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Proposal for a

COUNCIL DECISION

on the AIEM tax applicable in the Canary Islands

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

The Treaty on the Functioning of the European Union (TFEU), which applies to the outermost regions of the EU, which include the Canary Islands, does not in principle allow any difference between the taxation of local products and the taxation of products from Spain or other Member States. Article 349 of the TFEU provides, however, for the possibility of introducing specific measures for those regions because of the permanent handicaps which affect the economic and social conditions of the outermost regions.

Council Decision 2002/546/EC of 20 June 2002¹, adopted on the basis of Article 299(2) of the EC Treaty, authorised Spain, up to 30 June 2014, to apply exemptions from or reductions in the ‘Arbitrio sobre Importaciones y Entregas de Mercancías en las Islas Canarias’ (hereinafter ‘AIEM’) to certain products produced locally in the Canary Islands. The Annex to that Decision contains a list of products to which tax exemptions and reductions may be applied. The difference between the taxation of locally manufactured products and the taxation of other products may not exceed 5, 15 or 25 percentage points, depending on the product.

Decision 2002/546/EC sets out the reasons for adopting specific measures, which include isolation, raw material and energy dependence, the obligation to build up stocks, the small size of the local market and the low level of export activity. The combination of these handicaps means that production costs, and therefore the cost price of goods produced locally, are increased, so that without specific measures they would be less competitive than goods produced elsewhere, even taking into account the cost of transporting the latter to the Canary Islands. This would make it harder to maintain local production. The specific measures covered by Decision 2002/546/EC were thus designed to strengthen local industry by making it more competitive.

The AIEM is an indirect State tax levied in a single stage on the supplies of goods in the Canary Islands. The taxable base for the imported goods is based on the customs value, and that of the supplies of goods by producers in the Canary Islands is based on the total amount of the consideration. The specific measures covered by Decision 2002/546/EC establish a form of differentiated taxation, benefiting the local production of some products. This tax benefit constitutes state aid that requires the approval of the Commission, which was granted by Decision on State Aid NN 22/2008.

On 16 November 2010, Spain submitted a request to the Commission to extend the period of application of Decision 2002/546/EC for two years, so that its expiry date coincided with the one of the Guidelines on national regional aid for 2007-2013².

In addition, Spain also introduced a request for the extension for two years of the period of application of Decision on State Aid NN 22/2008, according to which the aid given by the Spanish authorities, in respect of the AIEM, was compatible with the common market. The Commission authorized this extension for two years by means of its Decision on State Aid SA.31950 (N 544/2010)³, which extended the period of Decision on State Aid NN 22/2008 up to 31 December 2013.

¹ OJ L 179, 9.7.2002, p. 22-27

² OJ C 54, 4.3.2006, p. 13

³ OJ C 237, 13.8.2011, p. 1

As regard the request for the extension of the period of application of Decision 2002/546/EC, the Commission assessed it in light of the scale of the handicaps affecting the Canary Islands and came to the conclusion that it was justified to grant the requested extension.

In fact, the report from the Commission to the Council on the application of the special arrangements concerning the AIEM tax applicable in the Canary Islands, adopted on 28 August 2008, confirmed that the AIEM was functioning in a satisfactory manner and without the need to any amendments to the provisions of Decision 2002/546/EC.

Therefore, Council Decision 895/2011/EU of 19 December 2011⁴ amended Decision 2002/546/EC, extending its period of application up to 31 December 2013.

On 04 March 2013, the Spanish authorities requested the Commission to prepare a Council Decision authorising Spain to apply exemptions from or reductions in the AIEM to certain products produced locally in the Canary Islands for the period 2014-2020, modifying the list of products and the maximum rates applicable to some of them.

On 28 June 2013 the Commission has adopted new regional aid guidelines for the period 2014-2020⁵. These Guidelines are part of a broader strategy to modernise state aid control, aiming at fostering growth in the Single Market by encouraging more effective aid measures and focusing the Commission's enforcement on cases with the biggest impact on competition.

Considering that these Guidelines will enter into force on 1 July 2014, it seemed justified to extend the period of application of Decision 2002/546/EC, as amended by Decision 895/2011/EU, for six months, so that its expiry date coincides with the expiry date of the current Guidelines. Decision 2002/546/EC has been amended accordingly by Decision 1413/2013/EU⁶ that extended its application until 30 June 2014.

The Commission has analysed the request received from the Spanish authorities, as well as the information provided by many different stakeholders that have taken the initiative to contact the Commission. This analysis confirms that the special characteristics of the Canary Islands restrain their development and are responsible for additional costs for the operators situated there. It is therefore justified to maintain the exemption of the AIEM to a list of locally produced industrial products. This measure is necessary and proportionate and does not undermine the integrity and the coherence of the Union legal order.

2. ANALYSIS OF THE SPANISH REQUEST AND PROPORTIONALITY OF THE DEROGATION DECISION

According to Article 110 TFEU no Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products. Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products.

However, on the basis of Article 349 TFEU the Council may authorise Member States with outermost regions to derogate from the provisions of Article 110 TFEU so as to take account of the structural social and economic situation of these regions and which is compounded by other factors that severely restrain their development. Such derogation may not undermine the integrity and the coherence of the Union legal order, including the internal market and common policies, such as common taxation policies based on Article 113 TFEU. Thus, such

⁴ OJ L 345, 29.12.2011, p. 17

⁵ OJ C 209, 23.7.2013, p. 1.

⁶ OJ L 353, 28.12.2013, p.13,14

derogations must remain proportionate, i.e. they must not go further than necessary to address the adverse framework conditions hampering the economic development of these regions and it must not excessively distort competition in the single market. In consequence, any derogation from Article 110 TFEU should remain limited to fully or partially compensating the cost disadvantage from which producers in these regions suffer.

The Canary Islands economy is highly dependent on tourism. This dependency is a serious threat to the development of the Canary Islands because change of taste, natural disasters or economic recessions can have a huge impact in the economic and social situation of the archipelago. This was precisely what occurred during the global financial crisis of 2008 and 2009 that had a strong impact in the number of tourists visiting the Islands and, consequently, in its economy. The decrease in tourists led to a huge increase in the levels of unemployment, with the rate of unemployment becoming higher than in mainland Spain, which is, together with Greece, one of the two Member States with the highest unemployment rate in the European Union. The growth was even more visible in the rate of youth unemployment, which can be explained by the large number of young people depending on the seasonal jobs created by tourism.

The Canary Islands market is also characterised by its reduced dimension that prevents industries from reaching the optimal point of production. Most industrial machines are designed to produce at large scale, in order to increase productivity and profitability. These machines are not designed for a smaller market, generating unused productive capacity, which means that industries are forced to operate at a production level lower than the necessary to minimise production costs, restricting opportunities for economies of scale.

The countries and territories in the proximity of the Canary Islands (Morocco, Western Sahara and Mauritania) have reduced acquisitive capacity, and the considerable development gap limits the possibilities for Canary Islands exports.

Another characteristic of the Canary Islands with an important effect in the additional costs incurred by operators established there is the territorial fragmentation and distance to the sources of most raw materials, which generates higher transport costs. The problem has been aggravated by the rise of oil prices that has had an important impact in the increase of transportation costs.

Water is a scarce resource in Canary Islands. The insufficiency of water has an obvious impact in its cost, creating a competitive disadvantage towards industries located in other parts of Spain or the European Union. This is particularly important for the industries that use water as an important raw material (e.g. food, chemistry, paper) but also the ones that require high levels of refrigeration.

There are projects for the introduction of natural gas in the two major islands of Canary Islands, but it is not clear when this fuel can be used in an effective way. The absence of natural gas generates an important element of loss of competitiveness, as the cost of generating heat and energy using other sources is considerably more expensive.

As there are no recycling plants and waste has to be transported to the mainland and toxic waste has to be treated outside the Canary Islands, the disposal of industrial waste and treatment of toxic waste leads to higher environmental costs.

The characteristics of the Canary Islands previously described affect to a certain extent all domestic production. It is therefore appropriate to verify what has been the effect of the existing differentiated taxation in the market share of local production and adjust this differentiated taxation to ensure that there is no excessive distortion of competition.

The analysis made to conclude on the differentiated rates accepted took into account not only the average market share of local production in the period 2008-2011 but also its evolution and other information provided by stakeholders that contacted the Commission to provide relevant information. For industries producing products with different common customs tariffs it was analysed the evolution of the combined market share for all products and not only the individual market shares. These reasons explain why products with similar average market shares of local production have a different maximum rate of differentiated taxation.

In the case of tobacco, it is suggested to keep the differentiated rate in 25% and update the minimum for 1000 cigarettes from EUR 6 to EUR 18 as requested by the Spanish authorities.

The Spanish authorities have included in the list of products to be subject to differentiated taxation some products with an extremely low market share of local production. The justification presented by the Spanish authorities is that there are plans to increase local production of these products, an increase that will not be possible without the differentiated taxation.

In total, of the 139 products mentioned in the request received from the Spanish authorities, the Commission accepts the rate as requested for 119 of these, while for the remaining 20 the Commission considers that the differentiated rate should be lower, to prevent possible cases of distortion of competition.

From the detailed analysis made by the Commission, it is possible to establish the different lists of products according to the rates of tax differentiation, sector and the Common Customs Tariff:

5%

Agricultural and fishery products:

0207 11/0207 13

Minerals:

2516 90 00 00/6801/6802

Building materials:

3816/3824 40 00 00/3824 50/3824 90 45 00/3824 90 70 00/ 3824 90 97 99/ 6809

Chemicals:

2804 30 00 00/2804 40 00 00/3105 20 90 00/3208/3209/3210/3212 90 00 00/3213/3214/3304 99 00 00/3925 90 80 00/ 3401/3402/3406/3814 00 90/3923 90 00 00/4012 11 00/4012 12 00/4012 13/4012 19

Metal-working industries:

7604/7608

Food industry:

0210 12 11 00/0210 12 19 00/0210 19 40 00/0210 19 81/0305 41 00/0305 43 00 90/ 0901 22 00 00/1101/1102/1601/1602/1704 90 30 00/1704 90 51 00/1704 90 55 00/ 1704 90 75 00/1704 90 71 00/1806/1901 20 00 00/1901 90 91 00/1901 90 99/ 1904 10 10/1905/2005 20 20/2006 00 31 00/2008 11 96 00/2008 11 98 00/2008 19 92/ 2008 19 93/2008 19 95/2008 19 99/2309

Beverages:

2009 11/2009 12 00/2009 19/2009 41/2009 49/2009 50/2009 61/2009 71/2009 79/2009 89/
2009 90/2201/2202/2204

Textiles and leather:

6112 31/6112 41

Paper:

4818 90 90 00/4823 90 85 90

Graphic arts and publishing:

4910

10%

Agricultural and fishery products:

0203 11/0203 12/0203 19/0701 90/0703

Building materials:

2523 29 00 00/

Food industry:

0210 11 11 00/0210 11 31 00/1905/2105

Paper:

4808/4819/4823 90 40 00/

15%

Agricultural and fishery products:

0407 21 00 00/0407 29 10 00/0407 90 10 00

Building materials:

2523 90/7010

Chemicals:

3809 91 00/3917 21/3917 23/3917 32 00/ 3917 33 00/3917 39 00/3917 40 00/3923 10 00/39
23 21 00/3923 30 10/3924 10 00

Metal-working industries:

7309 00/7610 10 00 00/9403 20 80 90

Food industry:

0403/0901 21/1902/2103 20 00 00/2103 30/2103 90 90/2106 90 98/

Beverages:

2203/2208 40

Textiles and leather:

6302

Paper:

4818 10/4818 20/4818 30/4821

Graphic arts and publishing:

4909/4911

25%

Tobacco:

2402

These lists of products address the objective of Article 349 of adopting specific measures to take into account the special characteristics of the Canary Islands as outermost regions, while at the same time, not distorting competition in a way that could undermine the internal market.

When the Spanish authorities submit the report foreseen in Article 2 of this Council Decision it would be advisable for the Commission to evaluate the effects of the differentiated rates and assess the need for changes. It would also be important at that time to check whether there has been an increase in local production of those products for which a differentiated taxation is requested but which do not have significant local production at the moment.

3. LEGAL ELEMENTS OF THE PROPOSAL

Summary of the proposed measures

To authorise Spain to apply exemptions from or reductions in the tax known as AIEM for certain products produced locally in the Canary Islands.

Legal basis

Article 349 TFEU.

Subsidiarity principle

Only the Council is authorised, on the basis of Article 349 TFEU, to adopt specific measures in favour of the outermost regions to adjust the application of the Treaties to those regions, including the common policies, because of the permanent handicaps which affect the economic and social conditions of the outermost regions.

The proposal therefore complies with the subsidiarity principle.

Proportionality principle

The proposal complies with the proportionality principle for the following reasons:

Choice of instrument

Proposed instrument: Council Decision.

Other instruments would not have been appropriate for the following reason:

Derogations granted under Article 349 TFEU are contained in Council Decisions.

4. BUDGETARY IMPLICATION

The proposal has no impact on the budget of the European Union.

Proposal for a

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 349 thereof,

Having regard to the proposal from the European Commission,

Having regard to the opinion of the European Parliament⁷,

Acting in accordance with a special legislative procedure,

Whereas:

- (1) Pursuant to Article 349 of the TFEU, the Council, taking into account the structural social and economic situation of the outermost regions, which is compounded by their remoteness, insularity, small size, difficult topography and climate and economic dependence on a few products, shall adopt specific measures aimed, in particular, at laying down the condition of application of the Treaties to those regions, including common policies.
- (2) Specific measures should therefore be adopted in order to establish the conditions for applying the Treaty to those regions. They must take account of the special characteristics and constraints of these regions, but without undermining the integrity and coherence of the Community legal order, including the internal market and common policies.
- (3) At the top of the list of handicaps identified in the Canary Islands is the predominance of the services sector and in particular tourism in the regional product and also the dependence of the Canary Islands' economy on this sector and the small share of industry in the Canary Islands' GDP.
- (4) In second place is the isolation inherent in an archipelago which hinders the free movement of persons, goods and services. Dependence on certain modes of transport, air transport and maritime transport is increased since these are modes of transport which have not yet been fully liberalised. Production costs are greater because these modes of transport are less efficient and more expensive than road or rail.
- (5) As a further consequence of this isolation, higher production costs result from dependence in terms of raw materials and energy, the obligation to build up stocks and difficulties affecting the supply of production equipment.
- (6) The small size of the market and the low level of export activity, the geographical fragmentation of the archipelago, and the obligation to maintain diversified but only small production lines in order to meet the requirements of a small market, restrict the opportunities for economies of scale.

⁷ OJ C [...].

- (7) It is in many cases more difficult or more expensive to obtain specialised and maintenance services, and training for managers and technicians, or to subcontract or promote business expansion beyond the Canary Islands' market. The narrow range of distribution methods also results in overstocking.
- (8) As regards the environment, the disposal of industrial waste and the treatment of toxic waste give rise to higher environmental costs. These costs are higher because there are no recycling plants, other than for certain products, and waste has to be transported to the mainland and toxic waste has to be treated outside the Canary Islands.
- (9) On the basis of all this information and the notification from the Spanish authorities, it is advisable to renew the authorisation to the application of a tax to a list of products for which exemptions for local products may be allowed.
- (10) Council Decision 2002/546/EC of 20 June 2002⁸, adopted on the basis of Article 299 of the EC Treaty, initially authorised Spain, up to 31 December 2011, to apply exemptions from or reductions in the tax known as 'Arbitrio sobre Importaciones y Entregas de Mercancías en las Islas Canarias' (hereinafter 'AIEM') to certain products produced locally in the Canary Islands. The Annex to that Decision contains a list of products to which tax exemptions and reductions may be applied. The difference between the taxation of locally manufactured products and the taxation of other products may not exceed 5, 15 or 25 percentage points, depending on the product.
- (11) Council Decision 895/2011/EU of 19 December 2011⁹ amended Council Decision 2002/546/EC, extending its period of application up to 31 December 2013.
- (12) Council Decision 1413/2013/EU of 17 December 2013¹⁰ amended Council Decision 2002/546/EC, extending its period of application up to 30 June 2014.
- (13) The AIEM tax is serving the objective of autonomous development of the Canary Islands' industrial production sectors and of diversifying the Islands' economy.
- (14) The maximum exemptions which may be applied to the industrial products in question vary depending on sector and product, from 5 % to 15 %.
- (15) The maximum exemption applicable to finished tobacco products is nevertheless higher, because the tobacco sector is an exceptional case. The tobacco industry, which had greatly expanded in the Canary Islands, has been declining very markedly for a number of years. The traditional handicaps of insularity described above are of course at the root of the decline in local tobacco production in the Canary Islands. There are grounds for keeping a substantial exemption for tobacco. Exemption from taxation is in direct relation with the objective of maintaining production in the Canary Islands.
- (16) The objectives of promoting the socio-economic development of the Canary Islands are reflected at national level in the purpose of the tax and the allocation of the revenue it generates. The incorporation of the revenue from this tax in the resources of the Canary Islands 'economic and tax system and its use for an economic and social development strategy involving the promotion of local activities is a legal obligation.
- (17) The arrangements are to apply for 6.5 years. It will nevertheless be necessary to evaluate its results. The Spanish authorities must therefore present to the Commission by 30 September 2017 at the latest a report on the application of the arrangements referred to in Article 1, in order to check the impact of the measures taken and their

⁸ OJ L 179, 9.7.2001, p. 22.

⁹ OJ L 345, 29.12.2011, p. 17

¹⁰ OJ L 353, 28.12.2013, p.13,14

contribution to promoting or maintaining local economic activities, account being taken of the handicaps affecting the outermost regions. On this basis, the scope and the exemptions authorised under Community rules will be revised if necessary.

- (18) The fiscal advantage covering the AIEM needs to remain proportionate so as not to undermine the integrity and the coherence of the Union legal order, including safeguarding undistorted competition in the internal market and state aid policies.
- (19) This Decision is without prejudice to the possible application of Articles 107 and 108 of the TFEU,

HAS ADOPTED THIS DECISION:

Article 1

1. By way of derogation from Articles 28, 30 and 110 of the Treaty on the Functioning of the European Union, the Spanish authorities shall be authorised until 31 December 2020 to lay down, in respect of products listed in the Annex that are produced locally in the Canary Islands, total exemptions from or partial reductions of the tax known as ‘Arbitrio sobre las Importaciones y Entregas de Mercancías en las islas Canarias (AIEM)’. These exemptions must form part of the strategy for economic and social development of the Canary Islands and contribute to the promotion of local activities.

2. Application of the total exemptions or reductions referred to in paragraph 1 may not lead to differences in excess of:

- (a) 5 % for the products listed in the Annex, Section A;
- (b) 10 % for the products listed in the Annex, Section B;
- (c) 15% for the products listed in the Annex, section C
- (d) 25 % for the products listed in the Annex, section D. Nevertheless, the Spanish authorities may establish a minimum tax on cigarettes of not more than EUR 18 per 1 000 cigarettes, applicable only if the AIEM tax resulting from the application of general types of taxation is below this figure.

Article 2

The Spanish authorities shall present to the Commission at the latest by 30 September 2017 a report on the application of the arrangements referred to in Article 1, in order to check the impact of the measures taken and their contribution to the promotion or maintenance of local economic activities, account being taken of handicaps affecting the outermost regions.

On this basis, the Commission shall present a report to the Council comprising a full analysis of the economic and social aspects and where appropriate a proposal for adapting the provisions of this Decision.

Article 3

This Decision shall be applicable from 1 July 2014.

Article 4

This Decision is addressed to the Kingdom of Spain.

Done at Brussels,

*For the Council
The President*