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MADEIRA AS A HUB FOR E-COMMERCE SERVICES

*AN EURO-AMERICAN LAWYERS GROUP BRIEFING ARTICLE PREPARED BY
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Any business must take into consideration direct and indirect taxes. Tax planning should bring benefits and competitive advantage to a business. As the Internet grows as a viable means for conducting e-commerce sales and services, businesses must consider the tax ramifications of their e-commerce operations. Madeira provides an attractive location from which businesses can establish and conduct their e-commerce services. In this article, EALG Portugal Member Firm Barros, Sobral. G. Gomes e Associados provides a brief summary of some of the legal issues governing the provision of e-commerce services in Europe and the advantages for providing such services in Madeira.

VAT and E-Commerce

It is commonly said that the Internet has no boundaries. However e-commerce in its very nature must operate within and across the boundaries of number of tax jurisdictions. Awareness of VAT rules is, in this context, of paramount importance. Planning for VAT enables E-traders to avoid turning a profitable and simple business into a tax nightmare with high administrative and compliance costs. While it is true that direct taxes are significant costs for business, indirect taxes such as VAT must never be overlooked. These indirect taxes normally exceed direct taxes and can have a direct impact on consumer price.

On-line sales and provision of services

It is essential to make the distinction between the sale of goods and the provision of services since each has a different VAT treatment. That distinction may in some cases determine a change in the characteristics of products being sold on the internet. The classic example is a book. If it is sold as a physical product, it is a sale of goods. If, on the other hand, the text is downloaded, it is a sale of a service. Software is similar.

On line sales

For VAT purposes, on-line sales of goods follow the same rules as 'distance sales'. This means that VAT will be paid in the country from where the goods are shipped. Thus there is an obligation for the e-trader to register in any such originating country, and to pay the VAT rate applicable in such country.

On-line Services the new EU regime starting on 1st July 2003

It is the general VAT rule that services are provided in the location of the service-provider. Therefore, the applicable VAT rate is that imposed in the country of the location of the provider. However this rule is reversed so that the rate applicable is that of the buyer of such services



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where the services are provided by a European Union company to another European Union company which is registered for VAT in another EU country, or where services are provided by a company outside the European Union to a European Union consumer company.

The VAT directive classifies as electronic services the following:

- E learning (education);
- Provision of Internet sites;
- Hosting;
- Online support for software and hardware;
- Software and respective upgrade;
- Images, text, information and data base access;
- Music, films, games, including gambling, broadcasting of political, cultural, artistic, sport scientific or recreational events.

In order to avoid distortions between EU and non EU e-traders, a special set of rules has been formulated for non EU e-traders who provide services to EU consumers. This will be effective from 1st July 2003. Briefly, it allows non-EU e-traders to choose an EU country for VAT registration purposes. This enables the non-EU provider to account for the VAT paid in connection with its taxable activities and to deal with only one tax administration.

Nonetheless, to prevent the e-trader taking advantage of VAT arbitrage, the rules require the e-provider to identify the EU country of each of its customers and to pay the applicable VAT rate in such country. To give an example, if the e-provider were dealing with a final consumer in Madeira, he will have to charge 13% VAT, whereas if he were dealing with a UK resident, the rate would be 17.5%, and if dealing with a Swedish customer, the rate would be 25%.

For a non-EU provider who either has a substantial business in the European Union, or who wishes to start such a business, it is better to set up a subsidiary company in one of the European Union countries, and then conduct all his business through that subsidiary. In that case only one VAT rate will be applicable to the services provided.

Madeira has a maximum VAT rate of 13%. This allows non-EU providers to establish a subsidiary in Madeira, and thus to take advantage of a VAT rate which is generally lower than in any other EU country.

That is not the only advantage that Madeira provides. In respect of direct taxation, and in particular, corporation tax, although Madeira has a corporate tax rate of 28% on companies trading with Portugal, the rate for companies trading outside Portugal under the Madeira International Business Centre ("MIBC") legal framework is only between 1% and 3%.

E-Commerce Legal Framework

Notwithstanding the political and administrative autonomy of Madeira, it is fully a part of Portugal, and therefore the laws of the Portuguese Republic are fully enforceable in Madeira. As a consequence, all the EU regulations, guidelines, standards and Directives that have, in the past few years, established the legal framework applicable to e-commerce are also fully effective in



MIBC. Moreover, the Portuguese government has been swift to enact further legislation applicable to e-commerce so as to provide a secure and favourable environment for e-commerce to thrive in.

Legal Signatures and Contract Recognition

Even before the enactment of Directive 1999/93/EC on electronic signatures the Portuguese government had drafted and approved a Decree-law on the same subject that implemented some of the principles that would be later embraced by the EU Directive.

Decree-law 290-D/99 of 2nd August firstly recognises electronic documents and grants them the same status as their traditional paper equivalents. Consequently, the use of an electronic document meets all the same legal requirements as a written document.

Secondly, and most importantly, the Decree-law recognises electronic signatures as valid and binding, and thus has the same effect in contract law as a conventional written signature.

The Decree-law goes one step further and provides for digital signatures to be a privileged form of consent when applied to an electronic document. In this context, digital signatures are those based on a cryptologic and asymmetric set of keys, one public and another private. The private key, known only to the signature titleholder, will sign and encrypt the document. The public one, made available by a certifying authority to anyone that so requires, will, if properly matched with its private counterpart, unencrypt the document.

Therefore, the inclusion of a digital signature in a document will give origin to three distinct legal presumptions:

- i) the person that included the digital signature is the titleholder of the signature;
- ii) the signature expresses agreement with the contents of the document; and
- iii) the document was not altered and/or tampered with.

In order to challenge these presumptions, it will be necessary to demonstrate the invalidity of the digital signature. Being based on an high-tech encryption system, such a challenge would be extremely hard to prove.

We may, therefore, conclude that contracts entered into entirely by electronic means and subject to Portuguese law are valid and fully enforceable. There are, however some exceptions. Agreements in family law matters, contracts relating to real estate, or other contracts that require the intervention of a notary public may not be concluded over the internet by electronic means.

Electronic Invoicing

Decree-law n° 375/99 of 18th September also represented a step forward in adapting the existing legal framework to the new economic activities. Under these provisions, a company may, with authorisation from the Minister of Finance, utilize electronic invoices instead of the traditional paper ones. In this regard electronic invoices are considered to be the same as any other elec-



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tronic document in relation to the legal validity and enforceability when signed by means of a digital signature. The Decree—law also establishes certain requirements for the storage and maintenance of electronic invoices.

The complex technical aspects of electronic invoicing systems have so far delayed the implementation of this project. Nonetheless, the administrative ruling that will approve the official model for electronic invoices is expected soon.

Telecommunications Infrastructure and means of payment

Being an island, Madeira has invested heavily in telecommunications. This has been further enhanced over the last decade with the use of EU funding and with the dividends from the Madeira Free Trade Zone ("MFTZ").

Madeira possesses today a highly advanced telecommunications system that meets the two main criteria for the success of e-commerce:

- i) bandwidth capacity; and
- ii) effective electronic payment systems.

The EU standards that are applicable to all aspects of MIBC are also in force with regards to telecommunications. Legal instruments such as Level of Service Agreements may therefore be successfully utilized in MIBC so as to ensure that no inadequacy in communications represents an obstacle to the development of e-commerce.

Similarly, electronic payment systems are also very effective. In this regard it is important to stress that Portugal has benefited from a first class coordinated ATM and electronic payment system that unites all the banks operating in Portugal.

Criminal Law

It is now ten years since, in Portugal, there was enacted what is known as the computer crime law. Although needing some fine-tuning to meet new concepts and technologies, Decree-law n° 109/91, of 17th of August still represents a milestone in the fight against computer crime. It was a pioneer law in this field.

The experience of the past 10 years enables us to conclude that, not only are the necessary legal means to fight computer crime available under Portuguese law, but also that law enforcement agencies are ready and prepared to do it, notwithstanding the need to develop further the existing computer crime department. There have been a number of recent international computer crimes which, had they taken place in Portugal, could have been dealt with under Portuguese legislation.

Personal Data Protection

Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 has been introduced into the Portuguese legal system by Law 67/98 of 26th October. The Portuguese Personal Data Protection Commission requires businesses that hold databases to be registered,



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and has full authority over MIBC, under its normal authority. Consequently, personal information given to a business based in Madeira is secure, and persons dealing with such businesses can be confident that no improper use will be made of it. The provisions set out in the Personal Data Protection Directive with regards to the collection of data, security in its storage and the manner in which the data is used are fully enforced.

Past experience has shown consumer confidence and trust to be key elements in the success of e-commerce. The modern competitive market makes it essential to maintain that confidence by enforcing the highest standards.

More importantly, MIBC, as a part of the European Union, also benefits from provisions in the European Union for the freedom of movement of information. No authorisation is required to transfer personal data to a company established within the European Union.

E-commerce as a viable business model can be adopted in most sectors of industry. Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information services, in particular electronic commerce, within the Internal Market is fully applicable to Madeira.

Therefore, no special authorisation is required to conduct e-business operations from Madeira.

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