

Madeira Free Trade Zone: New or Existing Aid?

Annotation on the Judgment of the General Court (Fifth Chamber) of 21 June 2023, in Case T-131/21 *Região Autónoma da Madeira v European Commission*.

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This case note concerns Região Autónoma da Madeira's (RAM) action for annulment of the Commission decision relating the aid scheme SA.21259 (2018/C) implemented by Portugal in favour of the free trade zone of Madeira.¹ The General Court's judgment presents a unique opportunity to analyse some key State aid concepts, including procedural aspects, such as the admissibility of infra-State bodies; concepts relating to the notion of State aid, such as the selectivity criterion; and concepts relating to the phase of recovery of unlawful aid, including the principles of legitimate expectations, legal certainty and proportionality and the limitation period. This note also addresses the Court's assessment of whether aid is new or existing.

I. Introduction

The Madeira Free Zone Regime was initially approved in 1987 (Regime I).² Its extension was authorised by the Commission in 1992 and 1995.³

The scheme was approved as regional operating aid, and takes the form of various tax advantages, such as reduced income tax rate in “*Imposto sobre o Rendimento das Pessoas Coletivas*” (IRPM) and exemptions from municipal, local and transfer or donation of real estate taxes, granted, under certain conditions, to new companies that were authorized to operate in the Zona Franca da Madeira (ZFM), the Centro Internacional de Negócios da Madeira (Madeira International Business Centre) and the Registro Internacional de Navios da Madeira (International Ships Registry of Madeira).

In 2002, a second regime (Regime II) was authorized by the Commission, granting practically the same tax advantages as Regime I, to new companies authorized to operate in the ZFM and the Madeira International Business Centre between 2003 and 2006.⁴ A third regime (Regime III) was authorised by the Commission⁵ on the basis of the guidelines on regional State aid for the period 2007-2013 (the 2007 Guidelines).⁶ This covered the period from 1 January 2007 to 31 December 2013, operating aid compatible with the internal market aimed at promoting regional development and the diversification of the economic structure of Madeira, as an outermost region. Regime III takes the form of a reduction in IRPM on profits resulting from certain activities actually and materially carried out in Madeira and exemption from local taxes, as well as an exemption from tax

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1 Case T-131/21 *Região Autónoma da Madeira v Commission* [2023] EU:T:2023:348; currently under appeal in C-547/23 P.

2 Commission Decision SG(87) D/6736 (1987) on the aid measure N 204/86.

3 Commission Decision SG(92) D/1118 (1992) on the aid measure E 13/91.

4 Commission Decision SG(95) D/1287 (1995) on the aid measure E 19/94.

5 Commission Decision on the aid measure SA.21259 (N 421/06) Zona Franca da Madeira OJ C/240 [2007]. Modifications of Regime III were authorised by: (i) Commission Decision of 2 July 2013 on the aid measure SA.34160 (2011/N); (ii) Commission Decision of 26 November 2013 on the aid measure SA.37668 (2013/N) and Commission Decision of 8 May 2014 in case SA.38586 (2014/N), for the extension of the regime until the end of 2014.

6 Commission, ‘Guidelines on national regional aid for 2007-2013’ (Communication) OJ C-54.

on the transfer of real estate in the ZFM, up to maximum aid amounts ceilings based on the taxable base of the beneficiaries. These ceilings are set according to the number of jobs maintained by the beneficiary during each financial year.

II. Background

In March 2015, the Commission initiated, on the basis of Article 108(1) of the Treaty on the Functioning of the European Union (TFEU), a monitoring exercise for Regime III, covering the years 2012 and 2013. In July 2018, the Commission informed the Portuguese Republic of its decision to initiate the formal investigation under Article 108(2) TFEU, for the clearance of the Commission's doubts concerning the application of the tax exemptions on income from activities actually and materially carried out in RAM and the link between the amount of aid and the creation or maintenance of effective jobs in Madeira.

In a 2022 decision, the Commission concluded that the Regime III was unlawfully implemented by Portugal and that it was incompatible with the internal market and consequently, Portugal should recover from the beneficiaries the incompatible aid granted under the Regime III (within eight months from the date of notification).⁷

Thus, RAM filed the action under Article 263 TFEU, and sought for the annulment of Articles 1 and 4 to 6 of the 2022 decision.

III. Judgment

1. Admissibility

First, the Commission argues that, the two Acts which serve as the legal basis for the Regime III were adopted by the Portuguese Republic and not by RAM,⁸ and the authority responsible for granting the aid would be the Portuguese Ministry of Finance and Public Administration, so the cumulative conditions set by case-law to consider an infra-State Body individually concerned by a decision addressed to a Member State, are not met.⁹

However, the General Court, in line with the arguments posed by RAM, held that RAM is directly and individually 'concerned' within the meaning of the fourth paragraph of Article 263 TFEU. Indeed, ac-

ording to case law, an infra-State entity is directly and individually concerned by an act of the EU when the latter prevents it from exercising its own powers as it sees fit.¹⁰

In the present case, the aid is granted by RAM from its own resources and is responsible for the operation of ZFM and for the financing of Regime III. Therefore, the General Court found that the contested decision prevents the applicant from exercising its own powers as it sees fit within the meaning of case-law.

2. Selectivity

RAM first argued that Regime III does not comply with the selectivity condition and should not be considered as State aid within the meaning of Article 107(1) TFEU, because it constitutes a measure of a general nature, being part of the general structure of the Portuguese tax system, as RAM has sufficient autonomy to adapt the national tax system to its specific regional characteristics.¹¹

For its part, the Commission maintained, and the General Court confirmed, that Regime III was already conferring a selective advantage on its beneficiaries,¹² given that only companies registered in the ZFM, can benefit from the tax reductions provided for by Regime III, but not companies established in other parts of RAM or Portuguese territory.

Secondly, even if Regime III is intended to alleviate the permanent handicaps from which undertakings carrying out their activity in RAM suffer, this is not sufficient to be considered that the scheme is justified by the nature or general scheme, since it does

7 Commission Decision 2022/1414 on the aid measure SA.21259 (2018/C) (ex 2018/NN) implemented by Portugal for Zona Franca da Madeira (ZFM) – Regime III (2020) OJ L 217/49.

8 Tax Incentives Statute (*Estatuto dos Benefícios Fiscais*) 1989 (republished by Decree Law No 108/2008 of 26 June, and amended by Law No 83/2013); Decree Law No 165/86 of 26 June, 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*).

9 For example, when that body is the author of the Act or Acts covered by that decision and when that decision prevents it from exercising its own powers as it sees fit.

10 Case T-257/04 *Poland v Commission* [2009] EU:T:2009:182 para 56.

11 Case C-88/03 *Portugal v Commission* [2006] EU:C:2006:511.

12 Case T-95/21 *Zone Franche de Madeira* [2022] EU:T:2022:567 paras 53 – 65.

not benefit companies established in RAM which are not registered in the ZFM.

3. New Aid or Existing Aid

RAM argued that the Commission was wrong to conclude that the Regime III had been implemented according to methods different from those authorized by the decisions of 2007 and 2013,¹³ and that it should be examined together as existing aid, as defined in Council Regulation (EU) 2015/1589.¹⁴

Conversely, the Commission found that an authorized, existing aid scheme (such as that authorized by the decisions of 2007 and 2013) is no longer covered by the decision which authorized it. Therefore it constitutes new aid where the Member State implements the aid scheme with methods substantially different from those taken into account by the Commission to determine the compatibility of the scheme, and, as a result, the scheme in question loses its classification as an existing aid scheme.¹⁵

To determine if Regime III was implemented in a substantially different manner from the decisions of 2007 and 2013, and, therefore, constituted new aid, the interpretation of the following conditions was at stake:

a. Condition 1: Activity Actually and Materially Carried Out in Madeira

Regime III and the decisions of 2007 and 2013 made the granting of authorized aid conditional on the profits of companies registered in the ZFM being derived from activities “actually and materially carried out in Madeira”.

RAM submitted that the decisions of 2007 and 2013 must be interpreted as allowing companies with their registered office or effective management in Madeira to be taxed on all of their income, regardless of where this income was obtained, in line with the commentaries of the Organization for Economic Cooperation

and Development (OECD). Otherwise, according to RAM the difficulties suffered by the outermost regions and the objective of attracting foreign investment in RAM would be ignored and the economy of the region harmed.

However, the General Court found that the terms “activities actually and materially carried out in Madeira” cannot be interpreted as referring to activities carried out outside RAM, even by companies registered in the ZFM.

The 2007 Guidelines state that operating aid may be granted exceptionally in regions benefiting from the exception of Article 107(3)(a) TFEU, such as RAM, provided that only activities affected by handicaps and therefore the additional costs specific to these regions should be eligible for such operating aid. Thus, the General Court stressed that activities performed outside RAM may be excluded from the benefit of Regime III, as long as they were not affected by those additional costs, even if they were carried out by companies established in RAM.

Similarly, the General Court concluded that, even though the interpretation adopted by the Commission may be contrary to a commentary of the OECD Committee on Fiscal Affairs, the Commission can take these texts into account in its decisions, but is not bound by them.¹⁶

Finally, the General Court stressed that RAM implicitly calls into question the assessment of the compatibility of Regime III carried out on the occasion of the decisions of 2007 and 2013, without its arguments being able to be interpreted as raising an objection of illegality within the meaning of Article 277 TFEU nor sufficient to satisfy the requirements of Article 76(d) of the Rules of Procedure of the General Court.

b. Condition 2: Creating or Maintaining Jobs in RAM

Another condition for access to Regime III was the jobs created or maintained for each beneficiary and, depending on the number of jobs declared, the corresponding aid was calculated according to the ceilings approved. For this reason, the calculation of the number of jobs created or maintained for each beneficiary was discussed.

RAM considered that the Commission wrongly imposed the use of the “full-time equivalent” (FTE) and “annual work unit” (AWU) methods; and that the decisions of 2007 and 2013 did not adopt any method-

¹³ Commission Decisions involving Regime III (n 5).

¹⁴ Council Regulation (EU) 2015/1589 laying down detailed rules for the application of Article 108 TFEU [2015] OJ L 248/9, art 1(b)(i).

¹⁵ Case C-467/15 *Commission v Italy* [2007] P, EU:C: 2017:799 paras 47 – 54.

¹⁶ Citing Joined Cases T-816/17 and T-318/18 *Luxembourg and Amazon v Commission* EU:T:2021:252, currently under appeal in C-457/21 P, para 154.

ology, so this condition had to be interpreted with regard to national legislation.

The Commission found that the application by the Portuguese authorities of Regime III as regards the condition of creating or maintaining jobs in RAM breached the decisions of 2007 and 2013. Additionally, the Commission stated that this parameter for calculating the amount of the aid had to be based on objective and verifiable methods such as those of FTE and AWU, employed in the 2007 Guidelines as well as in successive Block Exemption Regulations (GBER).¹⁷ The General Court agreed with the Commission as regards the fact that Regime III, as implemented, disregards the decisions of 2007 and 2013 because the method adopted by the Portuguese authorities to calculate the number of jobs created or maintained in RAM did not make it possible to verify the reality and the permanence of the jobs of work declared by the beneficiaries.

Indeed, the method adopted by the Portuguese authorities counted a job for the purposes of applying Regime III as: any job, of whatever legal nature, regardless of the number of hours, days and months of active work per year, declared by the beneficiaries. For this reason, the Commission did not commit an error of assessment in considering that the Regime III, as implemented, violated the requirement to create and maintain jobs in RAM.

c. Condition 3: Tax Audits Carried Out by the Portuguese Authorities

The General Court considered that the keeping of separate accounts for the income generated by the ZFM companies and the instruments of control that the Portuguese tax authorities carried out, were not sufficient to demonstrate that these tax audits made it possible to effectively monitor compliance with the conditions of Regime III, relating to the origin of the profits to which the reduction in the IRPM applied and to the creating or maintaining jobs in RAM, since the said authorities misapplied the regime in breach of the decisions of 2007 and 2013.

4. Principle of Legitimate Expectations and Legal Certainty

First, RAM stressed that the decision initiating the formal investigation procedure did not include an in-

itation to submit observations on the legitimate expectations liable to hinder the recovery of the aid, provided the Regime III constitutes an “aid scheme”, and that several circumstances suppose violation of the principles of legal certainty, the protection of legitimate expectations and good administration.

In this point, the Commission recalled its obligation to order the recovery of aid declared incompatible with the internal market, unless such recovery would be contrary to a general principle of EU law.¹⁸ It noted that a Member State which had granted aid in breach of the procedural rules provided for in Article 108(3) TFEU could not invoke the legitimate expectations of the beneficiaries to evade the obligation to take the measures necessary for the implementation of a Commission decision ordering the recovery of the aid. Otherwise, the national authorities could rely on their own unlawful conduct to defeat the effectiveness of the Decisions issued by the Commission.¹⁹

The General Court found that the fact that the decision to initiate the formal investigation procedure did not include an invitation to submit observations on the legitimate expectations, however, the obligation of cooperation in good faith on the Portuguese authorities required them to bring, on their own initiative, these difficulties to the attention of the Commission,²⁰ so the principle of the protection of legitimate expectations was not breached.

Regarding the analysis of the breach of principle of legal certainty, some of the factors from the case-law to be evaluated were the inaction of the Commission for an extended period without justification,²¹ and the reasonableness of the procedural time limit, according to the specific circumstances.²² The Commission is required to act within a reasonable time in the context of a State aid examination procedure.

17 Commission Regulation (EU) 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty [2014] OJ L 187 1-138.

18 Case C-403/10 P *Mediaset v Commission* [2011] EU:C:2011:533, para 124.

19 Joined Cases C-465/09 P to C-470/09 P *Diputación Foral de Vizcaya and Others v Commission*, EU:C:2011:372, para 150.

20 Case T-95/21 *Zone Franche de Madeira* [2022], EU:T:2022:567 para 232.

21 Case 223/85 *RSV v Commission* [1987] EU:C:1987:502 paras 14 – 15 and Case C-408/04 P *Commission v Salzgitter* EU:C:2008:236, paras 106-107.

22 Joined Cases C-630/11 P to C-633/11 P *HGA and Others v Commission* [2013] EU:C:2013:387, paras 81 – 82.

In this case, the General Court stated that the time between the 2007 and 2013 decisions, the start of the monitoring exercise of the Regime III on 12 March 2015, the decision to initiate the formal procedure on 6 July 2018, and the 29-month duration of the formal investigation procedure could not be considered unreasonable. This assessment took into account the confidentiality issues, the request for missing information and the 102 interested parties involved. Additionally, it noted that, pursuant to Article 15(2) of Regulation 2015/1589, the Commission was not bound by specific deadlines, so no prolonged or unjustified inaction by the Commission could be identified in this case.

5. Impossibility of Compliance

RAM claimed the impossibility of complying with the decision ordering the recovery of the aid concerned because of the “excessive difficulty” of determining the amounts to be recovered and verifying whether the beneficiaries fulfilled the conditions for benefiting from a *de minimis* regulation,²³ or from the GBER. RAM also added that many of the recovery decisions will lead to insolvency situations of the beneficiaries.

23 Commission Regulation (EC) 1998/2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid [2006] OJ L 379.

24 Joined Cases C-622/16 P to C-624/16 *Scuola Elementare Maria Montessori v Commission, Commission/Scuola Elementare Maria Montessori and Commission v Ferracci* [2018] EU:C:2018:873, para 82.

25 Case C-11/20 *Aids to agricultural producers* [2021] EU:C:2021:380, para 44.

26 Joined Cases C-622/16 P to C-624/16 *Scuola Elementare Maria Montessori v Commission, Commission/Scuola Elementare Maria Montessori and Commission v Ferracci* [2018] EU:C:2018:873, paras 91 – 92.

27 Case C-441/06 *Commission v France* [2007] EU:C:2007:616 [29], and Case T-489/11 [2013] *Rousse Industry v Commission* EU:T:2013:144, para 77.

28 Case T-489/11 [2013] *Rousse Industry v Commission*, EU:T:2013:144, para 79.

29 Case C-441/06 *Commission v France* [2007] EU:C:2007:616, para 29.

30 Case C-37/14 *Commission v France* [2015] EU:C:2015:90, para 84.

31 Council Regulation (EU) 2015/1589 laying down detailed rules for the application of Article 108 TFEU [2015] OJ L 248/9, art 17(1) and (2); Case C-369/16 P [2017], *Ireland v Commission* EU:C:2017:955, para 41.

32 Case T-369/00 *Département du Loiret v Commission* [2003] EU:T:2003:114, paras 81–82.

The General Court agreed with the arguments raised by the Commission. In essence, the Commission argued that it could not adopt a recovery order the execution of which, once adopted, would be objectively and absolutely impossible to carry out.²⁴ Second, the legal, political or practical difficulties which the Court attributed to RAM’s acts or omissions, and the large number of aid beneficiaries, did not allow recovery to be considered absolutely or technically impossible.²⁵ Moreover, RAM did not propose other means of implementing the recovery which would help to overcome these difficulties.²⁶

It was noted that Commission is not bound by EU law to fix the exact amount of the aid to be recovered when ordering the recovery of unlawful aid declared incompatible with the internal market.²⁷ The calculation of the precise amount of aid to be recovered is an obligation of the Member State, as part of the obligation of sincere cooperation in the implementation of the rules of the TFEU.²⁸ The General Court found that Commission’s decision enables Portuguese authorities to determine, without undue difficulty, the amount to be refunded.²⁹

6. Principle of Proportionality

The General Court stressed that the recovery was not contrary to the principle of proportionality, having regard to the fact that that obligation only affects individual aid paid in violation of the decisions of 2007 and 2013, and only the beneficiaries who do not meet the conditions in the *de minimis* regulation or the GBER. Moreover, the fact that the recovery of unlawful and incompatible aid could lead to the beneficiaries’ bankruptcy does not affect the compulsory nature of that recovery.³⁰

IV. Limitation Period

Finally, RAM claimed the aid granted until 9 July 2008 was time-barred, as it was ten years before the notification of the decision to open the formal procedure. This was not accepted by the General Court. It held that the ten-year limitation period began on 27 June 2007, when Regime III was authorised,³¹ and was interrupted on 12 March 2015 when the request for information was notified to the Portuguese authorities,³² less than ten years after the authorisation.

V. Conclusion

In all, the action of annulment raised by RAM was dismissed in its entirety. Some interesting points emerge from the reasoning of the General Court.

First, that an infra-state body can bring proceedings against a Commission decision, as long as it is directly and individually concerned within the meaning of the fourth paragraph of Article 263 TFEU. This occurs when the Decision prevents it from exercising its legitimate powers at its own discretion.

Second, when an aid scheme is applied only to companies established in a concrete zone of a Region, it cannot be considered a measure of general application, and consequently, it gives an advantage in a selective way to certain undertakings.

Third, if national authorities implement a decision in a substantially different manner from the connotation considered by the Commission when determining the compatibility of the scheme, the scheme must be considered as new aid.

In this case, it should be notified following the procedure provided for in Article 108(2) TFEU, in due time, to the Commission and the new scheme could not have any execution before the approval of the Commission decision.

Finally, after Regime III, Portugal has notified the Commission the Regime IV³³ applicable to ZFM and

Madeira International Business Centre, under GBER rules. The current regime of tax benefits allows the creation of new companies until the end of 2023, which will benefit from the application of reduced tax rates until the end of 2027.

Regarding the current application of the tax exemptions, the current *Estatuto dos Benefícios Fiscais* of the ZFM establishes at Article 33(5) that the income taken into account for the reduced corporate relates to the activity developed within the free trade zone.³⁴ Article 36, which regulates the application of the ceilings according to the number of jobs maintained, applies the AWU method.

This confirms that Portuguese authorities have taken the necessary steps to adapt the legislation according to the interpretation stressed by the General Court in its 2022 decision on Regime III.³⁵

33 SA.42790 (2015/X) Regime de auxílios fiscais da Zona Franca da Madeira (ZFM) ou Centro Internacional de negócios da Madeira - Regime IV, and its prolongations for 2021 (SA.60761) and 2022, 2023 (SA.104292).

34 Tax Benefits Statute, accessible in English at: <https://www.abc-madeira.com/images/pdf/en-03-Art_33_34_Tax_Incent.pdf> accessed 14 September 2023.

35 Commission Decision 2022/1414 on the aid measure SA.21259 (2018/C) (ex 2018/NN) implemented by Portugal for Zona Franca da Madeira (ZFM) – Regime III (2020) OJ L 217/49.