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**Subject:** State aid SA.38832 (2014/NN) – Portugal – Reduced rate of excise duty applied to liqueurs and eaux-de-vie produced and consumed in the Autonomous Region of the Azores for the period 1.07.2014-31.12.2020

Sir,

## 1. Procedure

- (1) The Portuguese authorities notified the above-mentioned aid measure on 2 June 2014. The Commission requested additional information on 17 July 2014 and 3 October 2014. The Portuguese authorities submitted the information requested respectively on 7 August 2008 and 20 October 2014.

## 2. Description of the measure

- (2) The notified measure provides for a reduced rate of the excise duty on traditional liqueurs and eaux-de-vie produced and consumed in the autonomous region of the Azores ("Azores"). This reduction has been approved by Council Decision No 376/2014/EU of 12 June 2014<sup>1</sup>, which stipulates that the applicable excise duty *"may be lower than the minimum rate of excise duty set by Council Directive 92/84/EEC<sup>2</sup>, but may not be more than 75% lower than the standard national excise duty on alcohol"*. The present decision assesses the compatibility of the measure with Art. 107 and Art. 108 TFEU.

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<sup>1</sup> Council Decision No 376/2014/EU of 12 June 2014, OJ L 182 of 21 June 2014, p. 1.

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

S. Ex.<sup>a</sup> o Ministro dos Negócios Estrangeiros  
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- (3) According to the Council Decision, the reduced rate of excise duty is applicable to the following products:
- (a) The "traditional liqueur" concerned by the measure is defined as *"a spirit drink produced by flavouring ethyl alcohol of agricultural origin or a distillate of agricultural origin or one or more spirit drinks or a mixture thereof, sweetened and with the addition of products of agricultural origin or foodstuffs such as cream, milk or other milk products, fruit, wine or aromatised wine. The minimum alcoholic strength by volume of liqueur shall be 15 %"*.<sup>3</sup>
  - (b) The "eaux-de-vie" concerned by the notification scheme is defined as *"a spirit drink produced exclusively by the distillation at less than 86 % vol. of wine or wine fortified for distillation or by the re-distillation of a wine distillate at less than 86 % vol., containing a quantity of volatile substances equal to or exceeding 125 grams per hectolitre of pure alcohol (hereinafter "HPA") of 100 % vol"*.<sup>4</sup>
- (4) The standard excise duty rate applicable in Portugal is EUR 1251.72 per HPA. The Portuguese authorities have notified a reduction of the excise duty by 75% for the liqueurs and the eaux-de-vie produced and consumed in the Azores. The standard excise duty is thus reduced to EUR 312.93.
- (5) The total aid amount to be granted under the measure (i.e. the total foregone tax revenue), amounts to EUR 5.86 million over the period between 1 July 2014 and 31 December 2020.
- (6) The legal basis of the measure is the Portuguese Excise Duties Code with subsequent amendments.<sup>5</sup>
- (7) The Portuguese authorities have notified the measure to the Commission on the basis of Article 108(3) TFEU from 1 July 2014 until 31 December 2020.

### **3. Assessment of the measure**

#### **3.1 Existence of aid**

- (8) According to Article 107(1) TFEU, 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 be incompatible with the common market, insofar as it affects trade between Member States.

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<sup>3</sup> Paragraph 32 of Annex II to Regulation (EC) No 110/2008 of the European Parliament and 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 1576/89, OJ L 39 of 13 February 2008, page 40.

<sup>4</sup> Paragraph 4 of Annex II to Regulation (EC) No 110/2008 referred to above.

<sup>5</sup> Article 76 and Article 77 of the Decree law n.º 73/2010 of 21 June 2010, published in the Official Gazette, I Serie, N.º 118, of 21 June 2010, p. 2170" ..

- (9) The reduction of the excise duty rate constitutes a transfer of State resources in the form of foregone State revenues which would have been accrued to the Portuguese State if the standard national excise duty rate would have been applicable to the producers of liqueurs and eaux-de-vie in the Azores. According to settled case law, foregoing of revenues for the public budget constitutes a transfer of State resources within the meaning of Article 107(1) TFEU.
- (10) The aid is considered to be selective in that it targets enterprises located in the Azores which are active in the production of liqueurs and eaux-de-vie. The measure has the effect of a tax reduction and therefore confers an advantage to the producers of liqueurs and eaux-de-vie by relieving them of charges they would normally have to bear.
- (11) The liqueurs and eaux-de-vie produced and consumed in the Azores are in competition with other spirit drinks such as whiskey, vodka, rum, gin, caipirinha. As these beverages are subject to intra-Community trade, the aid scheme is liable to affect trade between Member States and distort competition.
- (12) The Commission therefore considers that the proposed measure constitutes State aid within the meaning of Article 107(1) TFEU.

### **3.2. *Compatibility of the aid***

- (13) Considering that the objective of the notified measure is to foster the economic development of the outermost region of the Azores by supporting the local production of liqueurs and eaux-de-vie, the Commission finds that the measure constitutes a regional aid scheme. The compatibility of the measure will therefore be assessed in the light of the guidelines on regional aid for 2014-2020 (“RAG”).<sup>6</sup>
- (14) The measure is aimed at reducing the current expenses of the beneficiaries not linked to an initial investment. The Commission therefore considers that it constitutes operating aid. This type of aid may only be authorised to SMEs and large enterprises alike in the outermost regions, notably the Azores, insofar as it is awarded to compensate for additional costs linked to the permanent handicaps which severely restrain the development of these regions as set out in Article 349 TFEU.<sup>7</sup>

#### ***Contribution to a common objective***

- (15) The primary objective of regional aid is to reduce the regional disparities within the EU. With regard to regional operating aid, the Commission needs to assess the compensation of additional costs borne by the Member State concerned in relation with the positive effects of the aid for the economic

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<sup>6</sup> OJ C 209, 23.07.2013, p. 1.

<sup>7</sup> In accordance with Article 349 TFEU, these costs include remoteness, insularity, small size, difficult topography and climate and economic dependence on a few products.

development of the regions in terms of maintaining an important economic activity and securing a significant number of jobs.

- (16) In accordance with paragraph 45 of the RAG, the Member States concerned must identify the specific additional costs linked to the permanent handicaps which the operating aid scheme is intended to offset.
- (17) According to the Portuguese authorities, the production of liqueurs and eaux-de-vie in the Azores is affected by a number of structural handicaps which result from the factors set out in Article 349 TFEU. The Portuguese authorities have undertaken a quantification of the additional costs linked to these handicaps. To this end, as a reference point, they provided information on the production costs incurred by the producers of liqueurs and eaux-de-vie located in the Azores and producers of the same products located in mainland Portugal.
- (18) The Portuguese authorities stated that the small size and fragmented nature of agricultural holdings, low level of mechanisation and high labour intensity that are characteristic for the Azores lead to higher prices of the raw materials used as inputs into the production of liquers and eaux de vie in the Azores. Also for the inputs required for packaging of the final products (bottles, caps for bottles, boxes, labels, etc.) local producers in the Azores face higher costs than producers on the mainland due to the absence of local production of this type of material. All these extra costs are compounded by the "double insularity" of the Azores, since the archipelago is not only located at a long distance from the mainland, but also the individual islands of the archipelago are far apart (with the distance between them reaching a maximum distance of 600 km).
- (19) Due to the small size of the regional market, combined with the fact that production is largely seasonal, output does not coincide with demand, so that producers need to maintain high stocks to supply the market throughout the year, which implies higher costs related to additional investments in storage capacity.
- (20) Local producers are unable to achieve the economies of scale that are possible in continental regions, nor to achieve efficiency thresholds in the use of infrastructure and equipment. Higher levels of investment are required than in continental regions, not only because equipment is purchased from outside, but also because of transport costs and the under-use of the installed capacity in view of the small size of the regional market.
- (21) Further to the supply of inputs and equipment, additional costs are incurred for contact with suppliers and customers, maintenance of equipment, and distribution of the final product on the market of each island of the archipelago.
- (22) In view of the above, for the production of liqueurs, the additional costs are estimated at EUR 1.456 per 0.7 l bottle of liqueur with an alcoholic strength by volume of 20 %. For the production of eaux-de-vie, the additional costs are

estimated at EUR 2.857 per 0.7 l bottle of eaux-de-vie with an alcoholic strength by volume of 40 %.

- (23) In light of the foregoing, it can be concluded that the Portuguese authorities have identified the specific additional costs that are attributable to the permanent handicaps affecting the Azores.

#### *Appropriateness of the measure*

- (24) Under points 50 and 56 of the RAG, the notified aid measure must be an appropriate policy instrument to address the policy objective concerned.
- (25) According to the Portuguese authorities, it is important to maintain a reduced rate of excise duty on liqueurs and eaux-de-vie produced and consumed in the Azores in order to ensure the economic viability of the small-scale companies engaged in the traditional liqueurs and eaux-de-vie products. These companies generate approximately 90 direct jobs, and support a large number of indirect jobs in the local agricultural sector and other supply industries in the Azores. The aid contributes to maintaining the competitive position of these products vis-à-vis spirits from outside the region with lower production costs.
- (26) The Portuguese authorities emphasised that the tax advantage is limited to liqueurs and eaux-de-vie produced and consumed locally, in the Azores. The tax advantage is directly granted to the producers of the liqueurs and eaux-de-vie at the moment of introduction the final products into the local market, and then passed on to the rest of the distribution chain.
- (27) The Portuguese authorities stated that there has been no significant change in the number of economic operators benefiting from this scheme<sup>8</sup>, nor in the number of producers establishing themselves in the Azores. Furthermore, over the period 2004-2013, the market shares of the Azores liqueurs and eaux-de-vie – in spite of annual fluctuations – remain largely unchanged in relation to the market shares of spirits which are produced outside the region. Thus, according to the Portuguese authorities, the measure does not create significant distortions of competition and trade.
- (28) Therefore, the Commission accepts that granting of operating aid is an appropriate instrument to achieve the regional development objective in the region concerned.

#### *Incentive effect*

- (29) According to paragraph 76 of the RAG, the Commission will consider that the aid induces additional economic activity in the areas or regions concerned, if the Member State has demonstrated the existence and substantial nature of the problems which the aid is intended to address.
- (30) Having regard to the above analysis in paragraphs 15 to 22 of the decision, the Portuguese authorities have demonstrated the existence of the additional costs

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<sup>8</sup> The number of beneficiaries under the measure increased from 28 in 2008 to 35 in 2013.

linked to the handicaps in the production of liqueurs and eaux-de-vie in the Azores. Therefore, the Commission considers that the incentive effect of the State aid measure is present. It is likely that, in the absence of aid, the level of economic activity in the Azores would be significantly reduced due to the identified problems.

***Proportionality of the aid amount***

- (31) According to paragraphs 108 and 109 of the RAG, the Member State must demonstrate that the level of the aid is proportionate to the problems that the aid is intended to address.
- (32) The Portuguese authorities have quantified the additional costs per bottle of liqueur and eaux-de-vie on the basis of different categories of pre-identified costs, and compared them with the costs associated with the production of similar drinks in the mainland Portugal. The weighted average additional costs per 0.7 l bottle of liqueur with alcoholic strength by volume of 20% are estimated at EUR 1.456, whereas the additional costs per 0.7l bottle of eaux-de-vie with alcoholic strength by volume 40% are at EUR 2.857. The aid awarded per bottle of liqueur is EUR 1.314, whereas the aid per bottle of eau-de-vie is EUR 2.628. In view of the fact that the aid concerns approximately 35 locally based, family-run small enterprises (and mostly micro enterprises), active in the same sector, there are no significant differences in the costs faced by each beneficiary. Therefore, the Commission considers that the aid amount per beneficiary is proportional to the level of the problems actually experienced by each beneficiary.
- (33) In view of the above, since the tax advantage does not exceed the additional costs resulting from the handicaps referred to in Article 349 TFEU, the Commission considers that the aid granted under the notified aid scheme is proportionate.

***Avoidance of undue negative effects on competition and trade***

- (34) The notified measure concerns the traditional liqueurs and eaux-de-vie which are produced and consumed in the Azores. Additionally, the local production of spirits and eaux-de-vie is very limited compared to the size of the EU market for spirits. Given that the local production of spirits and eaux-de-vie was equivalent to less than 1,000 HPA in 2013, which represents only 0.0024% of the total consumption of spirits in the EU<sup>9</sup>, the effect of the measure on the EU market of spirits is bound to be very marginal. In addition, the overall budget of the aid scheme is also very limited (some EUR 900,000 annually). Taking into account the number of companies benefiting from the scheme, the average aid amount is around EUR 25.000 per beneficiary per year. In view of the above and in line with paragraph 140 of the RAG, the

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<sup>9</sup> The data for these calculations were taken from the Eurostat data on the EU population and the indicators relevant to alcohol of DG Health and Consumers.

Commission considers that the measure is not liable to cause any undue negative effects on competition and trade.

#### **4. Conclusion**

- (35) In the light of the foregoing, the Commission considers that the notified measure compensates for the additional costs related to the factors identified in Article 349 TFEU, and it is proportional to the handicaps it seeks to alleviate. The compensation provided under the scheme contributes to the maintenance of an important activity (and the associated jobs) in the Azores, which is an outermost region and eligible for regional aid under Article 107(3)(a) TFEU. Finally, the aid is unlikely to have undue negative effects on competition and trade between Member States. The Commission therefore considers that the scheme is compatible with the internal market on the basis of the RAG.
- (36) The Commission regrets that Portugal put the measure into effect, in breach of Article 108(3) of the Treaty on the Functioning of the European Union.
- (37) However, it has decided, on the basis of the foregoing assessment, not to raise any objections to the aid because it is compatible with the internal market under Article 107(3) a) of the Treaty on the Functioning of the European Union.

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State Aid Registry  
B – 1049 Brussels  
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Yours faithfully,  
For the Commission

Margrethe Vestager  
Member of the Commission