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COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a

COUNCIL DECISION

authorising Portugal to apply reduced rates of excise duty in the autonomous region of Madeira on locally produced and consumed rum and liqueurs and in the autonomous region of the Azores on locally produced and consumed liqueurs and eaux-de-vie

EXPLANATORY MEMORANDUM

1) CONTEXT OF THE PROPOSAL

- **Grounds for and objectives of the proposal**

Council Decision 2002/167/EC of 18 February 2002¹ authorised Portugal to apply a reduced rate of excise duty in the autonomous region of Madeira on locally produced and consumed rum and liqueurs and in the autonomous region of the Azores on locally produced and consumed liqueurs and eaux de vie. According to this decision, Portugal could apply to these products a rate of excise duty lower than the full rate on alcohol laid down in Article 3 of Directive 92/84/EEC², and lower than the minimum rate of excise duty on alcohol set by this Directive but not more than 75 % lower than the standard national excise duty on alcohol. This measure was applicable from 1 January 2002 until 31 December 2008. By its requests dated 16 June 2008 and 20 June 2008, Portugal has sought an extension of this authorisation until 31 December 2013

On 5 November 2008 and 25 February 2009, following requests from the Commission's services, the Portuguese authorities have provided additional information aiming to demonstrate that it is necessary to extend the reduced rate of excise duty beyond the end of 2008 in order to maintain the production of rum, liqueurs and/or eaux-de-vie and associated agricultural activities.

At present, eight companies are registered to produce rum and/or liqueurs in Madeira; nine companies produce liqueurs and thirty-eight companies produce eaux-de-vie in the Azores. The largest of all producers, a producer of rum and liqueurs in Madeira, is foreseen to produce a total of 558.02 hectolitres of pure alcohol on average per annum in the period 2009-2013. In 2007, the economic operators in the autonomous region of Madeira produced a total of 1304.99 hl of rum and 419.95 hl of liqueurs (alcoholic strength 100 %). In the same year, the operators in the autonomous region of Azores produced 1680 hl of liqueurs (alcoholic strength 20 %) and 994 hl of eaux-de-vie (alcoholic strength between 37.5% and 42 %). Practically all production is sold on the regional markets, with only a small proportion being exported (for Azorean liqueurs: ±10 % of output is exported mainly to North America).

The local industry employs around 130 workers in Madeira and around 90 workers in the Azores. In Madeira, the cultivation and processing of sugar cane and fruits provides work for around 1 000 family-owned agricultural holdings.

In 2007 the market share of the products benefitting from a reduced rate of excise duty was lower than that of similar products imported or supplied from other parts of the Community (20.3 % in Madeira; 38.9 % in the Azores) from which these products therefore face strong competition. Furthermore, notwithstanding the application of a reduced rate of excise duty, the average retail selling price (including tax) in Madeira and in the Azores of locally produced rum, liqueurs or eaux-de-vie is higher than that of similar products from outside these regions.

¹ OJ L 055, 26.2.2002, p. 0036 - 0037.

² Council Directive 92/84/EEC of 19 October 1992 on the approximation of the rates of excise duty on alcohol and alcoholic beverages, OJ L 316, 31.10.1992, p. 29

The main handicaps faced by the producers of rum, liqueurs and/or eaux-de-vie arise from additional costs linked to the factors identified in Article 299(2) of the Treaty (i.e. remoteness, insularity, small size, difficult topography, and climate).

Raw materials of agricultural origin (according to the case, sugar cane, fruit, plants, honey, cream, milk and wine) are more expensive than under normal conditions of production. This is due to the small size and fragmented nature of the agricultural holdings and the ensuing low degree of mechanisation. In the case of Madeira, in addition, output from the processing of sugar cane is lower than in other outermost regions, owing to topography, climate, soil and artisanal production.

The transport to the islands of certain raw and packaging materials not produced locally leads to additional cost, as compared to the transport merely of the finished product. In the case of the Azores, the insularity is twofold, since the islands are spread over a distance of 600 km, causing further additional cost for inter-island transports. Finally, the transport and installation of processing, production and packaging equipment is more costly in the territories concerned than on the mainland, due to their remoteness and insularity.

Additional costs for the storage of finished products arise because local consumption does not absorb output as it materialises, but stretches throughout the year.

Travel costs for visiting suppliers and customers on the mainland have to be taken into account, as well as the extra costs for the shipment of samples for the purposes of laboratory analysis (in the case of the Azores).

Per unit costs are increased through other factors linked to the small size of the regional market, such as the need to maintain large stocks of raw materials and, importantly, the unfavourable relationship between fixed costs and output. This unfavourable relationship concerns the over-sizing of equipment but also, to some extent, costs necessary to meet environmental norms. In this regard, rum producers in Madeira bear an additional disadvantage since they are obliged to assume the cost of treating waste from the processing of sugar cane whereas producers in other regions can recycle these by-products.

Other additional costs applicable to all enterprises located in the islands, as compared to those located on the mainland, have equally to be borne by the producers concerned. This covers in particular labour costs (the minimum wage is 5% higher in the two regions concerned) and energy costs, but also (in the case of Madeira) construction costs and the cost of land.

To demonstrate that the rate of the reduction of excise duty does not go beyond what is necessary to offset the additional costs caused by the factors identified in Article 299(2) of the Treaty (i.e. remoteness, insularity, small size, difficult topography, climate, economic dependence on a few products), the Portuguese authorities have provided a quantification of the additional costs linked to these handicaps which indicates that the additional costs per unit of product exceed the value of the corresponding reduction of excise duty by approximately between 7 % to 19 %.

The application of a reduced rate of excise duty can be therefore considered as necessary for producers in this sector to be able to maintain their competitive position in relation to similar products from other parts of the Community.

Having considered both the legal certainty which is required for local producers to develop their commercial activities and the need to set a time limit on tax derogations, the Commission proposes to authorise an extension of the derogation for a period of five years. It is proposed, though, to require Portugal to submit a mid-term report by 31 December 2011 to enable the Commission to assess whether the reasons that justified the granting of the reduced rate still exist.

- **General context**

The Community framework concerning excise duty on alcohol and alcoholic beverages is laid down in two Directives. Council Directive 92/83/EEC of 19 October 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages³ lays down common definitions of the products subject to the duty, specifies the method of calculating the duty and the criteria under which certain products may qualify for exemptions or reduced rates. Council Directive 92/84/EEC, referred to above, lays down minimum rates of duty for each product category.

Decision 2002/167/EC authorised Portugal to apply a reduction in the rate of excise duty on rum and liqueurs locally produced and consumed in the autonomous region of Madeira and on liqueurs and eaux-de-vie locally produced and consumed in the autonomous region of the Azores. The reduced rate applied must not be more than 75 per cent lower than the standard national excise duty on alcohol. This decision ceased to have effect on 31 December 2008.

- **Existing provisions in the area of the proposal**

Pursuant to Article 299(2) of the EC Treaty, the Treaty applies to the French overseas departments, the Azores, Madeira and the Canary Islands (the outermost regions). However, taking account of the structural social and economic situation of the outermost regions, which is compounded by their remoteness, insularity, small size, difficult topography and climate, economic dependence on a few products, the permanence and combination of which restrain their development, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, shall adopt specific measures aimed, in particular, at laying down the conditions of application of the EC Treaty to those regions, including common policies.

- **Consistency with the other policies and objectives of the Union**

The specific measures provided for in Article 299(2) of the EC Treaty must take account of the special characteristics and constraints of the outermost regions without undermining the integrity and the coherence of the Community legal order, including the internal market and common policies. As mentioned above, the tax reduction is limited to what is necessary to offset the handicaps borne by the locally produced and consumed products concerned. Bearing this in mind, as well as the fact that the volumes at stake remain modest and that the tax advantage remains limited to consumption in the regions concerned, the effects on the internal market are very limited, so that the above requirement of Article 299(2) is fulfilled.

³ OJ L 316, 31.10.1992, p. 21

2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

The Portuguese government's request was a response to demands from the economic operators concerned.

- **Collection and use of expertise**

No recourse to external expertise has been necessary.

- **Impact assessment**

The economic impact of the proposal concerns in essence producers of rum and liqueurs in Madeira and producers liqueurs and eaux-de-vie in the Azores and can, therefore, be considered as minimal.

If such producers were to lose the benefit of the reduced rate of excise duty, the resulting increase in retail selling price would risk jeopardising the subsistence and survival of these economic sectors, as well as employment directly and indirectly connected thereto.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

It is proposed to authorise Portugal to apply, from 1 January 2009 to 31 December 2013, a reduced rate of excise duty applicable to locally produced and consumed rum and liqueurs in the autonomous region of Madeira and to locally produced and consumed liqueurs and eaux-de-vie in the autonomous region of the Azores. The reduced rate may be lower than the minimum rate of excise duty on alcohol set by Directive 92/84/EEC, but may not be more than 75 per cent lower than the standard national excise duty on alcohol. This corresponds to the authorisation granted from 1 January 2002 until 31 December 2008 by Decision 2002/167/EC.

- **Legal basis**

Article 299 (2) of the Treaty.

- **Subsidiarity principle**

Derogations from rules of the Treaty in accordance with Article 299(2) thereof fall under exclusive Community competence. The subsidiarity principle does not therefore apply.

- **Proportionality principle**

The proposal complies with the proportionality principle. It does not go beyond what is necessary to offset the high costs associated with production of rum and liqueurs in the autonomous region of Madeira and production of liqueurs and eaux-de-vie in the autonomous region of Azores (cf. above).

- **Choice of instruments**

Article 299(2) of the Treaty provides for specific measures for the outermost regions to be adopted by decision of the Council.

4) BUDGETARY IMPLICATIONS

The proposal has no implication for the Community budget.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 299(2) thereof,

Having regard to the proposal from the Commission⁴,

Having regard to the opinion of the European Parliament⁵,

Whereas:

- (1) Through Council Decision 2002/167/EC of 18 February 2002⁶ Portugal has been authorised to apply a reduced rate of excise duty in the autonomous region of Madeira on locally produced and consumed rum and liqueurs and in the autonomous region of Azores on locally produced and consumed liqueurs and eaux-de-vie. The application of a reduced rate of excise duty on these products was considered necessary for the survival of the local industry producing and marketing these products. In view of the high cost of those activities arising mainly from factors inherent to their situation as outermost regions (remoteness, insularity, small size, topography and climate) it was considered that only a reduction of the rate of excise duty on the locally produced and consumed products concerned could enable them to continue to compete on an equal footing with similar products imported or supplied from other parts of the Community and thus ensure the survival of the industries. According to the same Decision, thus, Portugal could apply to these products a rate of excise duty lower than the full rate on alcohol laid down in Article 3 of Directive 92/84/EEC⁷, and lower than the minimum rate of excise duty on alcohol set by this Directive but not more than 75 % lower than the standard national excise duty on alcohol. This measure was applicable from 1 January 2002 until 31 December 2008.
- (2) By requests dated 16 June 2008 and 20 June 2008, Portugal has sought an authorisation subject to the same terms, for the time period from 1 January 2009 until 31 December 2013.

⁴ OJ C , , p. .

⁵ OJ C , , p. .

⁶ OJ L 55, 26.2.2002, p. 36.

⁷ Council Directive 92/84/EEC of 19 October 1992 on the approximation of the rates of excise duty on alcohol and alcoholic beverages, OJ L 316, 31.10.1992, p. 29

- (3) The granting of the new authorisation sought is justified in order to avoid endangering the development of these outermost regions. The local industry employs around 130 workers in Madeira and around 90 workers in the Azores. In Madeira, the cultivation and processing of sugar cane and fruits provides work for around 1 000 family-owned agricultural holdings. Faced with difficulties to export outside the regions, the regional markets are the only possible outlets to sell these products.
- (4) A reduction of the rate of excise duty should continue to be authorised at the level requested to help offset the competitive disadvantage which distilled alcoholic beverages produced in Madeira and in the Azores face as a result of higher production and marketing costs.
- (5) Indeed, raw materials of agricultural origin are more expensive than under normal conditions of production, due to the small size, fragmented nature and low mechanisation of agricultural holdings. In the case of Madeira, in addition, output from the processing of sugar cane is lower than in other outermost regions, owing to topography, climate, soil and artisanal production. The transport to the islands of certain raw and packaging materials not produced locally leads to additional cost, as compared to the transport merely of the finished product. In the case of the Azores, the insularity is twofold, since the islands are widely spread. Transport and installation of equipment in these remote and insular regions further increase the additional costs. The same applies to certain necessary travels and shipments to the mainland. Additional costs are also required for the storage of finished products as local consumption does not absorb output as it materialises, but stretches throughout the year. The small size of the regional market increases per unit costs in various ways, notably through the unfavourable relationship between fixed costs and output, both as regards equipment and costs necessary to meet environmental norms. Moreover, Rum producers in Madeira have to treat waste from the processing of sugar cane, whereas producers in other regions can recycle these products. Finally, the producers concerned also bear extra costs generally supported by the local economies, in particular increased labour and energy costs.
- (6) The 75 % reduction does not go beyond what is necessary to counterbalance the levels of additional costs that are incurred by operators as a result of the said particular characteristics of Madeira and of the Azores as outermost regions.
- (7) A careful examination of the situation shows thus that it is necessary to grant Portugal's request, if the alcohol industry is to be maintained in the outermost regions concerned.
- (8) Since the tax advantage is limited to what is necessary to offset additional costs and since the volumes at stake remain modest and the tax advantage limited to consumption in the regions concerned, the measure does not undermine the integrity and coherence of the Community legal order.
- (9) Weighing the need to set a time limit on tax derogations against the need for local economic operators to obtain the requisite security to develop their commercial activities, it is appropriate to grant the authorisation for a period of five years.
- (10) It should be ensured that Portugal can apply the reductions in question as from the expiry of the analogous authorisation granted through Decision 2002/167/EC for the

previous period. The new authorisation requested should therefore be granted with effect from 1 January 2009.

- (11) The submission of a mid-term report should be required, so that the Commission can assess whether the conditions justifying the granting of such derogation continue to be fulfilled.
- (12) This Decision shall not prejudice the possible application of Articles 87 and 88 of the Treaty,

HAS ADOPTED THIS DECISION:

Article 1

By way of derogation from Article 90 of the Treaty, Portugal is hereby authorised to apply a rate of excise duty lower than the full rate on alcohol laid down in Article 3 of Council Directive 92/84/EEC of 19 October 1992 on the approximation of the rates of excise duty on alcohol and alcoholic beverages in the autonomous region of Madeira, to locally produced and consumed rum and liqueurs, and in the autonomous region of the Azores, to locally produced and consumed liqueurs and eaux-de-vie.

Article 2

The derogation referred in Article 1 shall be confined:

- (1) in Madeira
 - (a) to rum as defined in category 1 of Annex II of Regulation (EC) No 110/2008 of the European Parliament and of the Council of 15 January 2008 on the definition, description, presentation, labelling and the protection of geographical indications of spirit drinks and repealing Council Regulation (EEC) No 1576/89⁸, having the geographical indication "Rum da Madeira" referred to in category 1 of Annex III of that Regulation,
 - (b) to liqueurs and 'crème de' as defined in categories 32 and 33 of Annex II of Regulation (EC) No 110/2008 produced from regional fruit or plants;
- (2) in the Azores
 - (a) to liqueurs and 'crème de' as defined in categories 32 and 33 of Annex II of Regulation (EC) No 110/2008 produced from regional fruit or raw materials,
 - (b) to eau-de-vie made from wine or grape marc having the characteristics and qualities defined in categories 4 and 6 of Annex II of Regulation (EC) No 110/2008.

⁸ OJ L L 39, 13.2.2008, p. 16

Article 3

The reduced rate of excise duty applicable to the products referred to in Article 1 may be lower than the minimum rate of excise duty on alcohol set by Directive 92/84/EEC, but may not be more than 75 % lower than the standard national excise duty on alcohol.

Article 4

By 31 December 2011 at the latest, Portugal shall send the Commission a report to enable it to assess whether the reasons which justified the granting of the reduced rate still exist.

Article 5

This Decision shall apply from 1 January 2009 until 31 December 2013.

Article 6

This Decision is addressed to the Portuguese Republic.

Done at Brussels,

For the Council
The President