowed under the ZFM scheme applies only to '*profits resulting from activities effectively and materially performed in Madeira*'²⁴. In the course of the 2015 monitoring, the Commission asked for clarification on the implementation of this condition. It appeared during the 2015 monitoring and the 2016 investigation that some companies registered in the ZFM scheme and included in the sample benefited from the reduced corporate income tax on profits resulting from activities not 'effectively and materially performed in Madeira'.

(20) This situation was confirmed by Portugal, which in this respect, indicated that, as far as corporate income tax was concerned, taxable persons with their head office or place of effective management in Madeira would be taxed there on all of their earnings, irrespective of whether their activity generated earnings, used inputs and/or incurred costs in a different location to that of their head office or place of effective management, as long as the said earnings, inputs and costs were received, allocated and borne by the undertaking and linked to its activity. Those earnings would all be obtained inside or outside Portuguese territory, and provided that they were generated by activities that were authorised within the ZFM and carried out by entities with their head office or place of effective management in Madeira, those earnings would be declared and taken into account for the calculation of the tax base and the amount to which the relevant tax rate would be applied²⁵.

(21) To ensure that earnings were declared correctly for tax purposes, Portugal explained that the ZFM scheme required separate accounting between earnings considered as generated in Portuguese territory, which were subject to the normal income tax, and earnings considered as generated outside Portuguese territory, which were subject to the reduced corporate 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 ARM, but excludes the Madeira Free Trade Zone itself. The latter consist in earnings the ZFM beneficiaries obtain from their transactions with entities not resident in the national territory as well as those generated in the ZFM itself²⁶.

(22) Portugal argued that in view of the NACE codes authorised within the scope of the ZFM scheme, and the predominantly international nature and scope of the activities carried out in the ZFM, the condition that activities were carried out effectively and materially in Madeira did not mean, nor could it mean, that the activities must be restricted, geographically speaking, to Madeira territory and earnings obtained solely in that geographical area²⁷. Thus, according to Portugal, the Commission's 'restrictive interpretation' failed to reflect the current situation, was not consistent

²³ Footnote 2 above.

²⁴ Footnote 14 above.

²⁵ Letter from Portugal of 11 September 2017 (2017/085166), pp. 20-23.

²⁶ Letter from Portugal of 11 September 2017, p. 22.

²⁷ Letters from Portugal of 31 March 2016 (2016/031779), p. 6, and of 11 September 2017, p. 18.

with the purpose of schemes for outermost regions, which was to attract investment from inside and outside the single market, and was also inconsistent with the Union's fundamental freedom of establishment and free movement of goods, people, services and capital. 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: that showed that attracting international and not only regional undertakings was and is very important for the development of the outermost regions.

- (23) Moreover, Portugal stated that the activity could be considered as being effectively and materially carried out in the ARM, if it was actually performed there and if the company had a proper office, adequate staff and resources and an actual, effective decision-making centre there. Portugal also argued that this did not mean that all of the company's human resources needed necessarily to carry out all of their tasks there or that its activity must be solely restricted to the geographical area of Madeira. Finally, Portugal stated that activities 'effectively and materially carried out in Madeira' as defined in paragraph 14 of the 2007 Commission Decision could not be understood to refer only to activities taking place within the territory of the ARM²⁸.
- (24) Furthermore, Portugal indicated that the annual tax declarations, based on which the tax due and the tax reduction were determined, were established on the beneficiaries' self-assessment. These statements are presumed by the tax authorities to be true and accurate 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-residents²⁹.
- (25) Finally, Portugal stated that controls had been carried out by means of tax inspections in case of doubt as to whether the activity was genuine and actually taking place and that international cooperation was in place with other tax authorities and information was exchanged in that respect³⁰.

2.3.2. *Job creation/maintenance in the region*

- (26) 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 number of jobs as a contribution to regional development.
- (27) It appeared in the 2015 monitoring and subsequent 2016 investigation that some companies registered in the ZFM scheme, having benefited from the reduced corporate income tax, could not prove the effective creation/maintenance of jobs in the region, an objective calculation of the number of jobs or the fact that the declared employees performed their activity in Madeira.
- (28) In its implementation of the ZFM scheme, Portugal informed that it considered as validly created jobs any type of working relationship provided by the national Labour Code³¹, according to which the employment relationship may be established

²⁸ Letters from Portugal of 31 March 2016, p. 6, and of 11 September 2017, p. 23.

²⁹ Letter from Portugal of 21 November 2017 (2017/110431), p. 7.

³⁰ Letters from Portugal of 2 May 2017 (2017/042449), p. 11; of 11 September 2017, p. 25, and of 21 November 2017, pp. 28-29.

³¹ Law No 7/2009 of 12 February 2009.

in any of the forms provided by the law³². 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 the purpose of calculating the maximum tax advantage for each beneficiary company that declared them.

- (29) Thus, for the purposes of the calculation of the tax benefit of ZFM beneficiaries, Portugal neither considered, nor checked, the full time equivalents ('FTEs')³³, but only the number of jobs declared by the beneficiaries in their annual tax declarations (Form 22, 'Modelo 22'³⁴), and in certain cases, in the declarations submitted by the beneficiary companies relevant to withholding tax on their employees' income (Form 10, 'Modelo 10', form 30, 'Modelo 30', or the monthly salary statement, *declaração mensal de remunerações*, 'DMR'³⁵): these latter declarations may allow cross-checking with the information on declared jobs in 'Modelo 22'³⁶. All these declarations are presumed to be true within the meaning of Article 75 of the General Tax Law ('*Lei Geral Tributária*'). 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 ('*Regime Geral das Infrações Tributárias*') apply³⁷.

³² Including deployment/posting (Articles 7 and 8), contract with several employers (Article 101), fix term contract and teleworking (Article 139), contract of indefinite duration (Article 147), part time work (Article 150), intermittent work (Article 157), secondment (Article 161), temporary work (Article 172), loaning (Article 288), occasional assignments (Article 289), etc. See letter from Portugal of 2 May 2017, p. 7.

³³ Based on the definition set out in paragraph 58 and footnote 52 of the 2007 RAG. (i.e. '*the number of employees means the number of annual labour units (ALU), namely the number of persons employed full time (FTE) in one year, part-time and seasonal work being ALU fractions.*') The concept of ALU is also referred to in Article 5 of Annex I to Commission Regulation (EC) No 800/2008 (and Commission Regulation (EU) No 651/2014) as 'annual work-units (AWU)'. See footnotes 39 and 56 below.

³⁴ Pursuant to Articles 117 and 127 of the Corporate Income Tax Code ('CIRC'), 'Modelo 22' (Annex D, field 6 – '*Entities licensed in the ZFM*') is annually submitted by companies to indicate the number of jobs created/maintained in order to determine the compliance with the eligibility requirements set out in Article 36 of the EBF. According to the Portuguese authorities, it only enables the quantification of the jobs generating withholding tax that are created and maintained during the period (Decision No 16566-A/2012 of the Cabinet of the Minister of Finances). See letter from Portugal of 21 November 2017, pp. 3-4.

³⁵ '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. According to the Portuguese authorities, this tax declaration only contains information on the country of residence of the taxpayer, which may not coincide with the country in which they carry out their activities as employees under the direction of the company for which they work. The 'DMR' which came into effect from the 2013 fiscal 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. It also include information on the withholding tax, the obligatory contributions to social security schemes and legal subsystems for health and for trade unions (see letter from Portugal of 21 November 2017, pp. 2-3). All these declarations are considered by the Portuguese tax authorities as 'ancillary obligations', as they do not give rise to tax assessment.

³⁶ Letters from Portugal of 29 October 2015 (2015/107167), of 2 May 2017, pp. 8-9, and of 11 September 2017, p. 25.

³⁷ Letter from Portugal of 21 November 2017, p. 2.

- (30) As from 2013, the ‘DMR’ included monthly statements³⁸, and 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 did not apply to regional operating aid but only to investment aid schemes approved under the 2007 RAG, as it was not included specifically in the operating aid section of the 2007 RAG but in the investment aid section. It also argued that the definition of staff headcount included in Article 5 of Annex I to Commission Regulation (EC) No 800/2008³⁹ (General Block Exemption Regulation, ‘2008 GBER’) only related to the definition of small and medium-sized enterprises (SMEs) within the scope of the 2008 GBER and did not apply to Regime III, as it was subject to an *ad hoc* decision. Portugal also argued that the main purpose of the approved ZFM scheme was not the creation of jobs or the compensation of wage costs, but rather the promotion of the economic, social and territorial cohesion in an outermost region through the modernisation and diversification of its economy⁴⁰.
- (31) In the context of the 2016 investigation, the Commission’s services requested Portugal to provide the social security number of all employees employed by the ZFM beneficiaries in the years 2012 and 2013 in order to check possible job double counting. Although Portugal provided the data in question, it indicated that they were not relevant for the purposes of the application of the ZFM scheme because it was a tax scheme and checks were carried out by means of tax returns⁴¹.
- (32) In addition, Portugal indicated that the beneficiary companies did not have to provide to the Tax Administration any evidence on the employment relationship they had with the employees declared, as the tax assessment was made on the basis of the tax declarations (‘Modelos’) mentioned in recital 29 of this Decision⁴². Such information may only be requested by the Tax Administration in case it has information that leads to suspicion of errors, omissions, inaccuracies, etc.⁴³ Article 16 of the Portuguese Labour Code envisages the protection of the privacy of personal life, which does not allow automatically access to personal data comprised in an employment relationship without consent of the data subject⁴⁴. Moreover, in accordance with Article 59(2) and Article 75(1) of the Lei Geral Tributária, the taxpayers are deemed to act in good faith. Thus, the declarations they submit, as well

³⁸ Footnote 35 above.

³⁹ 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, 9.8.2008, p. 3).

⁴⁰ Letters from Portugal of 11 September 2017, pp. 15-16, and of 21 November 2017, pp. 5-6.

⁴¹ Letters from Portugal of 2 May 2017, p. 7, of 11 September 2017, pp. 14 and 17, and of 21 November 2017, p. 1.

⁴² Letters from Portugal of 6 July 2015 (2015/065783), p. 8, of 31 March 2016, p. 19, and of 11 September 2017, p. 17.

⁴³ Letters from Portugal of 29 October 2015, p. 11, of 11 September 2017, p. 25, and of 21 November 2017, p. 7. Whenever deemed necessary, the national Tax Authority asks companies to submit their employees’ contract of employment. Should the contract of employment not be available (in many cases the labour relationship is constituted without being formalized in writing – indefinite and full-time contracts – for which the principle of freedom of form applies under Portuguese law (Article 219 of the Civil Code)), the taxable person may be required to demonstrate the existence of employment relationship by other means. In particular, see letters from Portugal of 31 March and 2 May 2017, pp. 5 and 9, respectively.

⁴⁴ Letter from Portugal of 11 September 2017, pp. 16-17.

as the data and assessments of their accounts or bookkeeping, are presumed to be true and conducted in good faith⁴⁵.

- (33) Moreover, Portugal submitted information demonstrating that for some of the ZFM aid beneficiaries included in the sample of the 2015 monitoring and subsequent 2016 investigation part of the jobs for which tax benefits had been granted were located outside Madeira (some even outside the Union). Portugal indicated that for the purposes of the application of the ZFM scheme, its practice was to take into account jobs created inside or outside of the Madeira region, as long as the jobs were created by the company registered within the ZFM, it was not necessary that they were located in the region. As the companies and the employees are free, in accordance with Portuguese labour law, to define contractually 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. Portugal further considered that ‘employees’ data provided in the concerned tax declarations had no relation with their nationality (i.e. nationality is irrelevant for tax purposes)⁴⁶. Moreover, according to Portugal, the employees of ZFM 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, their jobs must be counted as ‘jobs created and maintained’ for the purposes of the application of the ZFM scheme⁴⁷.
- (34) On 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 was the ‘Modelo 10’ and ‘Modelo 30’, as well as the ‘DMR’ (as of 1 January 2013) that took precedence over ‘Modelo 22’⁴⁸. Following the Commission services’ information request on several discrepancies that had been detected in the 2015 monitoring, Portugal stated that ‘Modelo 22’ enabled quantification only for the posts generating withholding tax that were 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 did 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.
- (35) 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 of the amount of the tax reduction was not affected.
- (36) Finally, Portugal argued that, for a specific type of holding companies - the ‘Sociedades Gestoras de Participações Sociais’ (‘SGPS’) -, the ZFM scheme did not require the creation of jobs in order for these companies to benefit from the corporate tax reduction. According to Portugal, the waiver of the job creation requirement for SGPS was included in the draft Decree-Law⁴⁹ attached to the notification. In their

⁴⁵ Letter from Portugal of 21 November 2017, pp. 7-8.

⁴⁶ Letter from Portugal of 21 November 2017, p. 4.

⁴⁷ Letter from Portugal of 31 March 2016, pp. 5-6.

⁴⁸ Letters from Portugal of 2 May 2017, p. 9, and of 21 November 2017, p. 2.

⁴⁹ Article 36(8) of the draft Decree-Law amending Decree Law No 163/2003 of 24 July 2003, Decree-Law No 215/1989 of 1 July 1989, and Decree-Law No 500/80 of 20 October 1980. See letter from Portugal of 28 June 2006 (1900/80392).

view, the 2007 Commission Decision's approval of the scheme therefore implicitly approved it along with the other provisions of the same law.

3. GROUNDS FOR INITIATING THE FORMAL INVESTIGATION PROCEDURE

- (37) In its Opening Decision, the Commission took the preliminary view that the ZFM scheme constituted State aid for the purposes of Article 107(1) TFEU and expressed serious doubts as to the compatibility of the scheme, as implemented by Portugal, with the internal market.
- (38) As regards the existence of aid, the Commission concluded on a preliminary basis that the ZFM scheme implemented by Portugal in favour of the ZFM companies constituted State aid⁵⁰. It is decided by the State and is imputable to it⁵¹. The aid is selective because it confers an advantage to the companies established in the ZFM insofar as it allows the ZFM companies to get a tax reduction of corporate income tax normally due, which cannot be justified by the logic of the tax system⁵². To the extent that companies registered in the ZFM carried out activities that were open to international competition, the Commission preliminarily concluded that the ZFM scheme distorted or threatened to distort competition, as it was liable to improve the competitive position of the ZFM scheme beneficiaries compared to other companies with which they competed⁵³.
- (39) As regards the lawfulness of the ZFM scheme, the Commission decided to initiate a formal investigation procedure on two issues⁵⁴:
- (i) the geographical origin of the profits, and
 - (ii) the unverified job creation/maintenance in the region.
- (40) In accordance with the 2007 and 2013 Commission Decisions, the ZFM scheme was approved on the condition that the income tax reduction allowed would be applied to profits resulting from activities effectively and materially performed in the region. This fundamental condition is strictly linked to the aim of regional operating aid for outermost regions (i.e. the compensation of the additional costs companies incur in these regions due to the structural handicaps of the regions) and it also explains why the 2007 Commission Decision's approval was based on the study on the additional costs companies incur in the outermost region of Madeira⁵⁵.
- (41) The Commission preliminarily concluded that if the companies did not conduct their activities in Madeira, they did not incur any additional costs due to their activity in an outermost region. Therefore, they could not be considered as valid beneficiaries of the approved ZFM scheme and they were not entitled to regional operating aid.
- (42) The Commission also noted that Portugal did not provide any evidence on possible controls the relevant tax authorities had conducted as regards the origin of the revenues declared and subject to the income tax reduction. In addition, as illustrated

⁵⁰ Paragraph 54 of the Opening Decision.

⁵¹ Paragraph 51 of the Opening Decision.

⁵² Paragraph 52 of the Opening Decision.

⁵³ Paragraph 53 of the Opening Decision.

⁵⁴ Paragraph 63 of the Opening Decision.

⁵⁵ 'Towards a Diversification Strategy for Madeira Autonomous Region – Recommendations to overcome the problem of ultra-peripherality, final report', ECORYS-NEI (Netherlands Economic Institute), Rotterdam, 2004.

by the case of each sample beneficiary of the scheme, Portugal did not submit information on the place of effective activity, but only limited itself to submitting the address of the head office of the beneficiaries in Madeira. Since Portugal recognised that it was mainly the income deriving from activities outside Portugal that was subject to tax reductions, there was already a strong indication that the relevant compatibility condition on the origin of the profits benefiting from the income tax reduction had not been complied with. Moreover, the reported work of employees outside Madeira or even the Union, or the inexistence of employees due to the higher number of duplications, as illustrated in the 2015 monitoring, provided also a strong indication that the tax benefits granted to ZFM beneficiaries might not relate to profits generated in the region.

- (43) With respect to the compatibility criterion relevant to job creation/maintenance in the Madeira region, the Commission preliminarily considered that Portugal had applied the ZFM scheme, for its whole duration, in a manner that was contrary to the objective of the approved scheme, as well as to the compatibility criteria laid down in the 2007 and 2013 Commission Decisions. The unverified job creation/maintenance was illustrated by the results of the 2015 monitoring, which indicated that: (i) employees having worked for part of the fiscal year were taken into account as fully occupied employees, (ii) employees and board members were counted simultaneously as valid employees in more than one ZFM company, and (iii) employees working outside Madeira and even outside the Union were taken into account for the calculation of job creation giving access to the income tax deduction provided for by the scheme, all elements confirmed by Portugal as common practice in the 2016 investigation.
- (44) Furthermore, the Commission noted that the notion of ‘job’ and the method to calculate the jobs created and maintained in the region did not comply with the definitions, conditions and principles set out in the 2007 RAG.
- (45) On a preliminary basis, the Commission also concluded that activities performed by employees outside the region could not be considered to be materially and effectively performed in Madeira, even though the revenues generated might be allocated to companies located in the ZFM.
- (46) The Commission took also the preliminary view that the tax controls implemented by the Portuguese tax authorities provided a strong indication that in practice Portugal did not ensure a proper control of the compliance with the fundamental compatibility criteria set out in the 2007 and 2013 Commission Decisions. Indeed, Portugal did not provide any proof that it had conducted controls outside the scope of the Commission services’ monitoring; the nature of those controls seemed in any case entirely tax-related and not related to the criteria above; and [30%-40%]* of all employees declared as employees of ZFM beneficiaries for the years 2012 and 2013, were counted as working in more than one ZFM beneficiary company for the purposes of establishing the tax reduction for the beneficiaries.
- (47) Finally, the Commission expressed its doubts as to the lack of maintenance of the jobs created based on the 2015 monitoring results, which showed a very important fluctuation of the employees that were occupied each month by the ZFM scheme beneficiaries.

* Confidential information.

- (48) Furthermore, the Commission examined whether individual awards under the ZFM scheme could be deemed compatible, if they were block-exempted by Commission Regulation (EU) No 651/2014 (General Block Exemption Regulation, ‘2014 GBER’)⁵⁶, which might apply retroactively to individual aid granted before the respective provisions of the 2014 GBER entered into force, provided the relevant conditions were complied with⁵⁷.
- (49) The Autonomous Region of Madeira (‘ARM’) is an outermost region designated by Article 349 TFEU. In accordance with Article 15(4) of the 2014 GBER, it is eligible for regional operating aid under the derogation provided for by Article 107(3)(a) TFEU, provided that: (i) the beneficiaries have their effective activity in the outermost region, and (ii) the annual aid amount does not exceed a maximum percentage of gross value added annually created, or annual labour costs incurred, or annual turnover realised, by the beneficiary in the region.
- (50) The ZFM scheme consists in tax benefits as described in recital 12 of this Decision, which have the effect of reducing the expenses that companies would have to bear as part of their business activities. It constitutes therefore operating aid in favour of the companies that may benefit from it in ZFM. However, based on the information provided by Portugal during the monitoring, the Commission took the preliminary view that the beneficiaries of the scheme implemented by Portugal did not necessarily have their activity in Madeira. Moreover, on a preliminary basis the Commission concluded that the aid amounts involved were not necessarily related to gross value added, labour costs or turnover generated in Madeira⁵⁸.
- (51) In conclusion, the Commission expressed the preliminary view that the ZFM scheme, as implemented by Portugal, would not comply with the 2007 and 2013 Commission Decisions and, in any event, with the 2007 RAG, since the two issues referred to in recital 39 of this Decision reflected the fundamental conditions for the approval of regional operating aid under the 2007 RAG. The Commission also raised doubts that the individual aids granted under the scheme could be considered compatible based on the 2014 GBER on operating aid in the outermost regions⁵⁹. Finally, the Commission expressed doubts that the ZFM scheme, as implemented by Portugal, could be considered compatible directly on the basis of Article 107(3)(a) TFEU, as the Portuguese authorities seemed to have applied it in a manner that did not compensate the structural handicaps companies might effectively incur in their activity in Madeira⁶⁰.

⁵⁶ 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).

⁵⁷ Article 58 of the 2014 GBER.

⁵⁸ Paragraph 60 of the Opening Decision.

⁵⁹ Paragraph 61 of the Opening Decision.

⁶⁰ Paragraph 62 of the Opening Decision.

4. INFORMATION SUBMITTED AFTER THE OPENING DECISION AND COMMENTS FROM PORTUGAL

4.1. Additional information submitted by Portugal in the course of the in-depth investigation

- (52) With the Opening Decision, the Commission asked Portugal to produce detailed information on the implementation of the ZFM scheme throughout its duration (2007 to 2014)⁶¹. In particular, Portugal was required to provide:
- a list of all the companies registered in the ZFM for the period of 2007 to 2014, indicating the amounts of aid received each year;
 - a list of all employees employed by companies registered in the ZFM (2007 to 2014);
 - a list of the largest 25 ZFM aid recipients under Regime III in the years 2007 to 2011 and 2014 (indicating aid amounts received each year and number of employees taken into account for the grant of the tax reduction and providing relevant documentary evidence);
 - proof of the origin of the income for all sample ZFM beneficiaries selected in the course of the monitoring for years 2012 and 2013, as well as for the largest 25 ZFM aid recipients for the years 2007 to 2011 and 2014 (including relevant documentary evidence);
 - proof of the effective place of activity for all sample ZFM beneficiaries for the period 2007 to 2014 (including relevant documentary evidence);
 - a calculation of the number of employees of all sample ZFM beneficiaries (years 2007 to 2014) in full time equivalents based on the definition set out in paragraph 58 and footnote 52 of the 2007 RAG (including relevant documentary evidence);
 - argumentation not provided before as regards the compatibility conditions of the ZFM scheme implemented by Portugal on the basis of the 2014 GBER or Article 107(3)(a) TFEU.
- (53) The Commission further informed Portugal that, in the absence of that information, it would have to adopt a decision based on the information in its possession⁶².
- (54) By letters dated 11 and 26 September 2018⁶³ and 24 April 2019, respectively, Portugal provided additional information on the implementation of the ZFM scheme and submitted its comments on the Opening Decision.

⁶¹ Paragraph 64, points 1 to 7, of the Opening Decision. Thus, beyond the two years that had been subject to the 2015 monitoring (i.e. 2012 and 2013). In addition, it should be noted that most of the information requested in paragraph 64 of the Opening Decision had already been included in repetitive and unsuccessful requests for information addressed to Portugal in the course of the 2016 investigation; in particular, on (i) proof of the origin of the income taken into account for the calculation of the taxable base for all sample ZFM beneficiaries, (ii) proof of the place of effective activity for all sample ZFM beneficiaries, (iii) calculation of the number of employees (including management positions) for all sample ZFM beneficiaries in full time equivalents and (iv) proof of control of the activities of the sample ZFM beneficiaries for the period 2012 and 2013, see Commission's letters of 29 February 2016 (D/020793), 29 March 2017 (D/030362), 11 August 2017 (D/069475) and 2 October 2017 (D/099275).

⁶² Paragraph 64, second paragraph, of the Opening Decision.

⁶³ Letters of 11 September 2018 (2018/144207) and of 26 September 2018 (2018/153989).

- (55) On 11 September 2018, Portugal submitted data on all companies registered in the ZFM for the entire duration of the scheme (from 2007 until 2014). It also provided the amounts of aid received each year per beneficiary until 2014. Portugal further provided a list of the largest 25 ZFM aid beneficiaries in the years 2007 to 2011 and 2014⁶⁴, including the indication of aid amounts received. In addition, by letter of 26 September 2018 for the years 2007 to 2014, Portugal provided a list of employees employed by all companies registered in the ZFM⁶⁵. However, that information does not allow complete verification of the problematic issues detected in the monitoring: (i) board members and workers holding such functions simultaneously in many ZFM companies, (ii) incidences of double counting of jobs, and (iii) part-time jobs taken into account for job creation/maintenance and full tax benefits given to ZFM companies.
- (56) Portugal did not provide information on the number of employees taken into account for the grant of the tax reduction for the years 2008, 2009 and 2010⁶⁶, and it provided incomplete information for the years 2011 and 2014⁶⁷. Moreover, for each year the information submitted on the number of employees is presented on unclear terms: (i) different sources, and (ii) different periods of declaration without straightforward relation between the number of jobs created/maintained and the amount of aid received in each period.
- (57) Furthermore, Portugal did not provide the following information, data and supportive documentary evidence⁶⁸ needed for assessment of the compatibility of the aid:
- proof of the documentation used to verify the number of employees; for the years up to 2010, Portugal specified that there was no obligation for the companies to declare the number of employees in their tax declarations;
 - proof of the origin of the income of sample beneficiaries selected in the course of the preliminary investigation⁶⁹ and of the largest 25 ZFM scheme beneficiaries of the years 2007 to 2009⁷⁰;
 - proof of the effective place of activity of the employees of the ZFM scheme beneficiaries;
 - calculation of the number of employees of all sample ZFM scheme beneficiaries selected in the course of the monitoring for the years 2012 and 2013, as well as for the largest 25 aid beneficiaries in the years 2007 to 2011 and 2014, in FTEs on the basis of the definition set out in paragraph 58 and footnote 52 of the 2007 RAG.
- (58) In the meeting with the Commission services on 10 April 2019 referred to in recital 8 of this Decision, Portugal was recalled the procedural steps of the ongoing formal investigation procedure and reminded of the commitment of mutual cooperation

⁶⁴ Information for the years 2012 and 2013 was provided under the 2015 monitoring.

⁶⁵ Information based on data supplied by Social Security and the Tax Authority on 6 August 2018.

⁶⁶ ‘Modelo 22’ from 2007 to 2010 did not request that information from taxpayers.

⁶⁷ For the year 2011, there is information for 25 out of 62 aid recipients. For 2014, there is information for 25 out of 526 aid recipients.

⁶⁸ Information asked under paragraph 64, points 3 to 6, of the Opening Decision.

⁶⁹ As regards paragraph 64, point 3 of the Opening Decision, Portugal explains that such information has been requested to ZFM beneficiaries by the national tax authorities. However, such ‘information is not yet available’. See letter from Portugal of 26 September 2018, paragraph 127, p. 30.

⁷⁰ Portugal did not provide the largest 25 ZFM aid beneficiaries for the years 2007 to 2009 because the aid recipients were less than 25 each year: 2007:0; 2008:9 and 2009:20.

from September 2017, which had not brought fruitful results so far. Furthermore, Portugal was invited to provide the missing information in accordance with paragraph 64 of the Opening Decision, which would allow the Commission services to have a full set of facts/information on the ZFM scheme.

- (59) By letter of 24 April 2019⁷¹, to address the Commission's preliminary view on the inappropriateness of the tax controls⁷², Portugal submitted data regarding tax controls carried out between 2015 and 2018 on ZFM beneficiaries⁷³ by means of tax inspections. In the period concerned, [300-600] tax inspections have been initiated and [300-600] tax inspections have been completed. Tax corrections reported amount to approximately EUR [100-250] million. Portugal further reported divergences regarding [100-300] ZFM beneficiaries' tax returns. However, as regards the closed tax inspections for the ZFM scheme (Regime III), the information provided did not allow to establish the link between the tax controls and corrections reported and the two issues on which the formal investigation procedure was initiated.
- (60) In addition, Portugal recognised that the criteria for job creation/maintenance should be further clarified, aiming at eliminating any doubts concerning its interpretation, by preventing abuse of the aid in question and by introducing further guarantees that the job accounting would contribute to Madeira social and economic development⁷⁴. In this regard, Portugal submitted a draft Order (*'projeto de despacho da Vice-Presidência do Governo Regional da Madeira'*) clarifying the concept of 'job creation' in line with the definitions in the 2007 RAG⁷⁵.
- (61) In this context, Portugal recognised that the introduction of legislative changes in the ZFM scheme were necessary to avoid potential abuse. Furthermore, Portugal put forward a set of legislative, regulatory and inspective measures to the ZFM scheme for which it asked the Commission's agreement by means of a recommendation proposing appropriate measures to the Member State concerned pursuant to Article 22(a) and (b) of Council Regulation (EU) 2015/1589⁷⁶. Alternatively, Portugal envisaged that such legal amendments should be approved by Commission decision ('conditional decision'), as provided for in Article 9(4) of Regulation (EU) 2015/1589⁷⁷.
- (62) In this regard, further to the clarification of the concept of 'job creation' indicated in recital 60 of this Decision, Portugal proposed amendments to the legal basis of the ZFM scheme⁷⁸: (i) the exclusion of the SGPS⁷⁹; (ii) the consignment of the ZFM

⁷¹ Letter from Portugal of 24 April 2019 (2019/055874).

⁷² Paragraphs 36, 44 and 45 of the Opening Decision.

⁷³ The reporting also covers Regime IV, the successor ZFM scheme (2015-2020) which is being implemented by Portugal since 1 January 2015 under the 2014 GBER.

⁷⁴ Letter from Portugal of 24 April 2019, p. 4.

⁷⁵ The draft Order aims to ensure that: (i) part-time work is accounted for only in proportion to the number of hours worked ('full-time equivalent'), (ii) the link between the worker and the Madeira region is ensured, and (iii) the creation and maintenance of jobs by means of temporary work is not considered within the definition. Differently from the first version of the draft Order submitted on 6 April 2018, the current version applies also to Regime III (the '2018 draft Order' applied only to Regime IV).

⁷⁶ 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).

⁷⁷ Letter from Portugal of 24 April 2019, p. 3.

⁷⁸ Article 36 of the EBF covers matters falling within the field of reserved legislative competence of the national Parliament (i.e. taxes and tax advantages). See Article 165(1)(i) of the Portuguese Constitution. Portugal recognised that proposed amendments aiming to introduce a 'new scheme' for the ZFM require further legal acts approved by the national parliament and cannot be implemented merely by administrative measures. See letter from Portugal of 24 April 2019, p. 4.

corporate income tax revenue to health and education policy objectives; (iii) the creation of a specific anti-abuse clause for the ZFM scheme in accordance with Council Directive (EU) 2016/1164⁸⁰ on tax avoidance practices that directly affect the functioning of the internal market as regards hybrid mismatches with third countries; and (iv) the definition of criteria to identify large tax payers in the ZFM whose taxation situation requires permanent monitoring by the Free Zone Office (*'Gabinete da Zona Franca'*)⁸¹ as a complement to taxation inspection activities to be conducted on an annual basis.

4.2. Comments from Portugal

- (63) The comments submitted by Portugal in the letter of 26 September 2018 are summarised in the following recitals.
- (64) Portugal argues that a negative decision on the ZFM scheme would have dramatic and irreparable effects on the economic sustainability of Madeira⁸². The Commission should therefore take into account the outermost region status of Madeira, which is recognised in Article 349 TFEU.
- (65) Portugal further argues that the Commission should consider in its assessment the economic impact of the ZFM scheme in the development of the region⁸³, particularly by considering its economic effect on the national, European and international trade⁸⁴.
- (66) Finally, Portugal considers that the ongoing in-depth investigation would discriminate Madeira against other jurisdictions, which apply preferential income tax rates and escape State aid rules⁸⁵.

⁷⁹ Recital 36 of this Decision.

⁸⁰ Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (OJ L 193, 19.7.2016, p. 1).

⁸¹ Regulatory Decree No 14/2015/M of 19 August 2015. In accordance with Article 8(1), the mission of the office is to monitor and coordinate the activities performed in the ZFM.

⁸² In 2016, the ZFM enabled collection of nearly EUR [100-200] million in corporation tax (almost [15-25] % of the total taxes collected in that year in the region). It would imply the relocation of more than [1000-2000] companies registered in the ZFM to other regions or countries and strong increase of unemployment in the region (in 2014, there were [4000-6000] direct, indirect and induced jobs in the ZFM, which amounted to [1-10] % of the total employment in Madeira). See letters from Portugal of 2 May 2017, p. 6, and of 26 September 2018 (Annex I), p. 62.

⁸³ In the period 2012-2015, on average, the activity of the ZFM, according to the information provided by the Regional Statistics Directorate of Madeira (*'Direção Regional de Estatística da Madeira'*), represented around [1-10] % of Gross Value Added (GVA) and [0,5-10] % of the employment of the AMR. The activities linked to trade, transport and storage and to accommodation and catering have contributed most to the total GVA of the companies established in the ZFM (about [70-80] %). The manufacturing activities, linked to industry, contributed most to the total employment generated in the region ([30-40] %). In 2014, the ZFM amounted to [1-10] % of the value added generated in the region, i.e. approximately EUR [200-400] million, 'Tax and economic analysis report - Madeira Free Trade Zone', Ernest & Young, September 2018, pp. 60-62 (Annex I to the letter from Portugal of 26 September 2018)'.

⁸⁴ In 2014, ZFM companies ensured 79% of the exports (EUR [50-200] million). In 2016, compared to 2014, the exports to the European community raised from [20 000-30 000] to [30 000-40 000] thousands of euros. The food and agricultural sectors represented the main volume of exports, followed by the machinery and textiles sectors, which had undeniable positive effects on the development of the European economy. See 'Tax and economic analysis report', Ernest & Young, 24 September 2018, p. 68.

⁸⁵ Malta, Luxembourg, Netherlands and Cyprus. See letter from Portugal of 26 September 2018, pp. 14-16.

- *Existence of aid*

- (67) Portugal considers that the ZFM scheme does not involve State resources (i.e. an increase in expenditure or even a reduction in revenue for the public budget). The scheme does not correspond to 'real tax expenditure' but simply to a virtual tax expenditure or even accounting fiction ('theoretical tax revenue losses')⁸⁶. Portugal further explains that companies are only established in the ZFM, and invest there, following the existence of the tax relief. Otherwise, without the tax benefit, they would not have established in the ZFM or paid the usual taxes applicable in continental Portugal or in Madeira⁸⁷.
- (68) Portugal argues that the ZFM scheme forms part of the general economy of the Portuguese tax scheme⁸⁸. Portugal further considers that, according to Commission's practice⁸⁹, a low tax rate applied in an entire Member State or autonomous region should be seen as a general measure and, therefore, it does not confer an advantage to the companies established in the ZFM⁹⁰.
- (69) Portugal also considers that the ZFM scheme is not selective because the measure is not '*favouring certain undertakings or the production of certain goods*' within the meaning of Article 107(1) TFEU. Portugal argues that, pursuant to Article 36(6) of the Tax Incentives Statute (*Estatuto dos Benefícios Fiscais*, 'EBF'), all companies engaged in commercial, industrial, maritime or other service activities (if not explicitly excluded from the scheme, as it is the case of insurance and financial activities), are likely to be established in the ZFM. Therefore, the tax benefits enjoyed by the ZFM beneficiaries do not comply with the condition of selectivity, which is essential for the existence of State aid. Finally, it cannot be even concluded that selectivity 'de facto' exists, since the relevant tax benefits are not limited to certain categories or sectors with common characteristics.
- (70) Portugal concludes that the ZFM scheme has to be considered as a general measure rather than a State aid measure⁹¹. The measure under examination does not entail a selective advantage for the companies registered in the ZFM and it can be justified by the logic of the tax system. Finally, Portugal considers that the Commission bears the burden of proof to determine whether the ZFM scheme involves aid within the meaning of Article 107(1) TFEU.
- (71) Furthermore, Portugal argues that if the ZFM scheme should entail 'aid', it has to be qualified as 'existing aid'. The ZFM scheme predates the accession of Portugal to the EEC⁹² and the scheme has not undergone any substantial changes outside the negotiation framework on existing aid. Thus, the ZFM scheme should not be subject to the prior approval of the Commission under Article 108(3) TFEU. Conversely, the

⁸⁶ The General State Budgets of 1999 to 2004 state: 'This exemption ... represents tax not levied on income which, in the absence of this benefit, would not exist' (2002 General State Budget), or 'the removal of the current scheme ... would certainly not lead to this tax revenue being obtained' (2004 General State Budget).

⁸⁷ Letter from Portugal of 26 September 2018, paragraph 50, p. 18.

⁸⁸ Letter from Portugal of 26 September 2018, paragraph 29, p. 13, and letter from Portugal of 11 September 2017, p. 30.

⁸⁹ Commission Decision (EU) 2019/1252 of 19 September 2019 on tax rulings SA. 38945 (2015/C) (ex 2014/CP) granted by Luxembourg in favour of Mc Donald's Europe (OJ L 195, 27.7.2019, p. 20).

⁹⁰ 'Tax and economic analysis report', Ernest & Young, 24 September 2018, p. 67.

⁹¹ Letter from Portugal of 26 September 2018, paragraph 28, p. 13, and 'Tax and economic analysis report', Ernest & Young, September 2018, pp. 66-68.

⁹² Paragraph 10 of the 2007 Commission Decision.

Commission should initiate the appropriate measures procedure instead⁹³, which could involve changing the content of the aid scheme, the introduction of requirements or its clarification. Alternatively, Portugal proposes that the Commission adopt a positive decision subject to conditions ('conditional decision')⁹⁴.

- *Origin of the profits benefiting from the income tax reduction*

- (72) Portugal recognises that the 2007 and 2013 Commission Decisions provide that the aid in the form of reduced corporate income tax reduction apply to '*profits resulting from activities effectively and materially performed in Madeira*'⁹⁵. However, Portugal rejects the Commission's conclusion 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 and, consequently, are not entitled to regional operating aid⁹⁶.
- (73) Portugal recalls that the quantified additional costs incurred by companies in the outermost region of Madeira⁹⁷ were adjusted to the economic dimension of the ZFM, which was recognised by the 2007 Commission Decision⁹⁸. Moreover, the current implementation of the ZFM scheme is entirely coherent with that resulting from the 2007 and 2013 Commission Decisions, which concluded that 'the measure allows to compensate the additional costs of companies located in the referred outermost region'⁹⁹. Portugal further argues that the ZFM tax benefits are substantially less than the 'additional costs' and the condition that activities should be 'effectively and materially performed in Madeira' is reflected in the ZFM licensing obligation and compliance with other legal requirements, which make the companies registered in the ZFM scheme (Regime III) legitimate beneficiaries of the scheme and entitled to regional operating aid¹⁰⁰.
- (74) Portugal reiterates that to '*conduct their activities in Madeira*' should merely mean that the activity is performed in Madeira if it is undertaken there with a registered office, management and decision-making centre without requirement for full permanent human capital there. Portugal considers that by requiring the effective implementation in Madeira of activities, which are by definition international, the Commission denies the link of such international activities with the region, recognised by the 2007 and 2013 Commission Decisions¹⁰¹.
- (75) Portugal, moreover, reiterates its view that requiring that activities are carried out effectively and materially in Madeira, neither mean, nor could mean, that the activities must be restricted, geographically speaking, to Madeira territory and earnings obtained solely in that geographical area. Thus, the Commission's 'restrictive interpretation' is not consistent with settled Union case-law on 'main

⁹³ Article 22(a) and (b) of Regulation (EU) 2015/1589. See recital 61 of this Decision.

⁹⁴ Article 9(4) and Article 20 of Regulation (EU) 2015/1589. See letter from Portugal of 24 April 2019, p. 3. See also recital 61 of this Decision.

⁹⁵ Letter from Portugal of 26 September 2018, paragraph 88, p. 20.

⁹⁶ Paragraph 30 of the Opening Decision.

⁹⁷ Footnote 55 above. The minimum additional costs arising from Madeira's remoteness stand at 26% of Gross Value Added (GVA) of the private sector or 16.7% of Madeira's Gross Domestic Product (GDP), totaling around EUR 400 million in 1998. See paragraphs 46 and 48 of the 2007 Commission Decision.

⁹⁸ Paragraph 51 of the 2007 Commission Decision.

⁹⁹ Letter from Portugal of 26 September 2018, paragraph 124.

¹⁰⁰ Letter from Portugal of 26 September 2018, paragraph 125.

¹⁰¹ Paragraphs 11, 25, 72 and 73 of the 2007 Commission Decision, and paragraphs 24, 26 and 28 of the 2013 Commission Decision.

centre of interests'¹⁰², Commission decision practice and Union case-law on 'spillover effect'¹⁰³, and the Union's fundamental freedom of establishment and free movement of goods, people, services and capital.

- (76) Portugal further concludes that imputability occurs by reference to the place of the company head office or the location of its effective management. This is fully consistent with the 2007 Commission Decision, which provides that '*the scheme applies without distinction to companies' resident and non-resident in Portugal*'¹⁰⁴. The 2013 Commission Decision also recognises that the activities of the ZFM licensed companies are essentially international in nature, since '*the activities carried out by those companies are open to international competition*'¹⁰⁵. Thus, the reinterpretation of paragraph 14 of the 2007 Commission Decision that the relevant activities could only be fully implemented within the strict geographical limits of Madeira contradicts the ZFM scheme itself and the 2007 RAG as a key instrument to attract investment originating in and outside the internal market. It also contradicts the aim of Article 349 TFEU, which allows the adoption of specific (tax) measures to attract investment and thus induce the modernisation and diversification of the economy.
- (77) Furthermore, Portugal complies with its commitments under the OECD's Action Plan on Base Erosion and Profit Shifting¹⁰⁶ ('BEPS Action Plan') that it signed in 2016. The BEPS Action Plan includes the concept of 'substantial activity', which limits the application of preferential schemes to earnings which have a causal connection to costs borne by the company to develop the underlying asset.
- (78) Portugal considers that the Commission in its examination of the lawfulness of the ZFM scheme should consider the criterion on 'substantial activity' as defined in the OCED rules and, in particular, the 'General guiding principles concerning evaluation of measures under BEPS Action Plan'¹⁰⁷. Portugal considers that the Commission should include in its assessment the existing Union legal instruments on fight against tax evasion and fraud, in particular, the rules on abuse of genuine arrangements established by Directive (EU) 2016/1164. Also, the rules on mandatory automatic exchange of information in the field of taxation in relation to the reportable cross-border arrangements introduced by Council Directive 2011/16/EU¹⁰⁸.

¹⁰² Judgment of the Court of Justice of 2 May 2006, *Eurofood IFSC*, C-341/04, ECLI:EU:C:2006:281, paragraphs 34-36, and judgment of the Court of Justice of 22 December 2010, *Weald Leasing*, C-103/09, ECLI:EU:C:2010:804, paragraph 44.

¹⁰³ Activities outside a given region can benefit significantly the region concerned. According to Portugal, the Commission has acknowledged this principle in a 2007 decision relating to the French overseas departments, Commission Decision C (2007) 5115 final of 27 October 2007 on SA case N522/2006 France – Loi de programme pour l'outre-mer – Aide fiscale, sections 2.8.3 and 2.8.8., pp. 24 and 25. See also judgment of the Court of Justice of 19 December 2012, *GAMP*, C-579/11, ECLI:EU:C:2012:833, paragraphs 30 to 39.

¹⁰⁴ Paragraph 22, footnote 9 of the 2007 Commission Decision.

¹⁰⁵ Paragraph 22 of the 2013 Commission Decision.

¹⁰⁶ Action 5 'Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance', and Action 6 'Prevent Treaty Abuse' (<http://www.oecd.org/tax/beps/action-plan-on-base-erosion-and-profit-shifting-9789264202719-en.htm>).

¹⁰⁷ Action 5 of BEPS Report and Guidelines from the Forum on Harmful Tax Competition of the OECD, with respect to the substantial activity requirement in the context of non-IP regimes (<https://www.oecd.org/tax/beps/beps-actions/action5/>).

¹⁰⁸ Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC (OJ L 64, 11.3.2011, p. 1).

- (79) Portugal explains that tax avoidance rules introduced by Directive (EU) 2016/1164 seek to apply to non-genuine arrangements (i.e. situations where companies established in low-tax areas and not carrying out there any type of economic activity are taxed at a rate lower or even at a zero rate tax). In accordance with this Directive, it should be pointed out that, for the purposes of assessing the lawfulness of the companies established in the ZFM, the Commission should rely on general anti-abuse clauses at the assessment phase of State aid granting. Portugal considers that it is unacceptable to conclude that the tax advantage granted to companies licensed in the ZFM, which constitutes a ‘tax relief’, means necessarily that such companies are in a non-genuine arrangement¹⁰⁹.
- (80) Finally, Portugal describes the tax control system in place regarding the companies registered in the ZFM¹¹⁰. Furthermore, Portugal describes the verification of the separate accounting requirement as regards the ZFM earnings¹¹¹, and on this basis contests the view of the Commission in the Opening Decision that there could be doubts on the effectiveness of the controls conducted by the tax authorities¹¹².

- *Job creation/maintenance in the region*

- (81) Portugal explains that the introduction of the limitations relating to the minimum number of jobs is intrinsic to a similar logic of an anti-abuse measure: the goal was to avoid companies, which do not have substantial economic activity, from taking undue advantage in Madeira. However, this does not impose or legitimise a reading of job requirements outside the context of applicable Union and national law.
- (82) Further to Union legislation on harmonisation¹¹³, Portugal argues that Union law does not adopt a uniform concept of ‘labour contract’ or of ‘labour relationship’ or of ‘worker’¹¹⁴ or, consequently of ‘job’. The relevant ‘job’ concept is set out in the Portuguese labour law¹¹⁵, which does not contradict applicable Union law.
- (83) Portugal has always considered that the requirement for entities licensed to operate in the ZFM to create or maintain jobs is only complied with as long as a labour contract is established with a company established in the ZFM¹¹⁶. The forms of contracting labour which form part of the Union and national rules cannot be ignored, in particular temporary employment as well as the (fundamental) freedom of movement for workers.

¹⁰⁹ ‘Tax and economic analysis report’, Ernest & Young, 24 September 2018, p. 66.

¹¹⁰ Letter from Portugal of 26 September 2018, paragraphs 282 to 318.

¹¹¹ Letter from Portugal of 26 September 2018, paragraphs 296 to 298.

¹¹² Paragraph 34 of the Opening Decision.

¹¹³ Council Directive 98/59/EC of 20 July 1998 on the approximation of the laws of the Member States relating to collective redundancies (OJ L 225, 12.8.1998, p. 16), Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees’ rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses (OJ L 82 22.3.2001, p. 16), or Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provisions of services (OJ L 18, 21.1.1997, p. 1).

¹¹⁴ Opinion of Advocate-General Poiares Maduro delivered on 27 January 2005, *Celtec*, C-478/03, ECLI:EU:C:2005:66.

¹¹⁵ Law No 7/2009 of 12 February 2009, as amended by Law No 14/2018 of 19 March 2018.

¹¹⁶ Letter from Portugal of 26 September of 2018, paragraph 222.

- (84) Portugal further argues that the spirit of Union legislation¹¹⁷ and Union case-law¹¹⁸ is to accept and protect the various types of employment relationship (whether they are temporary or permanent) and the mobility of workers in the Member States by considering that phenomenon (mobility), including as a positive element for the development of the economy of the Member States. Similarly, the Union broadly recognises the freedom of companies to provide services from other Member States, to temporarily post their employees in those Member States, which again reflects the mobile nature of current employment relationships, without this implying a lack of verification of the substantive economic activity of the companies. Therefore, Portugal does not accept that the legality of the ZFM scheme is directly dependent on the creation of a certain number of jobs, nor on the basis of a retrograde concept of ‘job’, which is exclusively based on the notion of space (physical place) in which the employees carry out their tasks, and on a permanent basis¹¹⁹.
- (85) Portugal refers to the negotiations with the Commission in the context of the 2002 Commission’s approval decisions of Regime II¹²⁰, following which Portugal accepted to include the maximum taxable ceilings related to the number of jobs; however, this did not mean that this condition was a *sine qua non* condition and Portugal never implemented the scheme considering that it was¹²¹.
- (86) Finally, Portugal considers that the ZFM is not an employment aid scheme but an aid scheme for the diversification and modernisation of Madeira. The aim of the ZFM scheme is primarily to contribute to regional Gross Domestic Product (‘GDP’). The contribution of the scheme to the GDP of Madeira demonstrates the strong link between the economic activities performed by the ZFM companies and the region.
- *Definition of number of jobs created*
- (87) Portugal reiterates that the concepts of ‘job creation’ and ‘annual labour units’(ALU) set out in paragraph 58 and footnote 52 of the 2007 RAG do not apply to the ZFM scheme. The definitions apply only to ‘regional investment aid’ (section four of the 2007 RAG) and not to operating aid (section five of the 2007 RAG). Moreover, Portugal underlines that there is no precedent in the application of the ALU concept to regional aid in an outermost region, conversely to what the Commission stated in

¹¹⁷ Directive 2008/104/EC of the European Parliament and the Council of 19 November 2008 on temporary agency work (OJ L 327, 5.12.2008, p. 9); Regulation (EU) No 492/2011 of the European Parliament and the Council of 5 April 2011 on freedom of movement for workers within the Union (OJ L 141, 27.5.2011, p. 1), and Directive 2014/54/EU of the European Parliament and the Council of 16 April 2014 on measures facilitating the exercise of rights conferred on workers in the context of freedom of movement for workers (OJ L 128, 30.4.2014, p. 8).

¹¹⁸ Opinion of Advocate-General Ruiz-Jarabo Colomer delivered on 10 July 2003, *Collins*, C-138/02, ECLI:EU:C:2003:409.

¹¹⁹ ‘Tax and economic analysis report’, Ernest & Young, September 2018, p. 54.

¹²⁰ Commission Decision C(2002) 4811 of 11 December 2002, State aid N 222/A/02 – Portugal – Aid scheme relating to Zona Franca da Madeira for the period 2003 to 2006 (OJ C 65, 19.5.2003, p.23) and Commission Decision C(2003) 92 of 4 April 2003 (State aid N222/B/2002 – Portugal - Regime de auxílios da Zona Franca da Madeira para o período 2003-2006). See also Commission letter D/52122 of 25 February 2002 and the Portuguese letter of reply of 3 June 2002 (1580).

¹²¹ The commitment has to be interpreted against the position Portugal stated at the ‘negotiation process’ of the aid scheme. Portugal argued that the ZFM scheme should be considered over the proportionality to the additional costs companies incur in the outermost region of Madeira (*‘restricting the idea of proportionality to the simple quantifiable additional costs is to devalue the importance of Article 349 of the TFEU (ex-Article 299(2) of the EC Treaty)’*). See letter from Portugal of 26 September 2018, pp. 22-24.

the Opening Decision¹²². According to the Portuguese authorities, due to the exceptional character of the outermost regions, a different definition of job creation should be accepted. Portugal recalls, in a more global manner, that the 2007 RAG as well as the conditions of the 2007 and 2013 Commission Decisions are non-binding. In any case, as far as the concept of job creation in the 2007 RAG is concerned, Portugal never committed to apply such concept. The calculation of jobs created and maintained in the region should therefore not be subject to the conditions provided for in the 2007 RAG or to the staff headcount determined under Article 5 of the Commission Recommendation concerning the definition of micro, small and medium-sized enterprises¹²³.

- *Jobs located outside Madeira region*

- (88) Portugal further reiterates that the ZFM beneficiaries' activity should not necessarily take place in the region as the scheme aims at attracting foreign investment and developing international services. A restrictive interpretation limiting activity to Madeira territory removes the incentive for businesses internationalisation, reversing the logic of the regional development that must be promoted. Portugal concludes that jobs exclusively limited to Madeira or collecting tax revenue were not the primary concerns of the ZFM scheme.

- *Controls of the job creation/maintenance*

- (89) Portugal reiterates that the control of ZFM job creation/maintenance is sufficiently made through the annual tax declarations 'Modelos 10, 30 and DMR (monthly statement declaration)' and the declaration on jobs created/maintained as indicated in 'Modelo 22', Annex D, field 6 (only mandatory for ZFM scheme recipients)¹²⁴. These declarations, in accordance with the Portuguese Labour law, will allow checking the existing jobs at the beginning and at the end of the financial year.
- (90) Portugal considers that the Portuguese tax system incorporates multiple instruments enabling effective control of the ZFM scheme. The companies established in the ZFM are subject to inspection by the Tax and Customs Authority ('AT'), Regional Government, the Inspectorate-General of Finance and all other tax departments, including the Directorate of Fraud and Special Action Investigation, the Directorate of Tax Inspection and the Large Tax Payers Unit. Moreover, administrative offences or even criminal proceedings are instigated whenever illegal activity is detected. The supervision, inspection and control of the legality of activities carried out in the ZFM has been a priority in the national tax inspection plans.
- (91) Finally, Portugal considers the Commission's preliminary views that the different tax declarations cannot be used as a basis for an accurate calculation of the number of jobs held by each ZFM beneficiary and cannot be either used as a valid alternative of the definition of jobs within the meaning of the 2007 RAG¹²⁵, constitutes a breach of the respect due to the State functions as provided for in Article 4(2) of the Treaty on the European Union.

¹²² Paragraph 41 of the Opening Decision.

¹²³ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (C(2003) 1422)(OJ L 124, 20.5.2003, p. 36).

¹²⁴ Recital 29 of this Decision.

¹²⁵ Paragraph 42 of the Opening Decision.

- *Contribution to regional development*

- (92) Portugal underlines the contribution of the ZFM scheme to the regional development of the outermost region of Madeira and provides to that end a study¹²⁶ showing the weight of the ZFM in the internationalisation and diversification of the Madeira economy. Portugal further argues that the applied measure complies with the 2007 and 2013 Commission Decisions and applicable State aid rules. Portugal further concludes that the Commission should assess, in a consistent manner, the ZFM scheme against Union policies on the outermost regions with regard to economic, social and territorial cohesion.

- *Retroactive application of the 2014 GBER*

- (93) Portugal reiterates that the 2014 GBER may not apply retroactively to individual aid awards under the ZFM scheme for the purposes of declaring their compatibility, if that General Block Exemption Regulation exempted them. Portugal further considers that a flexible interpretation of the 2014 GBER would not require that the ZFM beneficiaries have their economic activities exclusively in the outermost region of Madeira. Portugal concludes that the implementation of the ZFM scheme has to be based on the 2007 RAG, which was in force at that time.

- *Recovery and breach of legitimate expectations and legal certainty*

- (94) Portugal argues that the ZFM scheme was approved by the Commission several times in the past. Therefore, the national tax authorities could not be now called to recover the aid.
- (95) Portugal further considers that all tax benefits were awarded in full respect of the ZFM scheme. Consequently, a different interpretation would not comply with the requirements of clarity, accuracy or predictability of effects in settled Union case-law¹²⁷. Portugal and aid recipients assumed that they could trust that the implemented ZFM scheme was covered legitimately by the 2007 and 2013 Commission Decisions. Portugal concludes that companies, which have received aid under Regime III, acquired the right to legal certainty and security and to legitimate expectations not to be subject to any recovery decision.

5. OBSERVATIONS FROM THIRD INTERESTED PARTIES AND COMMENTS FROM PORTUGAL

5.1. Observations from third interest parties

- (96) The Commission received observations from 102 interested parties (citizens, companies or associations of companies). ZFM companies and their employees submitted the majority of the observations (94 out 102). These interested parties stressed their concerns about the termination or reduction of the ZFM operation, which would result in massive job losses and negative impact on the regional economy. In addition, they argued that the nature of the activities developed by the ZFM companies should not be restricted to the Madeira territory, not only because its market size was rather small, but mainly because the internationalisation of the

¹²⁶ Footnote 55 above.

¹²⁷ Judgment of the Court of Justice of 15 February 1996, *Duff and Others*, C-63/93, ECLI:EU:C:1996:51, paragraph 20, and opinion of Advocate General Cosmas of 8 June 1995, ECLI:EU:C:1995:170; judgment of the Court of Justice of 7 June 2007, *Britannia Alloys & Chemicals v Commission*, C-76/06 P, ECLI:EU:C:2007:326, paragraph 79; and judgment of the Court of Justice of 18 November 2008, *Förster*, C-158/07, ECLI:EU:C:2008:630, paragraph 67.

economy of an outermost region was one of the aims of the ZFM from its inception. Furthermore, they concluded that the Commission's view on *'the place where the economic activities were carried out'* was a restrictive interpretation of the ZFM operative conditions in a context of an open and global economy.

- (97) The Commission also received comments from seven sectoral company associations¹²⁸ and by the company managing the ZFM itself¹²⁹. They unanimously criticised what they consider as the Commission's restrictive interpretation of the link of the aid amount to the creation and maintenance of real jobs in Madeira and the application of the income tax exemption to income deriving from *'activities effectively and materially performed in Madeira'*.
- (98) The arguments put forward by interested parties in order to support their views on the existence of aid, origin of the profits and job creation are summarised in the following recitals.
- (99) Only one interested party, the Commercial and Industrial Association of Funchal (Associação Comercial e Industrial do Funchal, 'ACIF')¹³⁰, argues that the corporate income tax reduction does not constitute aid. It considers that the tax reduction merely represents the differential of uncollected taxes on income that, in absence of that tax reduction, would not exist at all. The ZFM scheme involves purely a theoretical and artificial tax expense, which is budgeted and calculated annually for accounting purposes only, as it does not correspond to an actual tax expense or to a decrease in collected revenue. The elimination of the ZFM tax benefits would not give rise to the collection of said tax differential. ACIF further considers that, if Madeira has to be compared to other European countries that have competitive tax systems, which do not face the same permanent constraints and do not limit the tax benefits to the jobs created, it should be concluded that there is no economic advantage linked to Madeira's ZFM scheme. In this regard, it is highly unlikely that the ZFM scheme will distort competition and affect trade between Member States.
- (100) The interested parties argue that the location of activities and jobs which are international by nature in the region of Madeira is wrongly limiting the support in favour of the Madeira outermost region to the mere compensation of additional costs incurred by companies in Madeira due to its natural handicaps as enshrined in Article 349 TFEU.
- (101) The interested parties consider that the Commission's interpretation ignores the fact that all companies established in ZFM can benefit from the scheme only if they have a permanent establishment in Madeira, taking into account the model of the OECD

¹²⁸ Associação Comercial e Industrial do Funchal ('ACIF'), Câmara do Comércio e Indústria dos Açores ('CCIA'), Confederação de Comércio e Serviços de Portugal ('CCP'), Confederação da Indústria Portuguesa ('CIP'), Confederação de Turismos de Portugal ('CTP'), European International Ship Owners Association of Portugal ('EISAP') and 'EURODOM' (representative association of the French outermost regions).

¹²⁹ Sociedade de Desenvolvimento da Madeira S.A. ('SDM'). The SDM is, since 1984, the responsible company, on behalf of the Regional Government of Madeira ('concession contract'), for the management, administration and promotion of the ZFM (also called 'International Business Centre of Madeira, 'IBC').

¹³⁰ ACIF is a business association representing 800 associated companies from all sectors of activity (63% in trading and services, 23% in industry, and 14% in tourism).

Convention for the avoidance of double taxation¹³¹, and have their combined domicile and effective place of business in the region.

- (102) Moreover, the interested parties claim that a large number of activities currently carried out by ZFM companies on top of immaterial activities have to be carried out in a different place from their headquarters. A limitation of such a possibility would constitute a discretionary and negative treatment of Madeira, which is incomprehensible and unreasonable, especially in the case of incentives that are not effective tax expenditure – but rather virtual or apparent expenditure – nor even a loss of tax revenues for the Madeira region.
- (103) Only a limited number of interested parties claim that the Commission is prohibiting the internationalization of Madeira’s economy by encouraging instead an economic isolationism of the region, which will constitute a violation of the principles of a market economy and the integration of less favoured regions into it.
- (104) The interested parties further consider abusive the submission of the ZFM scheme to the definitions, conditions and principles set out in the 2007 RAG in terms of definition and calculation of jobs, since the aid scheme was approved as regional operating aid and not as investment aid. Consequently, it is not appropriate to apply, not even analogically, the criteria and concepts defined in paragraph 58 and footnote 52 of the 2007 RAG to the assessment of regional operating State aid, including the aid authorised for the ZFM scheme. Finally, the interested parties claim that the concept of ‘job’ has to be considered under the definitions and conditions set out in the Portuguese Labour code.
- (105) The interested parties further note that, under the GBER provisions, the concept of ‘creation of employment’ is exclusively provided for by Article 14, which governs regional investment aid, and by Article 17, which governs investment aid for SMEs. In both cases, for delimiting their eligible costs, the *‘estimated wage costs arising from the creation of employment, as a result of an initial investment, is calculated over a period of two years’*. The interested parties conclude that *‘the aid granted to the ZFM companies does not relate to wage costs, does not fall within any initial investment and it is not limited to a period of 2 years’*.
- (106) Only a limited number of interested parties argue that the concept of ‘number of annual work-year units (AWU)’ is set out only in Article 5 of Annex I to the 2014 GBER (as it was the case under the 2008 GBER). In addition, they argue that the concept is intended to ‘protect’ SMEs by preventing all their employees from being considered ‘effective’ and counted as ‘full employee’, in particular to avoid that the maximum number of workers acceptable for the purpose of maintaining the SME status be exceeded¹³².

¹³¹ OECD Model Tax Convention on Income and Capital: condensed version 2017 (https://www.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version_20745419)

¹³² See letter from ACIF of 12 April 2019, Annex I on the defense of the ZFM and their companies, p. 26.

- (107) Furthermore, the interested parties argue that the ‘AWUs requirement’ to the management posts of the companies benefiting from the scheme is devoid of any logical and legal sense. In accordance with the applicable national rules governing members of management corporate bodies¹³³, the performance of such tasks/duties in more than one company is legal. Therefore, the Commission’s interpretation ‘prohibiting’ the performance of such tasks/duties in more than one company not only subverts the national legal framework, but ignores the functional content of the duties/positions in question and the characteristics of the persons who fill such positions.
- (108) The interested parties claim that management posts and tasks involved do not require full and exclusive permanence and availability, as such office duties are usually filled by highly qualified and skilled persons, who often undertake other professional and business activities. There are endless cases of administrators/directors and/or managers-entrepreneurs linked to several companies, contributing with their expertise and professional skills to the development of such companies. The interested parties further conclude that, conversely to the Commission’s view, there is no rule nor limitation regarding the possible cumulation of positions/duties in more than one company established in the ZFM. Thus, the holders of company’s management boards are considered to be ‘effective employees’ provided that the rules in the national legislation with that purpose are complied with.
- (109) Only a limited number of interested parties claim a positive discrimination in favour of Madeira based on its outermost region status as recognised by Article 349 TFEU and stress the importance of the ZFM in Madeira’s economy¹³⁴ (including the quantification of the impact on the region, if most or all the business currently operating there cease trading¹³⁵).
- (110) Finally, a limited number of interested parties claim that any recovery would be in violation of general principles of Union law. To this end, they argue that the

¹³³ The performance of such duties may not be remunerated. The remuneration is freely fixed by the company and does not necessarily correlate with the number of hours actually worked or with the remuneration earned by other employees. There is no performance on an exclusive basis, unless it is imposed by the company and accepted by the management board holder. These duties are, as a rule, performed on exemption from working hours, and subject to a no minimum or maximum limits of the working period.

¹³⁴ On 31 December 2017, with regard to employment, there were [5 000-10 000] people employed in the ZFM ([1000-3000] in International Services; [100-1000] in the industrial zone, and [4000-6000] in the International Shipping Register). In 2018, according to data directly collected through a survey conducted by ACIF, there were [1000-3000] employees in international services part of the ZFM. On 31 December 2018, [1000-3000] companies were established in the ZFM. According to data compiled by the Madeira Tax Authority, the ZFM generated in 2018 a direct tax revenue to the Autonomous Region of Madeira of EUR [50 000-200 000] thousand, corresponding to [10-20] % of the overall tax revenue collected in the region. According to data from the Bank of Portugal of 2013, the ZFM was responsible of [10-20] % of direct investment in Portugal. See ACIF defense of the ZFM and companies settled therein, pp. 29-35 (Annex I attached to the letter from ACIF of 12 April 2019).

¹³⁵ Admitting that all the companies currently installed in the ZFM would cease their activity in the region (scenario 1), it is estimated that there will be a fall in GVA between [1-10] % and [10-20] %, as a percentage of the GVA in 2015, and a fall of employment between [1000-4000] and [5000-7000] jobs. If any of the current activity is maintained, but in which companies responsible for [80-90] % of the GVA currently generated in the ZFM cease their activity (scenario 2), the effects foreseen also correspond to a crisis, with a fall of [1-10] % to [1-10] % and a loss of jobs between [1000-3000] and [4000-6000]. See letter from ACIF of 12 April 2018, pp. 36-37, and attached study commissioned by ACIF to the Centre for Applied Studies of the Portuguese Catholic University in Lisbon: CONFRARIA, João, ‘Impacto do Centro Internacional de Negócios da Madeira na economia da Região’, Universidade Católica de Lisboa – Centro de Estudos Aplicados, 4 April 2019, p. 1-25.

Commission, by concluding that the scheme implemented by Portugal constitutes unlawful aid, would breach the principles of legal certainty¹³⁶ and legitimate expectations as settled in Union case-law¹³⁷.

5.2. Comments from Portugal

- (111) The Commission forwarded the comments received from interested parties to Portugal on 23 May and 12 June 2018. Portugal's response to those comments can be summarised as follows¹³⁸.
- (112) Portugal stresses that all comments received from interested parties unequivocally state the compatibility of the ZFM scheme as implemented by Portugal with the internal market. These comments also underline the importance of the ZFM for the regional development, the territory cohesion, the employment of the Madeira region as well as its contribution to reduce the consequences of the outermost status of Madeira. They thus consider as unproven the risks and situations that led to the Commission's preliminary conclusions.
- (113) Portugal further notes that the number and meaning of the comments received show the absence of an appreciable effect of the scheme on trade between Member States or on competition.
- (114) Furthermore, Portugal considers the general positive comments received, the absence of comments from jurisdictions that compete with the ZFM scheme, and the absence of comments from companies that do not benefit from the scheme as strong indicators that the scheme has been properly implemented.
- (115) Portugal urges the Commission to take into account the legal nature of the ARM as an outermost region under the terms and for the purposes of Article 349 TFEU and the Act of Accession of Portugal to the European Economic Community (EEC), considering the positive discrimination resulting from the approved scheme as justified.
- (116) Portugal further considers the ZFM of the utmost importance both for the State and to the modernization, diversification and development of the Madeira region, as it represents a decisive contribution to the economic and financial systems and has a relevant impact for the national economy and finances. Such modernization and development would not have been possible without the existence of the jobs created and effectively developed in the region together with material investments.
- (117) Portugal stresses that the diversity of activities carried out in the ZFM, the number of direct and indirect jobs created, the investments (domestic and foreign) carried out, the consumption generated, the strong contribution of the taxes collected to the regional budget as well as the internationalization of the regional economy are crucial for Madeira's economic and social sustainability. This also results from the economic studies annexed to the comments submitted by ACIF.
- (118) Portugal, moreover, expresses its view that the comments from interested parties confirm that the Portuguese authorities exercised its supervisory powers regarding

¹³⁶ Judgment of the Court of Justice of 5 July 2012, *SIAT*, C-318/10, ECLI:EU:C:2012:415; judgment of the Court of Justice of 3 October 2013, *Itelcar*, C-282/12, ECLI:EU:C:2013:629; and judgment of the Court of Justice of 11 June 2015, *Berlington Hungary and Others*, C-98/14, ECLI:EU:C:2015:386.

¹³⁷ Judgment of the Court of Justice of 24 November 2005, *Germany v Commission*, C-506/03, ECLI:EU:C:2005:715, paragraph 58; and judgment of the General Court of 3 December 2014, *Castelnou Energía v Commission*, T-57/11, ECLI:EU:T:2014:1021, paragraph 189.

¹³⁸ Letter from Portugal of 26 June 2019 (2019/082914).

the scheme's eligibility conditions. To a certain extent the submitted comments show that the control exercised by the Portuguese authorities towards the ZFM scheme beneficiaries has been more demanding than the requirements of the 2007 and 2013 Commission Decisions.

- (119) Finally, Portugal argues that Article 36 of the EBF requires job creation without expressly mentioning that such jobs must be created in the region. Portugal further argues that job creation was not conceived as a way to verify how each company specifically contributed to the region's development; instead it was merely considered as a criterion of substantial economic activity, in light of the recommendations of the OECD and of the Code of Conduct Group (Business Taxation)¹³⁹, with the purpose of excluding 'letterbox' companies¹⁴⁰.

6. ASSESSMENT OF THE AID

6.1. Existence of aid within the meaning of Article 107(1) TFEU

- (120) 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 shall, in so far as it affects trade between Member States, be incompatible with the internal market'.
- (121) Accordingly, for a support measure to be considered aid within the meaning of Article 107(1) TFEU it must meet the following conditions cumulatively: (i) it must be financed by the State or through State resources and it must be imputable to the State; (ii) it must confer a selective advantage on its recipients by favouring certain undertakings or the production of certain goods; (iii) it must distort or threaten to distort competition; and (iv) it must have the potential to affect trade between Member States.
- (122) In the following recitals the Commission will assess whether the ZFM scheme implemented by Portugal in favour of the ZFM beneficiaries satisfies the criteria mentioned in recital 121 and consequently constitutes State aid.

6.1.1. State resources and imputability

- (123) Portugal considers that the ZFM scheme does not involve State resources because it does not correspond to 'real tax expenditure' but simply to a virtual tax expenditure ('theoretical tax revenue losses') and, therefore, it is not a State aid measure¹⁴¹.
- (124) One interested party, ACIF, raises similar arguments and considers that the scheme does not constitute aid¹⁴².
- (125) The Commission notes that the Portuguese Constitution recognises Madeira as an 'Autonomous Region' with its own political and administrative status (*Estatuto*

¹³⁹ On 1 December 1997, the Council and the representatives of the governments of the Member States, meeting within the Council, adopted a resolution on a Code of Conduct for business taxation, with the objective to curb harmful tax competition. The Code of Conduct Group (Business Taxation) was set up within the framework of the Council by the ECOFIN Council on 9 March 1998 to assess tax measures that may fall within the scope of the Code of Conduct (OJ C 99, 1.4.1998, p. 1). See <https://www.consilium.europa.eu/en/council-eu/preparatory-bodies/code-conduct-group/>.

¹⁴⁰ Letter from Portugal of 26 June 2019, p. 3.

¹⁴¹ Recital 67 of this Decision.

¹⁴² Recital 99 of this Decision.

Político-Administrativo da Região Autónoma da Madeira'¹⁴³, 'Estatuto') and self-governing institutions. The Commission further notes that, pursuant to Article 5(1) of its Estatuto, the Autonomous Region of Madeira (ARM) enjoys, inter alia, financial, economic and fiscal autonomy. The Commission also notes that the Estatuto ensures the existence of a specific 'regional tax system', which also expressly includes the ZFM¹⁴⁴. Taxes and levies collected by the regional authorities are revenues of the ARM¹⁴⁵ and tax revenues are, inter alia, those resulting from income and gains of legal persons and stamp duty¹⁴⁶. The ARM has its own fiscal competence and the power to adapt national fiscal provisions to particular regional features¹⁴⁷. Furthermore, the regional parliament has the power to reduce the rate of the corporate income tax established on an annual basis by the national parliament for the Portuguese territory¹⁴⁸. Finally, the Commission notes that Article 36 of the EBF governs the ZFM legal framework¹⁴⁹.

- (126) As described in recitals 12 and 13 of this Decision, the ZFM scheme concerns a corporate income tax reduction and other tax exemptions normally payable to the Portuguese State¹⁵⁰. In particular, it allows a reduced corporate income tax compared to the tax normally payable on corporate income under the Corporate Income Tax Code – Income and Gains of Collective Persons (*Código do Imposto sobre o Rendimento das Pessoas Coletivas*, 'CIRC')¹⁵¹, including, under certain conditions, a further 50% corporate income tax cut.
- (127) A loss of tax revenue for the State is equivalent to consumption of State resources in the form of tax expenditure. By allowing a tax reduction from the CIRC in compliance with the ZFM scheme approved by Article 36 of the EBF, Portugal foregoes revenue that it would have obtained if it had not enacted this fiscal provision. The corporate income tax reduction, is granted through State resources. This measure has been put into effect in the form of a State regulation (the Tax Incentives Statute, *Estatuto dos Benefícios Fiscais* 'EBF' that is a parliamentary act) that is a legal act attributable to the Portuguese State. Since this tax benefit is granted by the Portuguese authorities, it is imputable to the State.

¹⁴³ Law No 13/91 of 5 June 1991, as amended by Law No 130/99 of 21 August 1999 and Law 12/2000 of 21 June 2000.

¹⁴⁴ Article 107(4) and Article 146 of the Estatuto.

¹⁴⁵ Article 108(b) of the Estatuto.

¹⁴⁶ Article 112(1)(b) and (e) of the Estatuto. See also Article 26 of Law No 2/2013 of 2 September 2013 (Law of the Finances of the Autonomous Regions, *Lei das Finanças das Regiões Autónomas*, 'LFRA'). Article 55 and 56 of the LFRA.

¹⁴⁷ Article 59(2) of the LFRA.

¹⁴⁸ Article 146(4) of the Estatuto and Article 59(6) of the LFRA.

¹⁴⁹ Article 5, Article 26 and Article 59(2), (3), (4) and (6) of the LFRA. For the period of 2007 to 2013, see Law No 1/2007, of 19 February, as amended by Law No 1/2010 of 29 March 2010, by Law No 2/2010 of 16 June and by Law No 64/2012 of 20 December 2012.

¹⁵¹ 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 2013, 23% in 2014 and 21% from 2015 to 2020.

- (128) The concept 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 effect¹⁵².
- (129) The Commission therefore concludes that the corporate income tax reduction (including the additional 50% corporate income tax cut for companies carrying out industrial activities in the ZFM industrial zone) is granted from State resources and imputable to the State¹⁵³.

6.1.2. *Selective advantage*

- (130) Portugal considers that the ZFM scheme is not selective because the measure is not ‘*favouring certain undertakings or the production of certain goods*’ within the meaning of Article 107(1) TFEU. Portugal considers that all companies engaged in commercial, industrial, maritime or other service activities are likely to be established in the ZFM. It argues that the ZFM scheme forms part of the general economy of the Portuguese tax scheme and that the measure does not entail a selective advantage for the companies registered in the ZFM. Therefore, it does not constitute State aid. The ZFM scheme should be rather qualified as a general measure¹⁵⁴.
- (131) According to settled Union 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 intervention. 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) TFEU¹⁵⁵. Likewise, a measure allowing certain undertakings a reduction of tax normally due can amount to State aid.
- (132) The ZFM scheme is a regional aid scheme, which, as approved by the 2007 Commission Decision, authorised aid in the form of reduced corporate income tax on profits resulting from activities effectively and materially performed in Madeira and other tax exemptions as described in recital 12 of this Decision.
- (133) In accordance with recital 127 of this Decision, the ZFM scheme is governed by Article 36 of the EBF¹⁵⁶.

¹⁵² Judgment of the Court of Justice of 8 November 2001, *Adria-Wien Pipeline and Wietersdorfer & Peggauer Zementwerke*, C-143/99, ECLI:EU:C:2001:598, paragraph 38; judgment of the Court of Justice of 15 March 1994, *Banco Exterior de España*, C-387/92, ECLI:EU:C:1994:100, paragraph 13; and judgment of the Court of Justice of 1 December 1998, *Ecotrade*, C-200/97, ECLI:EU:C:1998:579, paragraph 34.

¹⁵³ Judgment of the Court of Justice of 16 May 2002, *France v Commission*, C-482/99, ECLI:EU:C:2002:294, paragraph 24; judgment of the General Court of 5 April 2006, *Deutsche Bahn v Commission*, T-351/02, ECLI:EU:T:2006:104, paragraph 103.

¹⁵⁴ See recitals 68 and 69 of this Decision.

¹⁵⁵ Judgment of the Court of Justice of 10 January 2006, *Cassa di Risparmio di Firenze and Others*, C-222/04, ECLI:EU:C:2006:8, paragraph 132.

¹⁵⁶ Footnote 5 above.

- (134) Undertakings in Madeira region were subject to several corporate (normal) income taxation rates across the period of 2007 to 2014 under successive regional budgetary laws¹⁵⁷. Companies registered in the ZFM benefit from a corporate income tax reduction on profits¹⁵⁸ or from other tax exemptions until 31 December 2020. The ZFM scheme enables the beneficiaries to save on their expenses. This derogation is put in place with the specific objective of benefiting and promoting activities carried out by the companies registered in the ZFM, putting these companies in a more favourable position than other companies located elsewhere in the country or in the ARM.
- (135) Therefore, the measure under examination confers an advantage solely to the companies established in the ZFM. Given its geographical scope of application, the measure under examination is selective, as it is only available to the companies registered in the limited ZFM.
- (136) In view of the above, the Commission concludes that, by alleviating a fiscal charge that they should normally pay, the ZFM scheme confers a selective advantage to the companies registered in the ZFM within the meaning of Article 107(1) TFEU.

6.1.3. *Distortion of competition and effect on trade*

- (137) Portugal did not directly argue that the measure did not distort or threaten to distort competition and did not affect trade between Member States¹⁵⁹. Conversely, ACIF, one of the interested parties, argued that it was highly unlikely that the ZFM scheme would distort competition and affect trade between Member States¹⁶⁰.
- (138) A measure 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 competes¹⁶¹. The distortion of competition within the meaning of Article 107(1) TFEU is thus assumed as soon as the State grants a financial advantage to an undertaking in liberalised sectors where there is, or could be, competition¹⁶². Where financial aid by a State strengthens the position of an undertaking as compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by the aid¹⁶³.

¹⁵⁷ 29% in 2007 (Article 12 of Decreto Legislativo Regional No 3/2007/M of 9 January 2007); 20% from 2008 until 2011 (Article 15 of Decreto Legislativo Regional No 2/2008/M of 16 January 2008, Article 14 of Decreto Legislativo Regional No 45/2008/M of 31 December 2008, Article 13 of Decreto Legislativo Regional No 34/2009/M of 31 December 2009, and Article 14 of Decreto Legislativo Regional No 2/2011/M of 10 January 2008); 25% from 2012 until 2013 (Article 2 of Decreto Legislativo Regional No 20/2011/M of 26 December 2011, and Article 16 of Decreto Legislativo Regional No 42/2012/M of 31 December 2012); 23% in 2014 (Article 18 of Decreto Legislativo Regional No 31-A/2013/M of 31 December 2013).

¹⁵⁸ Footnote 15 above.

¹⁵⁹ Recital 113 of this Decision.

¹⁶⁰ Recital 99 *in fine* of this Decision.

¹⁶¹ Judgment of the Court of Justice of 17 September 1980, *Philip Morris*, C-730/79, ECLI:EU:C:1980:209, paragraph 11; and judgment of the Court of First Instance of 15 June 2000, *Alzetta and Others v Commission*, 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, ECLI:EU:T:2000:151, paragraph 80.

¹⁶² Judgment of the Court of First Instance of 15 June 2000, *Alzetta and Others v Commission*, 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, ECLI:EU:T:2000:151, paragraphs 141 to 147.

¹⁶³ Judgment of the Court of First Instance of 4 April 2001, *Regione autónoma Friulia-Venezia Giulia v Commission*, T-288/97, ECLI:EU:T:2001:115, paragraph 41.

- (139) To the extent that the companies registered in the ZFM carry out activities that are open to international competition, the measure at stake improves their competitive position and threatens to distort competition and thus may affect trade between Member States.

6.1.4. Existing aid classification and appropriate measures

- (140) Portugal argues that the ZFM scheme should be treated as existing aid, if it should entail 'aid'. Portugal further argues that the ZFM was set up in 1980¹⁶⁴, which predates the accession of Portugal to the EEC in 1986, and it has not undergone any substantial changes outside the negotiation framework on existing aid. It should be therefore classified as an 'existing aid' scheme within the meaning of Article 1(b)(i) of Regulation (EU) 2015/1589¹⁶⁵.
- (141) In view of the above, Portugal considers that the Commission should propose appropriate measures to ensure the continued compatibility of the ZFM scheme with the internal market, which could involve changing the content of the aid scheme, the introduction of requirements or the clarification of existing requirements¹⁶⁶.
- (142) Article 1(b)(i) of Regulation (EU) 2015/1589 defines 'existing aid' as 'all aid which existed prior to the entry into force of the TFEU in the respective Member States, that is to say, aid schemes and individual aid which were put into effect before, and are still applicable after, the entry into force of the TFEU in the respective Member States'.
- (143) Article 26 and section 10 of Annex I to the Act of Accession of Portugal¹⁶⁷ provide adaptations to acts adopted by the institutions, which include under the customs legislation section the 'Zona Franca da Madeira'. The Act of Accession of Portugal does not provide that the ZFM should be regarded as existing aid within the meaning of Article 88(1) of the EC Treaty (now Article 108(1) TFEU).
- (144) Furthermore, the first notification of the ZFM scheme (Regime I) under State aid rules was in 1986, which the Commission approved by Decision of 25 May 1987. Since 1987, the ZFM scheme had several prolongations and successor schemes approved by Commission Decisions in 2002 and 2007, respectively¹⁶⁸. Furthermore, the ZFM scheme was subject to substantial changes across the successive regimes I, II and III. Regime I did not require the creation/maintenance of jobs. This requirement was introduced under Regime II (linked to maximum taxable base ceilings placed upon the beneficiaries' annual taxable base) and kept in Regime III. The Regime II excluded all activities involving financial intermediation, insurance and auxiliary financial and insurance-related activities as well as intra-group services activities (coordination, treasury and distribution centres)¹⁶⁹. It also introduced a progressive reduction of aid in the system by increasing the applicable tax rates (1% in 2003 and 2004, 2% in 2005 and 2006, and 3% as from 2007). Finally, it introduced the additional benefit of a 50% corporate income tax cut for companies

¹⁶⁴ Decree Law No 500/80 of 20 October 1980 and Regional Regulatory Decree No 53/82 of 23 August 1982. See also Decree Law No 502/85 of 30 December 1985 and Decree Law No 165/86 of 26 June 1986.

¹⁶⁵ Letter from Portugal of 26 September 2018, paragraph 67.

¹⁶⁶ Letter from Portugal of 26 September 2018, paragraph 85.

¹⁶⁷ Act concerning the conditions of accession of the Kingdom of Spain and the Portuguese Republic and the adjustments to the Treaties (OJ L 302, 15.11.1985, p. 23).

¹⁶⁸ See footnote 9 above.

¹⁶⁹ See preamble to Decree Law 163/2003 of 24 July 2003.

located in the ZFM industrial free trade zone. Under Regime III, in particular further to the 2013 Commission Decision, a 36.7% increase of the maximum taxable base ceilings on which the corporate income tax reduction could apply was approved.

- (145) In view of the above, the measure in this case does not constitute existing aid falling within the meaning of Article 1(b)(i) of Regulation (EU) 2015/1589. Article 22 of that Regulation, on the basis of which Portugal requires the Commission to limit itself to the adoption of 'appropriate measures', is therefore not applicable.

6.1.5. *De minimis aid*

- (146) In cases where individual beneficiaries of the ZFM scheme received an advantage not exceeding the thresholds specified in Commission Regulation (EC) No 1998/2006¹⁷⁰, that advantage will not be considered State aid and thus does not fall within the prohibition of Article 87(1) of the EC Treaty (now Article 107(1) TFEU), provided all the other conditions laid down by that regulation are fulfilled. In the same vein, beneficiaries of the ZFM scheme who received an advantage not exceeding the thresholds specified in Commission Regulation (EU) No 1407/2013¹⁷¹ (which applies retroactively to the present case by virtue of Article 7(1) thereof) have not received State aid falling within Article 107(1) TFEU, provided all the other conditions laid down by that regulation are fulfilled.

- (147) On the basis of the quantitative data provided by Portugal, it would appear that in many cases the amount of aid received by the beneficiaries of the ZFM is below the *de minimis* threshold of EUR 200 000.

- *Conclusion on the existence of aid*

- (148) In view of the above, the Commission considers that the measure implemented by Portugal in favour of ZFM companies constitutes State aid within the meaning of Article 107(1) TFEU.
- (149) Incidentally, it should be added that Portugal did not challenge the finding of the existence of aid reached by the Commission in its 2007 Decision¹⁷².

6.2. **Compatibility of the aid**

6.2.1. *Compliance of the ZFM scheme with the 2007 and 2013 Commission Decisions*

- (150) Portugal considers that the ZFM scheme as implemented by the Portuguese authorities is consistent with the commitments Portugal has made at the time of the notification and consistent with the 2007 and 2013 Commission Decisions.

- *Origin of the profits benefiting from the income tax reduction*

¹⁷⁰ Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid (OJ L 379, 28.12.2006, p. 5). This Regulation applied from 1 January 2007 until 31 December 2013 (see Article 6).

¹⁷¹ Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid (OJ L 352, 24.12.2013, p. 1).

¹⁷² In the context of the notification of the ZFM scheme submitted to the Commission in 2006, Portugal refers to the ZFM scheme as a 'regional operating aid scheme'. See letter from Portugal of 28 June 2006 (1900/80932); in particular sub-sections 2.1 and 10 of the general notification form, sub-section 1.2 of the supplementary information sheet, preamble to the notified draft law, explanatory memorandum and preamble to Decree-Law No 163/2003 of 24 July 2003. See also letters from Portugal of 29 October 2015, p. 22, of 31 March 2016, p. 4, and of 21 November 2017, pp. 5-6.

- (151) The ZFM scheme was assessed on the basis of the 2007 RAG as regional operating aid and approved by the 2007 and 2013 Commission Decisions. The ZFM scheme authorised aid in the form of reduced corporate income tax on profits resulting from activities effectively and materially performed in Madeira and of exemption from other taxes, up to maximum aid amounts, calculated on maximum taxable base ceilings based on the number of jobs held each fiscal year by the beneficiaries.
- (152) In the course of the notification process that led to the 2007 Commission Decision, Portugal did not contest that the fiscal reductions provided for in the scheme would be restricted to activities carried out in Madeira, as recalled in paragraph 32 of the Opening Decision¹⁷³.
- (153) The 2007 RAG allow regional operating aid only in exceptional cases¹⁷⁴: ‘such aid may be granted in regions eligible under the derogation in Article 87(3)(a) of the EC Treaty (now Article 107(3)(a) TFEU), provided that: (i) it is justified in terms of its contribution to regional development and its nature, and (ii) its level is proportional to the handicaps it seeks to alleviate’¹⁷⁵.
- (154) There is no question that Madeira is an outermost region for the purposes of Article 349 TFEU and is therefore eligible under Article 107(3)(a) TFEU.
- (155) However, the contribution of an operating aid scheme to the regional development of a region has to be assessed in relation and in proportion to the handicaps of this region, which in the case of outermost regions are structural and permanent handicaps recognized by the TFEU, such as remoteness, insularity, small size, difficult topography and climate, economic dependence on few products, as enshrined in Article 349 TFEU.
- (156) As recalled in paragraph 30 of the Opening Decision, the ‘*raison d’être*’ of regional operating aid for outermost regions is to compensate the additional costs companies incur in these regions due to these handicaps.
- (157) In the assessment of the ZFM scheme, the additional costs were identified and quantified based on a study submitted by the Portuguese authorities. In the 2007 Commission Decision, the assessment of the proportionality of the measure was made on the basis of these quantified additional costs, at the aggregated level of the ZFM, and at the level of each beneficiary registered in the ZFM¹⁷⁶.
- (158) On the origin of the profits benefiting from the income tax reduction, Portugal argues that it has to be assessed with regard to the contribution of the scheme to the regional development of the ARM and should not be geographically restricted to the region as this would limit the support scheme to a mere compensation of the additional costs incurred by companies located in the ZFM¹⁷⁷. Portugal further argues that the scheme as implemented is consistent with international tax standards and that the companies in the ZFM carry there a substantial activity within the meaning of the OECD’s BEPS Action Plan and are subject to tax legal requirements and subject to many controls¹⁷⁸. This position is generally supported by the interested parties¹⁷⁹.

¹⁷³ Letter from Portugal of 19 December 2006.

¹⁷⁴ 2007 RAG, paragraph 6.

¹⁷⁵ 2007 RAG, paragraph 76.

¹⁷⁶ Paragraphs 53 and 59 of the 2007 Commission Decision.

¹⁷⁷ Recital 74 of this Decision.

¹⁷⁸ Recital 77 of this Decision.

¹⁷⁹ Recitals 100 and 101 of this Decision.

- (159) Contrary to what Portugal says¹⁸⁰, companies registered in the ZFM only incur such additional costs if they effectively and materially conduct their activities in Madeira, which implies that their profits are resulting from operations directly burdened with such additional costs. Other type of profits, not burdened by these costs because realised as a result of activities carried out outside the region, cannot be taken into account in the taxable base benefiting from the tax measure.
- (160) The Commission notes that Portugal clearly stated throughout the 2015 monitoring and confirmed in the course of the formal investigation that beneficiaries did not necessarily have to conduct their activity in the region and that even activities carried out outside the region benefited from aid under the scheme (see recitals 20 and 21 of this Decision).
- (161) The Commission considers that the so-called ‘geographical restriction’ of the origin of the profits denounced by Portugal is a mere translation in the 2007 and 2013 Commission Decisions of the basic principles stated in the 2007 RAG and that the implementation of the ZFM scheme on the origin of the profits is not in line with the provisions on operating aid in those Guidelines.
- (162) In its Opening Decision, the Commission did not raise any doubts on the consistency of the scheme with international tax standards and tax legal requirements. For State aid control purposes, the effectiveness and materiality of the activity carried out by the beneficiaries has to be assessed in relation to the 2007 RAG principles on operating aid recalled in recitals 156 and 157 of this Decision, and not with regard to OECD tax agreements, which pursue their own tax objectives.
- (163) Similarly, the Commission points out that the legal requirement of separate accounting for income generated in the ZFM for tax purposes, described in recital (21) of this Decision is not, as such, sufficient to address the Commission’s doubts as to the adequate taxable base for the ZFM scheme, since the generation of income in the ZFM subject to this requirement is not defined in relation to the 2007 RAG principles on operating aid.
- (164) On the contrary, such separation of accounts merely shows that the lower tax rate was applied to earnings resulting from transactions between, on one side, the aid beneficiaries and, on the other, entities resident in the ZFM as well as entities resident outside the Portuguese national territory. However, such separation of accounts does not allow any conclusion as to whether those transactions resulted from activities effectively and materially performed, by the aid beneficiaries, inside or outside Madeira.
- (165) Finally, the Commission notes that the in-depth tax controls conducted as regards the taxable base and the origin of profit were carried out in the light of the approach of the Portuguese authorities recalled in recital 158 of this Decision and did not take into account the link between eligible profits and additional costs incurred in the ZFM, as implied by the 2007 RAG and the following 2007 and 2013 Commission Decisions.
- (166) The Commission considers, therefore, that the arguments put forward by Portugal with regard to consistency with taxation rules, legal requirements and tax related controls are not relevant for the assessment of the implementation of the ZFM scheme with regard to the 2007 RAG and the 2007 and 2013 Commission Decisions.

¹⁸⁰ Recitals 73 and 74 of this Decision.

(167) In view of the above, the Commission considers that its doubts as to the origin of the profits benefiting from the tax reduction in the ZFM are not removed, and concludes that the implementation of the ZFM scheme with regard to this criterion is in breach of the 2007 and 2013 Commission Decisions.

- *Job creation/maintenance in the region*

(168) As recalled in recital 151 of this Decision, the maximum aid amounts that beneficiaries registered in the ZFM can benefit from under the approved regional operating aid scheme are calculated on maximum taxable base ceilings based on the jobs held each fiscal year by the beneficiaries.

(169) The Commission points out that the requirement of job creation/maintenance was a condition to access the scheme and was embedded in the method of calculation of the aid amount in the ZFM scheme as notified by Portugal¹⁸¹, and approved by the 2007 and 2013 Commission Decisions.

(170) Moreover, in the 2007 Commission Decision, the generation of jobs in the ZFM scheme was assessed as contributing to regional development¹⁸².

(171) The Commission further notes that job creation/maintenance was an intrinsic part of the approved regional ZFM scheme. Consequently, the number of jobs is a parameter of the aid amount and a measurement of the contribution of the scheme to regional development and, for both purposes, it should be based on an objective proven method used in State aid decision practice.

(172) Portugal rejects the restrictive definition of jobs in FTEs or ALUs used by the Commission for the purpose of calculating of the aid amounts. Conversely, Portugal argues that its 'job definition' is consistent with national and international labour rules, that the beneficiaries were subject to numerous controls, the results of which have been shared with the Commission, and that the implementation of the scheme is therefore in compliance with the 2007 and 2013 Commission Decisions.

(173) Contrary to what Portugal argues¹⁸³ the Commission considers that the application of the method set out in paragraph 58 of the 2007 RAG, and especially the related footnote 52 to calculate the number of jobs created/maintained, i.e. '*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*', is appropriate, even if this definition is included only in the section of the 2007 RAG relating to regional investment aid. This method is also referred to in Article 5 of the Commission Recommendation concerning the definition of micro, small and medium-sized enterprises¹⁸⁴, which is of general application of Union legislation and in particular of Union State aid rules, as those Recommendations were consistently included as Annex I to the 2008 GBER, as well as to the 2014 GBER.

(174) Contrary to Portugal's argument, such a definition of jobs in FTEs and ALUs is the best way to include without discrimination all types of labour relationships and contracts, permanent or temporary employment, employees and board members under multiple labour contracts with different companies, teleworkers, the time

¹⁸¹ Letter from Portugal of 28 June 2006 (notification of Regime III).

¹⁸² Paragraph 64 of the 2007 Commission Decision.

¹⁸³ Recital 87 of this Decision.

¹⁸⁴ Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises C(2003) 1422 (OJ L 124, 20.5.2003, p. 36).

effectively spent by employee for the company in the ZFM being computed in an objective and verifiable manner. The Commission remains neutral with regard to the nature of the labour relationship under national law, as long as the computing of the jobs for State aid purposes is done in an objective manner.

- (175) In any event, the Commission further notes that, irrespective of the definition in footnote 52 of the 2007 RAG, Portugal has not applied any definition of jobs that would effectively count the number of jobs created and maintained in Madeira. As mentioned in recital (28) of this Decision, Portugal has accepted as valid jobs under the ZFM scheme any employment of whichever legal nature irrespective of the number of hours, days, and months of active labour per year, declared by the beneficiaries in their annual tax declarations. It did so without checking the reality of the time spent by the jobholder for each beneficiary and translating it in FTEs.
- (176) In view of the outcomes of the 2015 monitoring and information provided by Portugal during the formal investigation, the Commission considers that the Portuguese authorities, on the basis of the declarations made by the beneficiaries, were not in a position to check the reality nor the permanence of the jobs declared as requested by the 2007 and 2013 Commission Decisions, precisely because of the absence of a common objective computing methodology applicable to all cases of labour relationships.
- (177) Finally, the Commission points out that Portugal did not confirm that all jobs recorded for the application of the ZFM scheme were held by employees contributing to activities effectively and materially performed in Madeira. The Portuguese authorities indicated that in some cases the omission to declare a number of employees in the annual declarations did not affect the assessment of the tax due and tax benefit; in some other cases, during the 2015 monitoring, there was evidence of jobs outside the ZFM, Madeira and even outside the Union. Furthermore, the Commission notes that Portugal did not provide information on the place of effective activity of the employees of all ZFM beneficiaries, despite several requests from the Commission¹⁸⁵.
- (178) The Commission recognizes that Portugal has provided documentation showing that many controls have been conducted on the beneficiaries of the ZFM scheme. Conversely to Portugal's argument, the Commission never questioned the effectiveness of the tax controls performed by the Portuguese authorities *per se*, but only their effectiveness with regard to an accurate calculation of the number of jobs held by each ZFM beneficiary and an assessment of the link between the jobs created and the activities effectively and materially performed in Madeira. The documentation shared with the Commission confirms the reality of the controls for tax purposes. The data gathered are, however, not relevant from a State aid perspective, since the controls did not verify the two problems that are at stake in the present case: the accurate calculation of the number of jobs held by each ZFM beneficiary and the link between the jobs created and the activities effectively and materially performed in Madeira by such beneficiary.
- (179) In view of the above, the Commission considers that its doubts with regard to the creation/maintenance of jobs criterion in the ZFM have not been removed, and concludes that the implementation of the ZFM scheme with regard to this criterion is in breach of the 2007 and 2013 Commission Decisions.

¹⁸⁵ Recitals 52 and 57 of this Decision.

- *Conclusion*

(180) The Commission therefore concludes that the ZFM scheme as implemented by Portugal is in breach of the 2007 and 2013 Commission Decisions, which have authorised Regime III, and is therefore unlawful.

6.2.2. *Compatibility of the ZFM scheme with the 2007 RAG*

(181) Portugal argues that they never accepted the Commission's interpretation of the conditions of its 2007 and 2013 Decisions with regard to the origin of the profits and the job creation. Portugal further considers that these requirements are non-binding, as those Decisions have been adopted based on the 2007 RAG, which Portugal also considers as non-binding¹⁸⁶.

(182) Portugal further argues that the definition of job creation referred to in the 2007 Commission Decision with regards to FTEs and ALUs is not referred to in the section of the 2007 RAG on operating aid, which the Commission does not deny¹⁸⁷. Therefore, in the view of the Portuguese authorities, the ZFM scheme should be assessed solely on the basis of paragraphs 76 to 83 of the 2007 RAG.

(183) The Commission points out that Portugal has accepted the 2007 RAG and the subsequent appropriate measures¹⁸⁸ in a letter of 10 May 2006, implying that the rules laid down in the 2007 RAG had to be complied with by any regional aid scheme¹⁸⁹.

(184) Paragraphs 76 and 80 of the 2007 RAG authorized operating aid in outermost regions provided that: (i) it was intended to offset, for companies, the additional costs arising, in the pursuit of economic activity, from the factors identified in Article 299(2) [currently Article 349] TFEU, (ii) it was justified in terms of contribution to regional development, and (iii) it was proportionate to the handicaps it sought to alleviate.

(185) Therefore, to the extent that the ZFM scheme benefited companies that did not have their activities effectively and materially performed in the region and did not bear therefore the additional costs mentioned in the 2007 RAG, the implementation of the scheme was not in line with the requirements referred to in recital 184 of this Decision.

(186) Moreover, in the absence of an assessment of the job creation/maintenance condition with regard to the concept of job creation as set out in the investment aid section of the 2007 RAG or the Commission State aid case practice, the ZFM scheme as implemented by Portugal would in any event not comply with the conditions laid down in the 2007 RAG on operating aid because of the disconnection between the origin of the profits and the effective additional costs.

¹⁸⁶ Letter of Portugal of 26 September 2019, paragraphs 106, 107, and 272.

¹⁸⁷ Paragraph 41 of the Opening Decision.

¹⁸⁸ Appropriate measures were proposed by the Commission to amend or abolish previous existing regional aid schemes in view of the new adopted rules, as is always the case after the adoption of new guidelines.

¹⁸⁹ State Aid: Guidelines on national regional aid for 2007-2013: Acceptance by 24 Member States of the Commission's proposal of the appropriate measures pursuant to Article 88(1) of the EC Treaty (2006/C 153/04) (OJ C 153, 1.7.2006, p. 1).

- *Conclusion*

(187) In view of the above, the Commission considers that the ZFM scheme as implemented by Portugal is in breach of the provisions of the 2007 RAG and therefore constitutes unlawful aid that cannot be considered compatible with the internal market.

6.2.3. *Compatibility of the aid scheme directly on the basis of Article 107(3)(a) TFEU*

(188) Portugal argues that the Commission should assess the impact of the ZFM scheme ‘in a manner consistent with EU policies on the outermost regions with regard to economic, social and territorial cohesion’ and take into account that it is ‘the most efficient economic policy instrument for driving cohesion, economic growth and the economic sustainability of Madeira’¹⁹⁰.

(189) Pursuant to Article 107(3)(a) TFEU, aid to promote the economic development of the regions referred to in Article 349 TFEU, in view of their structural, economic and social situation, may be considered to be compatible with the internal market.

(190) In the 2007 RAG, the Commission set out the conditions under which regional aid may be considered to be compatible with the internal market and established the criteria for identifying the areas that fulfil the conditions of Article 107(3)(a) TFEU. According to the case-law,¹⁹¹ in adopting rules of conduct and announcing by publishing them that they will henceforth apply to the cases to which they relate, the Commission imposes a limit on the exercise of its discretion and, in principle, cannot depart from those rules without being found to be in breach of general principles of law, such as equal treatment or the protection of legitimate expectations. Therefore, the Commission is bound to assess the present case under the applicable guidelines, i.e. the 2007 RAG, except if the Portuguese authorities were to demonstrate that exceptional circumstances, different from those envisaged in the 2007 RAG, required the Commission to assess the ZFM scheme directly under the Treaty. Nevertheless, in the present case, the Portuguese authorities did not even invoke, let alone demonstrate, such exceptional circumstances. Even if the compatibility assessment of the ZFM scheme as implemented by Portugal should therefore be carried out under the 2007 RAG, the Commission will nevertheless assess, for the sake of completeness, in the following recitals if the ZFM scheme as implemented by Portugal could be considered compatible directly on the basis of the TFEU.

- *Contribution to an objective of common interest*

(191) Portugal argues that the ZFM scheme contributes to the economic development of the ARM recognized as an outermost region by the TFEU. The Portuguese authorities have provided elements on the impact of the scheme at a macroeconomic level.

(192) In particular, the Portuguese authorities insist on the important contribution of the ZFM scheme to the budgetary consolidation of the ARM. According to Madeira Regional Tax authority, the contribution by ZFM companies to Madeira’s regional budget was around [10-20] % on average on the period 2012-2018¹⁹².

¹⁹⁰ Letter from Portugal of 26 September 2018, paragraph 209.

¹⁹¹ Judgment of the Court of Justice of 8 March 2016, *Greece v Commission*, C-431/14 P, ECLI:EU:C:2016:145, paragraphs 69 and 70.

¹⁹² ‘Centro Internacional de Negócios da Madeira’, Sociedade de Desenvolvimento da Madeira, Statistics, December 2018.

(193) In light of the above, the Commission considers that, contrary to its preliminary view stated in paragraph 33 of the Opening Decision, the ZFM scheme could contribute to the regional development of Madeira, an outermost region, and therefore to an objective of common interest.

- *Appropriateness and proportionality*

(194) Operating aid is intended to release an undertaking from costs, which it would normally have to bear in its day to day management or normal activities¹⁹³.

(195) Therefore, such type of aid may exceptionally be granted in the outermost regions eligible under the derogation in Article 87(3)(a) of the EC Treaty [now 107 (3)(a) TFEU], 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 299(2) of the EC Treaty [now Article 349 TFEU]¹⁹⁴.

(196) The Commission notes that the companies that benefited from the scheme as implemented were released from normal tax charges though certain companies had conducted activities for which they did not incur additional costs due to the structural handicaps of the region as was assessed in sections 6.2.1 and 6.2.2 of this Decision.

(197) In this context, as it was not implemented in a way as to address the structural difficulties companies may effectively incur in their activity in Madeira, the ZFM scheme cannot be considered as appropriate, nor proportional with regard to the principles/conditions of regional operating aid aiming at the promotion of the economic development of the outermost regions (Article 349 TFEU) in view of their structural, economic and social situation.

- *Conclusion*

(198) In view of all the above, the Commission considers that the ZFM scheme as implemented by Portugal is in breach of Article 107(3)(a) TFEU and therefore constitutes unlawful aid that cannot be considered compatible with the internal market.

6.2.4. *Compatibility of the aid with the 2014 GBER*

(199) Portugal considers that the 2014 GBER does not apply retroactively to individual aid awards under the ZFM scheme for the purposes of declaring their compatibility¹⁹⁵. Portugal further considers that a flexible interpretation of the 2014 GBER would not require that the ZFM beneficiaries have their economic activities in Madeira. The individual aid awards have to be examined under the regional operating aid conditions provided for by 2007 RAG and are also covered by the 2007 and 2013 Commission Decisions.

(200) As the scheme has been implemented by Portugal in breach of the 2007 and 2013 Commission Decisions and cannot be considered compatible with the internal market under the 2007 RAG, the Commission has to examine whether individual awards under that scheme could, nevertheless, be deemed compatible¹⁹⁶ under the 2014

¹⁹³ Judgment of the Court of First Instance of 9 September 2009, *Diputación Foral de Álava and Others, v Commission*, T-30/01 to T-32/01 and T-86/02 to T-88/02, ECLI:EU:C:2009:314, paragraph 226.

¹⁹⁴ 2007 RAG, paragraph 80.

¹⁹⁵ Article 58(1) of the 2014 GBER.

¹⁹⁶ 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 ZFM scheme did not constitute an aid scheme within the meaning of Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 83, 27.3.1999, p. 1, no longer in force).

GBER, which may apply retroactively to individual aid, provided the relevant conditions are complied with¹⁹⁷.

- (201) In accordance with Article 15(4) of the 2014 GBER, '[i]n 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 one 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'. As mentioned in this article, the rationale for this exceptional authorisation of operating aid for a company is to compensate for the additional costs that derive from having its activity in the outermost region.
- (202) The Autonomous Region of Madeira is an outermost region designated by Article 349 TFEU. Therefore, based on Article 15(4) of the 2014 GBER it is eligible for regional aid under the derogation provided for in Article 107(3)(a) TFEU, provided that: (i) the beneficiaries have their activity in the outermost region, and (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 of the beneficiary incurred/realised in the region.
- (203) The Commission points out that the measure implemented consists of 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 the ZFM.
- (204) Based on the information provided by Portugal in the course of the 2015 monitoring, the beneficiaries of the ZFM scheme implemented by Portugal do not necessarily have their effective activity in Madeira. Moreover, the aid amounts involved are not necessarily related to gross value added, labour costs or turnover generated in Madeira.
- *Conclusion*
- (205) In view of the above, the Commission considers that the individual aid awards under the ZFM scheme as implemented by Portugal are in breach of the provisions of the 2014 GBER.

¹⁹⁷ Article 58(1) of the 2014 GBER.

- *Conclusion*

- (206) In view of all the above, the Commission concludes that the ZFM scheme as implemented by Portugal constitutes unlawful aid that is not compatible with the internal market within the meaning of Article 107(3)(a) TFEU.
- (207) The adoption of a conditional decision within the meaning of Article 9(4) of Regulation (EU) 2015/1589, as suggested by Portugal¹⁹⁸, is therefore not an appropriate mean to address the issues raised in section 6.2 of this Decision.

7. RECOVERY, LEGAL CERTAINTY AND LEGITIMATE EXPECTATIONS

7.1. Recovery

- (208) In accordance with the Treaty on the Functioning of the European Union and the established case-law of the Union Courts, the Commission is competent to decide whether the Member State concerned should alter or abolish aid when it has found that it is incompatible with the internal market¹⁹⁹. The Union Courts have also consistently held that the obligation on a Member State to abolish aid regarded by the Commission as being incompatible with the internal market is designed to re-establish the previously existing situation²⁰⁰.
- (209) In this context, the Union Courts have established that this objective is attained once the recipient has repaid the amounts granted by way of unlawful aid, thus forfeiting the advantage, which it had enjoyed over its competitors on the internal market, and the situation prior to the payment of the aid is restored²⁰¹.
- (210) In line with the case-law, Article 16(1) of Regulation (EU) 2015/1589 provides that ‘[w]here negative decisions are taken in cases of unlawful aid, the Commission shall decide that the Member State concerned shall take all necessary measures to recover the aid from the beneficiary’.
- (211) Thus, given that the measure in question was implemented in breach of Article 108(3) TFEU, and is to be considered as unlawful and incompatible aid, it should be recovered in order to re-establish the situation that existed on the internal market prior to their granting. Recovery should cover the time from the date when the aid was put at the disposal of the beneficiary until effective recovery. The amount to be recovered should bear interest until effective recovery.

- *Identification of the beneficiaries from which to recover the aid*

- (212) The unlawful and incompatible aid must be recovered from the undertakings that actually benefited from it. However, where the Commission is not in a position to identify, in the decision itself, all the undertakings that have received unlawful and incompatible aid, this will have to be done at the start of the implementation of the recovery process by the Member State concerned, which will have to look at the individual situation of each undertaking concerned.

¹⁹⁸ Recital 71 of this Decision.

¹⁹⁹ Judgment of the Court of Justice of 12 July 1973, *Commission v Germany*, C-70/72, ECLI:EU:C:1973:87, paragraph 13.

²⁰⁰ Judgment of the Court of Justice of 21 March 1990, *Belgium v Commission*, C-142/87, ECLI:EU:C:1990:125, paragraph 66.

²⁰¹ Judgment of the Court of Justice of 17 June 1999, *Belgium v Commission*, C-75/97, ECLI:EU:C:1999:311, paragraphs 64 and 65.

- (213) In this particular case, the potential beneficiaries of the unlawful and incompatible State aid are those natural and legal persons registered in the ZFM from 1 January 2007 until 31 December 2014. From this initial group of beneficiaries, the Portuguese authorities should exclude from recovery those natural and legal persons for which proof can be provided that: (i) they complied with the conditions necessary to benefit from the ZFM scheme as approved in the 2007 and 2013 Commission Decisions, which means that their earnings were linked to an activity effectively and materially performed in Madeira and jobs effectively created/maintained in the region; or (ii) the total advantage received per beneficiary under the scheme does not exceed the thresholds laid down in Regulation (EU) No 1998/2006²⁰² or Regulation No 1407/2013²⁰³, so long as these advantages also comply with the other conditions laid down in those regulations; or (iii) the individual aid received by a given beneficiary fulfils the conditions laid down by a regulation adopted pursuant to Article 1 of Council Regulation (EU) 2015/1588²⁰⁴, such as the 2014 GBER.
- (214) The remaining natural or legal persons who benefited from the ZFM scheme are the beneficiaries of the unlawfully implemented State aid from which the Portuguese authorities are required to recover the aid advantage received.
- *Quantification of the aid*
- (215) The Commission is not legally required to fix the exact amount to be recovered, especially where it lacks the necessary data to do so. Instead, it is sufficient for the Commission's decision to include information enabling the Member State to determine the recoverable amount without excessive difficulty.
- (216) The Commission considers that the following methodology should be used by Portugal to determine the amount of incompatible aid to be recovered from each beneficiary:
- (a) determine, per year, the number of jobs, in ALU, created and held in the region per beneficiary;
 - (b) determine, per year, the taxable base in relation to earnings linked to activity effectively and materially performed in Madeira;
 - (c) apply the ZFM tax rate to this taxable base taking into account the number of jobs created identified in point (a), on the basis of the tables of calculation presented in recitals 12 and 16 of this Decision;
 - (d) the amount of aid will be equal to the effective amount received per beneficiary per year less the amount effectively linked to the activity in Madeira calculated as in point (c).
- (217) In all cases where recovery is required, that recovery shall be put into effect from the time when the advantage accrued to the beneficiaries, that is, from the date of the legal act granting the beneficiaries the right to benefit from such scheme, without prejudice of the limitation period for the recovery of aid provided for by Article 17(1) of Regulation (EU) 2015/1589.

²⁰² Footnote 170 above.

²⁰³ Footnote 171 above.

²⁰⁴ Council Regulation (EU) 2015/1588 of 13 July 2015 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to certain categories of horizontal State aid (OJ L 248, 24.9.2015, p. 1).

- (218) The sums to be recovered should bear interest from the date on which they were put at the disposal of the beneficiaries until their actual recovery. The interest should be calculated on a compound basis in accordance with Chapter V of Commission Regulation (EC) No 794/2004²⁰⁵.
- (219) During the formal investigation procedure, Portugal had difficulty in providing reliable information to identify beneficiaries and to assess whether and how much aid they received under the scheme. It cannot be ruled out that when establishing the final list of beneficiaries and corresponding aid amounts to be recovered, as provided by the method outlined in recital 216 of this Decision, Portugal may need again additional time. In line with the Commission Notice on the recovery of unlawful and incompatible State aid²⁰⁶ with respect to the timing for the recovery from individual beneficiaries of the unlawful and incompatible State aid amounts, the Portuguese authorities should have four months to submit a final list of beneficiaries together with the implementation plan of the recovery process, and eight months to actually implement the recovery.

7.2. Legal certainty and legitimate expectations

- (220) Portugal considers that companies, which have received aid under the ZFM scheme, acquired the right to legal certainty and to legitimate expectations to not be subject to any recovery decision²⁰⁷.
- (221) A limited number of third interested parties raised a similar argument²⁰⁸.
- (222) It is settled case-law that the principle of the protection of legitimate expectations is a general principle of EU law. That principle has been progressively accepted into the Union legal order by case-law, which has described it as a ‘superior rule of law’ for the protection of individuals²⁰⁹, as ‘one of the fundamental principles of the Community’²¹⁰ and as a ‘general principle’²¹¹. It is considered the corollary of the principle of legal certainty, which requires that Union legislation must be certain and its application foreseeable by persons subject to it, in that it seeks, where rules are altered, to ensure the protection of situations legitimately entered into by one or more natural or legal persons in particular²¹². As described in recitals 12 to 17 of this Decision, the requirements laid down in the 2007 and the 2013 Commission Decisions for the ZFM scheme to be considered compatible with the internal market

²⁰⁵ Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EU) 2015/1589 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union (OJ L 140 30.4.2004, p. 1). See, in particular, the amendment of Article 9 and Article 11(3) by Commission Regulation (EC) No 271/2008 of 30 January 2008 amending Regulation (EC) No 794/2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty (OJ L 82, 25.3.2008, p. 1).

²⁰⁶ Commission Notice on the recovery of unlawful and incompatible State aid (2019/C 247/01) (OJ C 247, 23.7.2019, p. 1), paragraphs 68 and 72.

²⁰⁷ Recitals 94 and 95 of this Decision.

²⁰⁸ Recital 110 of this Decision.

²⁰⁹ Judgment of the Court of 14 May 1975, *CNTA v Commission*, 74/74, ECLI:EU:C:1975:59, paragraph 44.

²¹⁰ Judgment of the Court of Justice of 7 June 2005, *VEMW and Others*, C-17/03, ECLI:EU:C:2005:362, paragraph 73.

²¹¹ Judgment of the Court of Justice of 4 October 2001, *Italy v Commission*, C-403/99, ECLI:EU:C:2001:507, paragraph 35.

²¹² See, to that effect, judgment of the Court of Justice of 18 May 2000, *Rombi and Arkopharma*, C-107/97, ECLI:EU:C:2000:253, paragraph 66 and the case-law cited therein, and the Opinion of Advocate General Léger delivered on 9 February 2006, *Belgium and Forum 187 v Commission*, joined cases C-182/03 and C-217/03, ECLI:EU:C:2006:89, paragraph 367.

were clear, and implementation of those requirements was clearly foreseeable. Consequently, a recovery decision in the present case fully respects the principle of legal certainty.

- (223) According to settled Union case-law, the right to rely on the principle of legitimate expectations presupposes that precise, unconditional and consistent assurances originating from authorised and reliable sources have been given to the person concerned by an EU institution²¹³. However, a person may not plead breach of that principle unless he has been given precise assurances by the administration²¹⁴.
- (224) Consequently, there can be no legitimate expectations that an aid is lawful unless it has been granted in compliance with the procedure laid down in Article 108 TFEU, since a diligent businessman should normally be able to determine whether that procedure has been followed²¹⁵.
- (225) As is apparent from this Decision, the Commission does not challenge the existence and compatibility of the aid scheme that it had approved in its 2007 and 2013 Decisions. This Decision relates to the implementation of the ZFM scheme in so far as it did not comply with the terms of those decisions (i.e. in so far as it allowed in some cases companies registered in the ZFM to benefit from aid in the form of a reduced rate of taxation to profits resulting from activities not effectively and materially performed in Madeira, and calculated on the basis of unverifiable number of jobs created or maintained in the ZFM). The fact that the Commission approved the ZFM scheme by its 2007 and 2013 Decisions does not lead to the conclusion that precise, unconditional and consistent assurances would have been given by the Commission that Regime III would be treated as compatible aid including in situations where the terms of the approval would not be complied with.
- (226) The Commission further recalls that it had requested the introduction of an express provision in the draft law notified by Portugal on 28 June 2006 establishing that the tax reductions would be restricted to profits resulting from activities carried out in Madeira²¹⁶. Portugal declined to do so since it considered that such provision was not necessary as this fact derived from the ZFM legal basis²¹⁷.
- (227) In view of the above, Portugal and the ZFM scheme beneficiaries cannot validly claim that the finding that the ZFM scheme, as implemented by Portugal, constitutes aid incompatible with the internal market would breach the principles of either legitimate expectations or legal certainty, which would preclude the recovery of that incompatible aid.

²¹³ Judgment of the Court of Justice of 21 July 2011, *Alcoa Trasformazioni v Commission*, C-194/09 P, ECLI:EU:C:2011:497, paragraph 71 and the case-law cited therein; judgment of the General Court of 30 June 2005, *Branco v Commission*, T-347/03, ECLI:EU:T:2005:265, paragraph 102 and the case-law cited therein; judgment of the General Court of 23 February 2006, *Cementbouw Handel & Industrie v Commission*, T-282/02, ECLI:EU:T:2006:64, paragraph 77; judgment of the General Court of 30 June 2009, *CPEM v Commission*, T-444/07, ECLI:EU:T:2009:227, paragraph 126.

²¹⁴ Judgment of the Court of First Instance of 14 February 2006, *TEA-CEGOS and Others v Commission*, joined cases T-376/05 and T-383/05, ECLI:EU:T:2006:47, paragraph 88 and the case-law cited therein. See also by analogy judgment of the Court of First Instance of 30 November 2009, *France and France Télécom v Commission*, Joined cases T-427/04 and T-17/05, ECLI:EU:T:2009:474, paragraph 261.

²¹⁵ Judgment of the Court of Justice of 20 March 1997, *Land Rheinland-Pfalz v Alcan Deutschland*, C-24/95, ECLI:EU:C:1997:163, paragraph 25 and the case-law cited therein.

²¹⁶ Letter of 9 November 2006 (D/54422).

²¹⁷ Letter of reply from Portugal of 19 December 2006.

8. CONCLUSION

(228) The Commission concludes that Portugal has unlawfully implemented the ZFM scheme in breach of Article 108(3) TFEU and that aid granted to individual beneficiaries under this scheme is incompatible with the internal market,

HAS ADOPTED THIS DECISION:

Article 1

The aid scheme ‘Zona Franca da Madeira (ZFM) – Regime III’, to the extent that it was implemented by Portugal in breach of Commission Decision C(2007)3037 final and of Commission Decision C(2013)4043 final, was unlawfully put into effect by Portugal in breach of Article 108(3) of the Treaty on the Functioning of the European Union and is incompatible with the internal market.

Article 2

Individual aid granted under the scheme referred to in Article 1 does not constitute aid if, at the time it is granted, it fulfils the conditions laid down by a regulation adopted pursuant to Article 2 of Regulation (EU) 2015/1588 which is applicable at the time the aid is granted.

Article 3

Individual aid granted under the scheme referred to in Article 1 which, at the time it is granted, fulfils the conditions laid down by the Decisions referred to in Article 1 or laid down by a regulation adopted pursuant to Article 1 of Regulation (EU) 2015/1588 is compatible with the internal market up to maximum aid intensities applicable to that type of aid.

Article 4

1. Portugal shall recover the incompatible aid granted under the scheme referred to in Article 1 from the beneficiaries.
2. The sums to be recovered shall bear interest from the date on which they were put at the disposal of the beneficiaries until their actual recovery.
3. The interest shall be calculated on a compound basis in accordance with Chapter V of Regulation (EC) No 794/2004.
4. Portugal shall abolish the incompatible aid scheme to the extent referred to in Article 1 and cancel all outstanding payments of aid with effect from the date of notification of this Decision.

Article 5

1. Recovery of the aid granted under the scheme referred to in Article 1 shall be immediate and effective.
2. Portugal shall ensure that this Decision is implemented within eight months following the date of notification of this Decision.

Article 6

1. Within four months following notification of this Decision, Portugal shall submit the following information:
 - (a) the list of beneficiaries that have received aid under the aid scheme referred to in Article 1 and the total amount of aid received by each of those beneficiaries under the scheme;
 - (b) the total amount (principal and recovery interests) to be recovered from each beneficiary;
 - (c) a detailed description of the measures planned in order to comply with this Decision.
2. Portugal shall keep the Commission informed of the progress of the national measures taken to implement this Decision until recovery of the aid granted under the scheme referred to in Article 1 has been completed. It shall immediately submit, upon request by the Commission, information on the measures already taken and planned to be taken in order to comply with this Decision.

Portugal shall also provide detailed information concerning the amounts of aid and recovery interest already recovered from the beneficiaries.

Article 7

This Decision is addressed to the Portuguese Republic.

The Commission may publish the identity of the beneficiaries of incompatible aid and the amounts of aid and recovery interest recovered in application of this Decision, without prejudice to Article 30 of Council Regulation (EU) 2015/1589.

If the Decision contains confidential information which should not be published, please inform the Commission within 15 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 the Decision. Your request specifying the relevant information should be sent electronically to the following address:

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

Done at Brussels, 4.12.2020

For the Commission
Margrethe VESTAGER
Executive Vice-President