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**Subject: N 607/2008 – Bulgaria
Tax reduction for biofuels**

Excellency,

The Commission wishes to inform Bulgaria that, having examined the information supplied by your authorities on the above-mentioned measure, it has decided to raise no objections to the aid.

1 PROCEDURE

1. By electronic notification of 2 December 2008, the Bulgarian authorities notified the Commission of the above-mentioned measure in favour of biofuels.
2. By letter dated 10 February 2009, the Commission requested further information, which was received by letter of 24 February 2009.
3. By letter of 21 April 2009, the Commission asked for additional information, which was submitted by the Bulgarian authorities by letter dated 15 May 2009.
4. By letter of 13 July 2009, the Commission asked for further clarifications, which were received by letter of 27 July 2009.
5. By letter of 25 September 2009, the Commission asked for additional clarifications, which were received by letter of 12 October 2009.

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2 DESCRIPTION OF THE AID

2.1 Objective

6. In April 2009, the European Parliament and the Council adopted directive 2009/28/EC on the promotion of use of energy from renewable sources¹ (hereafter: the RES directive) with binding targets for each Member State for the use of energy from renewable sources and biofuels. Under that directive, Bulgaria is obliged to meet a target of 10 % of the fuel consumption in transport coming from sustainable biofuels and other renewable fuels in 2020. The directive follows up on amongst others directive 2003/30/EC on the promotion of the use of biofuels or other renewable fuels for transport², which established a reference value of 5.75 % of biofuel in all petrol and diesel from transport purposes placed on their markets by 2010.
7. In 2007, the national consumption in transport of biofuels amounted to less than 1 %. The proposed tax reduction for bioethanol and biodiesel would contribute to the achievement by Bulgaria of its national target under the mentioned directives.
8. According to the Bulgarian authorities, Bulgaria is heavily dependent on energy imports and, at the same time, it has great potential and sufficient land for energy crops from which biofuels can be produced. The objective of the notified aid scheme is to reduce greenhouse gas emissions and dependence on imports of petroleum products by promoting the placing on the market of biofuels. In addition, the proposed scheme is expected to contribute to the development of the agricultural sector and lead to a decrease in energy dependence.
9. As from 1 January 2008, Bulgarian law lays down that producers and importers of liquid fuels for use in transport must market blends of petroleum and biofuels with the highest biofuel content permitted under the relevant standard (BDS EN 228 for automotive petrol and BDS EN 590 for diesel). The Bulgarian authorities have explained that the law does not contain any restrictions as to the origin of the biofuels used in order to comply with the obligation. According to the Bulgarian authorities, the mixing obligation is, however, not yet implemented due to difficulties to meet the applicable standards³, lack of accredited laboratories for testing pure biodiesel, the time needed for liquid fuel producers and importers to implement the investment plans and technical preparation of the distribution systems. Problems have also arisen in controlling the quantity of pure biofuel blends placed on the market and in the imposition of penalties for non-compliance with the mixing requirement. For all these reasons, the obligation has not been implemented and, consequently, no penalties can be or have been imposed. The Bulgarian authorities submitted that they are currently proposing some amendments of the Alternative and Renewable Energy Sources Act in order to remove the existing barriers to the implementation of the mixing obligation. However, these changes have not yet been adopted. The Bulgarian authorities can

¹ Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC, OJ L 140, 5.6.2009, p. 16

² OJ L 123, 17.5.2003, p. 42

³ E.g. in areas with high temperatures and atmospheric humidity like Bulgaria, the vapour pressure which is caused from the blending of petrol with low-concentration ethanol has caused problems.

therefore not say when and to what extent the mixing obligation will be implemented. The Bulgarian authorities have committed to provide the Commission with a monitoring report at the latest 18 months after the date from which the obligation is enforced⁴. If necessary for a Commission authorisation of the proposed tax reliefs, Bulgaria has agreed to limit the duration of the measure to two years instead of the six years for which it was originally notified.

10. The notified aid will be granted in the form of an excise reduction for biofuel blends and a full excise exemption for pure biofuels.

2.2 Form of aid and national legal basis

11. The normal excise rate for unleaded petrol is BGN 685 per 1 000 litres, and that of gas oil is BGN 600 per 1 000 litres.
12. Bulgaria proposes to apply a zero rate for bioethanol (CN code 2207 20 00) and biodiesel (CN code 3824 90 99). For mixtures of biofuels with liquid fuels of petroleum origin⁵, the excise duty rates would be reduced to 664 BGN per 1000 litres for mixtures with bioethanol and to 582 BGN per 1000 litres for biodiesel. The reductions would, thus, be approximately 3 %. Consequently, the reduced rates would not exceed the percentage of the biofuel in the end product, i.e. the reduction never exceeds 5 %.
13. The legal basis of the aid is:
 - the Excise Duties and Tax Warehouses Act (SG No 31 of 13 April 2007);
 - the Act on renewable and alternative energy sources and biofuels (ZVAEIB) (SG No 49 of 19 June 2007);
 - the Clean Air Act (SG No 102 of 19 December 2006);
 - the Ordinance on the quality requirements for liquid fuels, the conditions, procedure and methods for their control (SG No 66/2003 amended and

⁴ The monitoring report should analyse market penetration of biofuels in Bulgaria and related price developments. The report should also contain preliminary indications on plans of a possible support scheme for biofuels after the expiry of the transitory period. In particular, the report should contain the following statistical information covering the transitory period: quarterly data on average blended fuels and biofuels prices at the pump, quarterly data on average pure biofuels prices at the pump, quarterly data on average pure fossil fuel prices at the pump if available on the market, quarterly data on pure biofuels wholesale suppliers average actual sales prices, quarterly data on blended fuels wholesale average actual sales prices, quarterly data on average biocomponents production costs in Bulgaria, quarterly data on biocomponents producers average actual sales prices, quarterly data on average quantities of biofuels produced in the EU and supplied on the Bulgarian fuel market, quarterly data on average quantities of blended fuels produced in the EU and supplied on the Bulgarian fuel market, quarterly data on average quantities of pure biofuels imported from third countries to Bulgaria, quarterly data on average quantities of blended fuels imported from third countries to Bulgaria and, if available, information on development of production costs of biofuels and blended fuels produced in the EU.

⁵ Namely unleaded petrol (CN codes 2710 11 31, 2710 11 41, 2710 11 45 and 2710 11 49) with a 4-5% content of bioethanol (CN code 2207 20 00) and diesel (CN codes 2710 19 41 to 2710 19 49) with a 4-5% content of biodiesel (CN code 3824 90 99).

supplemented by SG No 69 and No 78/2005 and No 40/2006 amended and supplemented by SG No 76/2007);

- the national long-term programme to promote the use of biofuels in transport 2008 – 2020, adopted by Decision of the Ministerial Council on 15 November 2007.

2.3 Fuels eligible for support

14. The excise reductions will be applied to:
 - bioethanol from agricultural products of CN code 2207 10 10;
 - alcohol-containing products produced from bioethanol from agricultural products of CN code 2207 10 10 (e.g. ETBE); and
 - methyl esters from vegetable oil (biodiesel) of CN code 3824 90 99.
15. The Bulgarian authorities have confirmed that all the supported biofuels meet the definition of sustainable biofuels laid down in point 70(7)-(8) of the Community Guidelines on State aid for Environmental Protection⁶ (hereafter referred to as the "Environmental Aid Guidelines").
16. More precisely, the excise tax reduction applies to bioethanol made from biomass and/or the biodegradable fraction of waste for use as biofuel and to biodiesel made from vegetable oil or animal tallow with the properties of a diesel fuel for use in diesel engines, produced from biodegradable fractions of products, waste and residues from agriculture, forestry and biodegradable fractions of industrial or household waste.
17. In practice, in Bulgaria biodiesel is produced from rape oil or sunflower oil. Bioethanol is produced from wheat, corn and to a limited extent from sugar beet.

⁶ OJ C 82 of 1.4.2008, p. 1

2.4 Support levels

18. As the production costs of biofuels are higher than the market price for fossil fuels, the Bulgarian authorities intend to support biofuels production in order to enable biofuels to compete with fossil fuels on the market. The support will partially cover the difference between the production costs of biofuels and the market price of fossil fuels on the market. In order to prove that the support does not lead to overcompensation of *biodiesel*, the Bulgarian authorities have submitted the following data:

Table 1: Production cost of methyl ester in 2007

	Unit	Rape seed	Sunflower	
1 • •	Total oil price⁷	EUR/t	850.00	1120.00
2 • •	Methanol/other products⁸	EUR/t	79.32	84.43
3 • •	Consumption (steam, electricity)	EUR/t	15.93	14.24
4 • •	Fixed production costs⁹	EUR/t	41.11	42.15
5 • •	Sales of by-product (glycerine)	EUR/t	-11.00	-11.00
6 • •	Yield losses¹⁰ (1.5%)	EUR/t	12.30	11.55
7 • •	Final production cost of biodiesel (=1+2+3+4-5+6)	EUR/t	987.67	1261.38
		EUR/hl ¹¹	87.21	111.38
		EUR/1000 l	872	1114
	Correction factor (9 %)		78.48	100.26
	Total (=7*1.09)	EUR/1000 l	950.48	1214.26

Source: Bulgaria's National Association for Biofuels

19. According to the Bulgarian authorities, data from the National Statistical Institute show that the average market price (ex refinery) of mineral diesel, which is the mineral fuel equivalent of biodiesel, in 2007 was EUR [...]*/1000 l (including excise duty of EUR 273.5/1000 l, but excluding VAT). Consequently, also after the tax reduction, the production costs of biodiesel will exceed the market price of mineral diesel¹².

⁷ The total oil price consists of the oil cost plus transport costs (rape oil: 830+20, sunflower oil: 1100+20)

⁸ Such as potassium base and sulphuric acid.

⁹ Including depreciation

¹⁰ This cost reflects losses of profit which are caused by the fact that some material is lost in the production process. For example, approximately 1000 litres of oil yields between 90-96 % of biodiesel (ca 900-960 litres). The loss depends primarily on the quality of oil, the relative weight and also on the skills of the experts in the field of chemistry.

¹¹ Density: 0.883 t/m³

* Covered by the obligation of professional secrecy.

¹² In previous Commission decisions the 'yield losses' were not listed separately. Also, the correction factors submitted by the Member States varied possibly due to differences in the quality of the biofuels. However,

20. In order to prove that the tax reductions do not lead to overcompensation of *bioethanol*, the Bulgarian authorities have submitted the following data:

Table 2: Production cost of bioethanol in 2007

	Price of wheat in EUR/t	205
1.	Industrial wheat ¹³	58
2.	Sales of by-product (husks)	-12.2
3.	Variable costs ¹⁴ : Energy: Others:	15 2.57
4.	Fixed costs ¹⁵	6.64
5.	Depreciation + financial costs	11
6.	TOTAL (EUR/hl) (=1-2+3+4+5)	81.01
	TOTAL (EUR/1000 l)	810

Source: Bulgaria's National Association for Biofuels

21. According to the Bulgarian authorities, the average market price (ex refinery) of 1000 litres of unleaded petrol, which is the mineral fuel equivalent of bioethanol, in 2007 (according to data from the National Statistical Institute) was EUR [...] (including excise duty of EUR 324.7/1000 l, but excluding VAT). Consequently, also after the proposed tax reduction, the production costs of bioethanol would be higher than the market price of unleaded petrol.
22. The Bulgarian authorities have confirmed that the notified aid cannot be cumulated with aid received from other local, regional, national or Community schemes to cover the same eligible costs.
23. The Bulgarian authorities have confirmed that there is no individual installation which will exceed the thresholds for detailed assessment set out in point 160(b)(iv) of the Environmental Aid Guidelines).
24. Bulgaria has committed to submit annual monitoring reports containing all information concerning the production costs of biofuels and the market price of fuels of petroleum origin and will, if necessary, adjust the tax exemptions/reductions with a view to complying with the requirement that tax exemptions should not result in overcompensation for the higher production costs of biofuels compared with the production costs of fuels of petroleum origin.

2.5 Beneficiaries

25. The reduced rates for mixtures and the zero rates for pure biodiesel and pure bioethanol are applied automatically to all producers of liquid fuels of petroleum origin

even when taking the yield losses out of the calculation and assuming a lower correction factor of (e.g. 8%) the production costs of biodiesel will still significantly exceed the market price of mineral diesel.

¹³ The cost for raw material (industrial wheat) has been calculated on the basis of the cost rate for the production of 100 l of bioethanol and in particular 282 kg of wheat, equal to 0.282 t (wheat) multiplied by 205 EUR/t = 58 EUR/100 l.

¹⁴ This heading includes the energy used by the technology at a natural gas price of EUR 7.73/GJ.

¹⁵ Amongst others direct costs for labour and social security, stationary, repair cost and technological and production materials.

and producers of biofuels recognised as licensed warehouse keepers under the Excise Duties and Tax Warehouses Act.

2.6 Budget and duration

26. The overall budget of the scheme over the six years for which it has been originally notified was estimated to be BGN 507 million (ca. EUR 247 million). If necessary for a Commission authorisation of the proposed tax reliefs, Bulgaria has agreed to limit the duration of the measure to two years instead of the six years for which it was originally notified. Since there is at the moment no information on when the mixing obligation will be in operation nor on its expected effects on the biofuels market, the Commission considers the time limit to two years appropriate. The budget for two years can be estimated to be BGN 169 million (ca. EUR 82 million).
27. The duration of the notified scheme is from the date of the Commission's approval until two years after that date.

3 ASSESSMENT

3.1 Existence of State aid

28. Article 87(1) of the EC Treaty provides that *“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 common market”*.
29. The notified tax reduction is granted by a Member State and financed through State resources, as it reduces tax revenue that otherwise would have been available to the State. The measure is aimed at alleviating the costs in a specific sector, namely that of production of biofuels. By partly alleviating the tax debtors from the costs they normally would have to bear, the measure favours certain undertakings and the production of certain goods. Since biofuels serve as a substitute for fossil diesel and petrol, this advantage may distort competition in the common market. Fuel and biofuel are widely traded between Member States and the measure is likely to have an effect on that trade. Consequently, the measure constitutes State aid in the meaning the mentioned Article 87(1).

3.2 Legality of the aid

30. By notifying the measure, Bulgaria has complied with the obligations arising from Article 88(3) of the EC Treaty.

3.3 Compatibility of the State aid with the common market

31. The Commission has assessed whether the measure at hand can benefit from the derogation laid down in Article 87(3)(c) of the EC Treaty, which enables the Commission to authorise State aid aimed *“to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest”*.

32. The promotion of biofuels and other renewable fuels to replace diesel or petrol for transport is a well established Community priority, as the former are expected to contribute to objectives such as reduction of CO₂-emissions and environmentally friendly security of supply. More concretely, the RES directive sets binding targets of 10 % for 2020 for each Member State in order to increase their share of biofuels in relation to their total energy consumption in transport. In Article 3(2) of that directive, it is stated that, Member States shall introduce measures effectively designed to ensure that the share of energy from renewable energy sources (including biofuels) equals or exceeds the targets.
33. The RES Directive defines 'biofuels' as liquid or gaseous fuel for transport produced from biomass. By 'biomass' the RES Directive means the biodegradable fraction of products, waste and residues from biological origin from agriculture (including vegetal and animal substances), forestry and related industries including fisheries and aquaculture, as well as the biodegradable fraction of industrial and municipal waste. According to the same directive, biomass is a renewable energy source.
34. The measure grants aid to fuels that are more environmentally friendly than conventional fuels. The Commission has therefore assessed the compatibility of the aid under the criteria for State aid for renewable energies which are set out in the Environmental Aid Guidelines.
35. According to point 49 of the Environmental Aid Guidelines, the Commission takes the view that biofuel promotion should benefit both security of supply and climate change policy in a sustainable way. State aid may be an appropriate instrument only for those uses of renewable energy sources where the environmental benefit and sustainability is evident. Therefore, biofuels not fulfilling the sustainability criteria set out in the RES directive are not eligible for State aid. In this case, the Bulgarian authorities have confirmed that the supported biofuels fulfil the sustainability criteria and comply with the definition of biofuels in the meaning of the RES directive and consequently also with the definition laid down in point 70(7) and 70(8) of the Environmental Aid Guidelines.
36. According to point 109 of the Environmental Aid Guidelines, Member States may grant operating aid to compensate for the difference between the cost of producing energy from renewable energy sources (including depreciation and a normal return on capital) and the market price of the form of energy concerned. Energy production from biomass requires relatively low investment costs, but higher operating costs. Therefore, operating aid can be allowed for the production of renewable energy from biomass exceeding the amount of investment where Member States can show that the aggregate costs borne by the undertakings after plant depreciation are still higher than the market price of the energy. The Commission notes that by the examples of biofuel production costs in table 1 and 2 above, the Bulgarian authorities have shown that even without the excise duty the production cost of biofuels will be well above the market price for conventional fuels. If the market conditions changes, the Bulgarian authorities have committed themselves to adjust the support levels accordingly. Consequently, the Commission finds that the proposed tax reduction is in line with point 109 of the Environmental Aid Guidelines.

37. The Commission notes that the Bulgarian authorities have confirmed that the support in no case would exceed the thresholds for detailed assessment under point 160(iv) of the Environmental Aid Guidelines.
38. In accordance with points 192 to 194 of the Environmental Aid Guidelines, the Bulgarian authorities have committed themselves to supply annual reports of the implementation of the proposed measure.
39. These Community objectives and policies are also reflected in the Community policy on energy taxation, in particular Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity¹⁶. Article 16(1) of this Directive allows Member States to apply an exemption or a reduced rate of taxation on biofuels. However, Article 16(2) of the same directive limits the exemption or reduction in taxation to the part of the product that actually derives from biomass. This means that, for blended fuels the reduction may be applied to the biofuel component only. In the case at hand, the tax rates for blends of petrol/denatured bioethanol and diesel/biodiesel are less than 3 % for blends which consist of 4-5 % of biofuels. Therefore, the proposed measure complies with Article 16(2) of the Energy Taxation Directive.
40. The notified scheme also respects Article 16(3) of the Energy Taxation Directive which requires that the reduction in taxation shall be adjusted to take account of changes in raw material prices to avoid overcompensating for the extra costs involved in the production of biofuels. In that regard the Bulgarian authorities committed to adjusting the tax reduction in order to avoid overcompensation (see para. 24 above).
41. According to points 142 et seq. of the Environmental Aid Guidelines State aid must have an incentive effect. In previous decisions the Commission authorised aid where in the absence of the tax reduction fuel suppliers would not bring biofuels on the market simply because they are too expensive to produce and cannot be sold at a higher price than the fossil fuels with which they are in direct competition. In that respect the Bulgarian authorities provided data according to which the production costs for the supported biofuels exceed the market prices for fossil fuels (see para. 19 above). At the same time the Commission notes that in parallel with the proposed tax reduction, there is a mixing obligation in Bulgaria, which requires that producers and importers of liquid fuels for use in transport market blends of petroleum and biofuels with the highest biofuel content permitted under the relevant standard. However, according to the Bulgarian authorities this obligation has not been implemented. Since technical problems hinder the implementation of the obligation and there is no system in place to impose fines for the non-compliance with the obligation, the Commission takes the view that the obligation cannot be considered to be legally enforceable. In the absence of a legally enforceable supply obligation the Commission considers the incentive effect to be met. In July 2007¹⁷ and March 2009¹⁸, the Commission came to the same conclusion for similar tax reductions in Slovakia and Lithuania. However, once the mixing obligation is implemented, this will result in a change of the Bulgarian biofuels

¹⁶ OJ L283 of 31.10.2003, p.51.

¹⁷ State aid No N 360/2006 – SK – Advantageous tax treatment for utilisation of fuels from renewables pursuant to directive 2003/96/ES (Biofuels), OJ C 213, 12.9.2007, p. 1

¹⁸ State aid No N 372/2007 – LT – Support for biofuels, OJ C 106, 8.5.2009, p. 14

market and consequently it may have implications for the case at hand. In this context, the Bulgarian authorities have committed to provide the Commission with a monitoring report at the latest 18 months after the date from which the obligation is enforced. In addition, the Commission reminds the Bulgarian authorities that they have committed to regularly analyse the support levels and adapt them if the economic conditions for the aid are changed. If necessary, the Bulgarian authorities have agreed to limit the duration of the aid measure to two years following the Commission's approval thereof. Since there is at the moment no information on when the mixing obligation will be in operation nor on its expected effects on the biofuels market, the Commission considers the time limit to two years appropriate. After that period, Bulgaria can of course re-notify the scheme. The Commission would then, however, be able to take into account also the effects of the mixing obligation in its assessment and it would thereby to a higher extent reflect the actual situation on the biofuels market in Bulgaria. This would be in line with the Commission's practice in similar cases¹⁹.

42. Finally, with respect to the future adoption of legislation by the Bulgarian authorities, the Commission would like to remind the Bulgarian authorities of their obligation in accordance with Article 88(3) of the EC Treaty to notify to the Commission any plans to alter the scheme pursuant to provisions of Commission Regulation (EC) No 794/2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 [now 88] of the EC Treaty²⁰.

4 DECISION

43. On the basis of the foregoing considerations, the Commission concludes that the notified aid measure with a duration of two years is compatible with the common market as it fulfils the criteria laid down in the Environmental Aid Guidelines. Accordingly, the Commission decides not to raise objections with respect to the measure.
44. If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen 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 the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/community_law/state_aids/state_aids_texts_en.htm.

¹⁹ See Cases N57/2008 (Poland), OJ C 247, 15.10.2009, p.1 and N326/2007 (Italy), OJ C 134, 31.05.2008, p. 1

²⁰ OJ L 140, 30.4.2004, p. 1

Your request should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition
Directorate for State Aid, Office SPA 3 6/5
B-1049 Brussels

Fax No: + 32 2 /296 12 42

Yours faithfully,

For the Commission

Neelie Kroes
Member of the Commission