MADEIRA - THE UNKNOWN TAX HAVEN

PART I

Introduction

Madeira is an archipelago, a group of islands of volcanic origin about 1,000 km southwest of Lisbon, 600 km west of the coast of Morocco, at the latitude of Southern California. Most people (over 250,000) live in the principal island, also called Madeira and almost half of them live in the capital, Funchal. The (mountainous) island of Madeira is about 56 km long and 19 km wide.

Madeira has been an autonomous region of Portugal since 1976, just as Newfoundland is part of Canada. This makes Madeira an integral part of the European Union ("EU"). Portuguese is the national language; because of 200 years of British influence, English is widely spoken. The currency, currently the Escudo, will become the Euro.

Telecommunications are excellent. As to transportation, Madeira has several daily flights from Lisbon, direct flights from other European cities such as London, Frankfurt, Paris, Madrid and Zurich, and charter flights. Non-stop flights from North American cities await the airport extension, in progress.

Operating costs in Madeira compare favourably with other European locations. About 20 management companies look after local requirements, incorporation, accounting, filing returns, etc. There are no exchange controls.

Madeira is a tourist destination, so hotels are excellent and local people are friendly and helpful. The business traveller can combine a business trip with relaxation in a pleasant environment and temperate climate.

Disadvantages of Madeira include physical remoteness from Canada, the need for a company's official books to be prepared according to Portuguese law, and some problems arising from the Lisbon bureaucracy. Another problem for some potential users of Madeira is the requirement to file tax returns with the authorities - even though no tax is payable.

Tax Benefits

Madeira is not a personal tax haven. The top personal tax rate is 40%. Anti-avoidance legislation (similar to the Canadian FAPI rules) is in place, though I understand that enforcement may be erratic.

PART I (Continued)

Madeira's tax advantages stem from two sources. First is the Industrial Free Trade Zone, 138 hectares, where manufacturing activities, repairs, warehousing, etc. are carried on, generally free of all direct and indirect taxes until December 31, 2011. About 40 companies currently operate there. Second, there are provisions for the incorporation of holding, service, and shipping companies, all of which carry considerable tax benefits, including direct tax exemptions until 2011. There are no withholding taxes on dividends, interest, or royalties, no capital gains taxes, no gift or inheritance taxes, and no stamp duties on capital.

Currently, about 3,400 companies take advantage of these tax benefits. All Portugal's double tax treaties apply to Madeira, except for the US treaty, which specifically excludes Madeira companies. Portugal currently has 18 tax treaties in effect, four more signed awaiting ratification, and others under negotiation. Unfortunately, there is no tax treaty with Canada, though negotiations have been ongoing for some years. Ratified treaties include 14 with European countries.

Because Madeira is part of Portugal, advantage can be taken of the EU Parent - Subsidiary Directive, which generally exempts from withholding tax dividends paid to a Portuguese (including Madeira) company by any company resident in the EU, after two years' ownership.

Banking

Foreign banks operate in Madeira, serving the offshore industry. There are no Canadian banks, but the banks include ABN/AMRO Bank (Netherlands); both Bank of Boston and Citibank (U.S.); Credit Lyonnaise (France); Deutsche Bank (Germany); and several large Spanish banks. Some operate through branches; others have incorporated Madeira subsidiaries.

All banks are strictly supervised and regulated from Lisbon by the Portuguese Central Bank.

Can Canadian companies use the tax advantages offered by Madeira? I shall discuss that topic in Part II.

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PART II

In the first part of this article, I introduced Madeira and explained its tax benefits. Can Canadian companies take advantage of these benefits? We shall see.

Madeira has a high reputation in the international community, and is free of the suspicion of money laundering and other illegal activities. All its tax incentives were pre-approved by the European Union ("EU").

Holding Companies

A Madeira "pure" holding company, known as an "S.G.P.S.", can be used by a Canadian-based group to own affiliates world-wide. Incoming dividends from EU countries are free of withholding taxes, provided the S.G.P.S. pays 34% tax on 5% of the dividends (effective rate 1.7%). Dividends received from other countries can claim reduced withholding tax rates under Portugal's tax treaties, and are free of Portuguese tax. As noted earlier, the Canada/Portugal treaty is still under negotiation. Dividends paid by Madeira companies are free of withholding taxes

Directors of an S.G.P.S. can be resident anywhere in the world; one Madeira resident director is usual.

Exempt surplus generated by a foreign affiliate of a Canadian parent maintains its character when paid to the Canadian company as a dividend via a Madeira S.G.P.S.

When considering the use of a Madeira holding company for EU subsidiaries, comparison should be made with Netherlands and Danish holding companies. An intermediate holding company in Spain, a subsidiary of the Madeira company, can sometimes work well.

There is no "one size fits all" solution. Sometimes a Madeira holding company can save tax; in other situations, the "mix" of subsidiaries will mean that a Netherlands or Danish holding company is more tax-effective.

Service Companies

At least one foreign company hired computer science graduates from Lisbon University and set up an I.T. affiliate to operate tax-free in Madeira. Canadians will prefer to wait until a Canada/Portugal tax treaty has been signed before setting up a profitable active business in Madeira. Until then, dividends to the Canadian parent will be from taxable surplus, and therefore taxable in Canada. The same comment applies to the use of the Madeira Free Trade Zone by Canadian residents.

PART II (Continued)

Free Trade Zone

For companies serving Europe with products suitable for delivery by air freight, the Zone's tax-exempt status, coupled with staff costs that are significantly less than in most EU countries, makes it worth investigating. Madeirans have a world-wide reputation for being dextrous and easily trainable.

Currently, of the 40 or so companies operating in the Zone, 10 are in the areas of food and drink, 5 in rubber and plastic products, and 16 in various manufacturing industries, including cosmetics, computer parts, electronics and cleaning materials.

As noted above, Canadian companies' use of the Zone is likely to await the signing of the Canada/Portugal tax treaty.

Shipping Companies

The Madeira International Shipping Registry is a growth area for Madeira. 175 ships (including 44 yachts) are currently registered. On registration, 12% VAT is payable, one of the lowest rates in the EU. Ships, rigs, hovercraft and yachts fly an EU flag, which has significant advantages over flags of convenience, like Liberia.

A Canadian-owned yacht that spends more than 182 days in one year in EU waters must pay VAT. Owners register their vessels in Madeira and pay VAT at 12% to avoid VAT rates of up to 25% in some other EU countries.

Conclusion

Madeira is not for everyone. The two reasons that no Canadian companies are operating there at present are lack of knowledge about Madeira, and the absence of a tax treaty with Portugal. I hope these articles will stimulate Canadian interest in the island.