

BULLETIN

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STATE AID IN SLOVAKIA

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A favourable tax regime and comparatively low labour costs – according to many analysts these are the two major factors that have recently attracted businesses to invest in Slovakia. However, investors planning to undertake large projects are also influenced by financial and other advantages given by governments to businesses, usually known as investment incentives, or, more generally, “State aid”.

On 1 May, 2004, Slovakia became a member of the European Union. As of that date, the laws of the EU became applicable in Slovakia, subject only to certain limited transitional arrangements. State aid is one of the most important, and controversial, areas in the EU. Rules on State aid were one of the most difficult aspects of the latest EU enlargement negotiations.

This bulletin summarises the Slovak system of State aid rules in the light of EU law. This system can be divided as follows:

- over-arching **general rules** on State aid (applicable EU legislation and the Slovak Act on State Aid¹), which determine the legality of any individual instance of State aid; and
- particular rules on the assistance that may be obtained in Slovakia, namely:
 - **investment incentives** as a particular form of State aid (the Slovak Act on Investment Incentives²); and
 - other forms of **investment support** (Act on the Support in Development of Industrial Parks³, Act on Large Investments⁴).

GENERAL RULES ON STATE AID

Although amended on a number of occasions, State aid and related “investment support” rules have been in place in Slovakia since 1999. In addition, from the day of Slovakia’s accession to the EU, EU legislation on State aid became fully applicable and directly effective in Slovakia (reflecting the principle of supremacy of EU law).

In order to achieve its goal of a “level playing field”, the EC Treaty prohibits, in principle, Member States from granting any selective aid measure that is capable of distorting competition and trade within the EU. This prohibition under Article 87 of the EC Treaty applies where the following conditions are satisfied:

¹ Act No. 231/1999 Coll. on State Aid, as amended; after 1 May, 2004, the Act on State Aid only contains technical and procedural provisions necessary to apply the EU State aid rules. The material provisions are contained in EU legislation.

² Act No. 565/2001 Coll. on Investment Incentive, as amended.

³ Act No. 193/2001 Coll. on the Support in Development of Industrial Parks, as amended.

⁴ Act No. 175/1999 Coll. on Certain Measures Regarding the Preparation of Large Investments, as amended.

- there is an economic benefit or advantage conferred on a specific undertaking or sector;
- the aid is granted by a Member State or through State resources;
- the aid distorts or threatens to distort competition; and
- the aid affects trade between Member States.

EXEMPTIONS

The EC Treaty sets out a number of exemptions from the prohibition principle. Subject to limited directly applicable block exemption regulations⁵, only the Commission can apply these exemptions in a procedure that rests on the dual obligation on Member States to notify all proposals to grant State aid to, and obtain clearance from, the Commission before they are put into effect. The most important grounds for exemption are contained in Article 87(3) EC Treaty (also reflected in the Act on State Aid).

These exempted aids are:

- aids to promote economic development in areas where the standard of living is abnormally low or where there is serious unemployment (“regional aid”);
- aids to promote important projects of common European interest or to remedy a serious disturbance in a Member State’s economy (e.g. projects for diversifying energy resources);
- aids to facilitate the development of certain economic activities or of certain economic areas provided they do not adversely affect trading conditions to an extent contrary to the common interest (such as aid to specific sectors, e.g. the automobile industry); and
- aids to promote culture and heritage conservation (e.g. aid to the film industry).

FORMS OF STATE AID

Although the EC Treaty does not specify the forms which State aid may take, both direct and indirect forms of State aid are recognised in the Slovak State Aid Act. The following is a non-exhaustive list of the eligible forms in which State aid may be granted:

- subsidies, contributions and grants;
- coverage of interest or a part of the interest paid by the recipient of the aid on its debt;
- coverage of part of a debt payable by the recipient of the State aid; and
- temporary financial support,

all being direct forms of State aid; and

⁵ Commission Regulation (EC) No 68/2001 on the application of Articles 87 and 88 EC Treaty to training aid; Commission Regulation (EC) No 69/2001 on the application of Articles 87 and 88 of EC Treaty to *de minimis* aid; Commission Regulation (EC) No 70/2001 on the application of Articles 87 and 88 of EC Treaty to State aid to small and medium-sized enterprises; Commission Regulation (EC) No 2204/2002 on the application of Articles 87 and 88 of EC Treaty on State aid for employment.

- issue of a State guarantee or bank guarantee;
- tax or social security payment allowances;
- sale of immovable assets owned by the State or a municipality for a lower than arms' length price;
- free or subsidised advisory services; and
- rescheduling of tax payments,

all being indirect forms of State aid.

LIMITS ON ELIGIBLE AID

The EU Commission interprets the extent of exemptions narrowly. The duration, intensity and scope of proposed aid must be proportionate to the importance of the intended result. The result must promote the Community interest and not simply the interest of the relevant Member State. The measures must not conflict with other provisions of the EC Treaty.

For this reason, the Commission has produced guidelines and other communications applying the Treaty's State aid rules to particular types of aid. These guidelines and communications set conditions for State aid eligibility and also limits (ceilings) for various types of State aid⁶.

To take regional aid as an example, different limits on permissible regional aid apply to different NUTS⁷ regions based on the EU GDP/PPS test⁸. Where this ratio is below 75 per cent., the NUTS II region qualifies for increased individual State aid measures. Apart from Bratislava, most of Slovakia qualifies for increased levels of permitted regional aid.

The actual amount of the aid is calculated as a percentage of the investment's value. The value of an initial investment is established on the basis of a uniform set of items of expenditure (standard base) corresponding to the following elements of the investment: land, buildings and plant/machinery; or, alternatively, the cost of buying assets from an establishment which has closed or which would have closed had it not been purchased (this type of purchase is also regarded as initial investment). Eligible expenditure may also include limited categories and amounts of intangible investment. There are also limits that apply to the time during which the approved aid must be used.

In addition, there are further rules and limits if the investment is directed to a sensitive sector (e.g. the ceiling of eligible aid is decreased if the investment is in the automotive sector). In some other economically sensitive sectors State aid in any form is prohibited (e.g. the steel industry).

KEY POINTS FOR A COMPANY INVOLVED IN RECEIPT OF STATE AID

If a Member State government fails to obtain clearance of an aid through the clearance procedure with the Commission, the recipient company runs the risk of having to repay the aid with interest. Therefore, a company which may be the recipient of State aid should ascertain at an early stage whether a proposed

⁶ For example, Communication from the Commission – Multisectoral framework on regional aid for large investment projects (2002/C 70/04); Commission Guidelines on National Regional aid (98/C 74/06).

⁷ NUTS = Nomenclature of territorial units for statistics; there are NUTS I, NUTS II and NUTS III regions; a NUTS II region is a territory with population between 800,000 and 3,000,000.

⁸ Per capita gross domestic product measured in purchasing power standards of the NUTS II region compared to the Community average (for the last three years for which statistics are available).

transaction or State intervention requires notification and, if so, ensure that the Member State authorities go through the correct procedures prior to the aid being granted. Aid may be recoverable even where the recipient of the aid is subsequently sold. Purchasers of, and lenders to, State-aided businesses should therefore undertake due diligence to establish the legality of any grant of aid that the business has previously received. The Commission maintains a comprehensive State aid register to assist in this process.

STATE AID IN THE NEW EU MEMBER STATES

There are various practical issues that every investor into or potential purchaser of a State-aided business in the new EU Member States should be aware of. These include: privatisations (particularly if preceded by State capital injections or debt write-offs); relations between the new Member States and publicly-owned companies; administration of EU funding; and the State's position under national law if pre-accession aid has to be modified or withdrawn. Mergers with and acquisitions of State-aided companies form another highly sensitive area.

STATE AID AVAILABLE IN SLOVAKIA

Investment Incentives as a particular form of State aid

Although not every State aid is an investment incentive, every investment incentive under the Slovak Act on Investment Incentives represents State aid. Investment incentives are a specific form of regional State aid. As such, in each case they must be eligible for exemption from the prohibition on State aid outlined above.

Currently:

- tax allowances;
- cash contributions for the creation of new jobs; and
- cash contributions for the training of new employees,

can be applied for under the Slovak Act on Investment Incentives.

For the State aid to qualify as an investment incentive under the Slovak Act on Investment Incentives, the investment concerned must fulfil the following criteria:

- it must involve the creation of a new operation or the extension or upgrade of an existing operation;
- it must be an investment of at least SKK 400,000,000 (about EUR 10,000,000), of which at least SKK 200,000,000 must be funded from equity (i.e. not financed by debt)⁹;
- it must generate 80 per cent. or more of total revenues from its core business; and
- the investment must be made and operations begin within three years after the award of incentives.

The Ministry of Economy is the department of state directly responsible for investment incentives. It is responsible for preparing the draft incentives paper, which is, after consultation with the applicant and subject to the clearance from the Commission, approved by the Government. After the Government approves the draft incentives paper, the Ministry of Economy issues the final decision on the investment incentives based on the previously approved draft.

Other forms of investment support

In addition to direct or indirect forms of State aid, Slovak legislation also contains provisions on State measures which could be described as “other support”. This is because these measures cannot be defined as State aid schemes, although a particular application of them might amount to State aid.

This other support includes:

- Government subsidies for the development of **industrial parks**; and
- support granted by means of awarding the investment the status of a “**large investment**”.

These forms of support, however, must be considered very carefully. It is necessary to consider in the case of each specific investment whether such support may constitute State aid, and as such is subject to the State aid rules outlined above, or whether it falls outside of the scope of State aid rules (for example because it is of general application).

INDUSTRIAL PARKS

The Act on the Support in Development of Industrial Parks governs the development of industrial parks by municipalities. It is the fact that municipalities, not the investor, apply for, and are the direct recipient of, the subsidy for the development of an industrial park which distinguishes this type of support. The award of subsidies to develop an industrial park is within the competence of the Ministry of Economy after the prior approval by the Slovak Government.

Conditions for the eligibility of a project to qualify for the state subsidy are as follows:

- at least one entrepreneur intends to carry out manufacturing business on the site;
- the applicable land planning resolutions pre-determine the site to be an industrial park;
- the municipality is responsible for at least 15 per cent. of the development costs (whether by means of its own funds, debt or co-funding);
- the municipality has secured the consent of the Slovak land fund, if its properties are concerned;
- the municipality has an “agreement on future agreement” (a binding type of a memorandum of understanding) with the relevant entrepreneurs outlining their intentions concerning their business in the park.

The Government’s subsidy of up to 85 per cent. of the costs may be provided to cover the following expenditure associated with the development of the park:

- infrastructure;
- acquisition/expropriation costs;
- costs of a “fee for conversion of forested land”;

⁹ The amounts referred to are reduced by 50 per cent. if the supported business is to be carried out in a region where the official rate of unemployment as at the last 30 June or 31 December is not lower than 10 per cent.

however, the total Government's portion must not represent more than 50 per cent. of the total Investment cost.

An investor should, therefore, consider if the investment project could be structured so as to benefit from the provisions on industrial parks and if so, what additional benefits (if any) could arise out of that structure.

Even if the support for the municipality to develop the industrial park is not regarded as State aid in itself, further actions by the municipality may put the municipality itself into the position of a provider of State aid.

“LARGE” INVESTMENTS LEGISLATION

The Act on Large Investments defines a “large investment” as a construction designed for production activities. The beneficiary of the special treatment applicable to a construction which is awarded the status of a “large investment” may be only a legal person incorporated in the Slovak Republic.

The status of a “large investment”: (i) facilitates the acquisition and constitutes a ground for expropriation (details are described below in the section on expropriation), if necessary, of the investment site; and (ii) may protect the investor from any adverse consequences of any third party claims in relation to the title to the investment site.

Following a request by the investor, the Ministry of Economy will award an investment project the status of a “large” investment if:

- the construction costs needed for the project are in the amount of not less than SKK 1,000,000,000 (about EUR 25,000,000);
- the contemplated production volumes and the impact on employment are regarded as material for the national economy; and
- the Slovak Government has decided that the investment is in the public interest.

The Ministry of Economy will also award an investment project the status of a “large” investment if the construction costs needed for the project are less than SKK 1,000,000,000 (about EUR 25,000,000), provided that this investment is essential for the operation of another large investment, to which the first investment is technically, technologically or logistically linked, or it is its supplier of parts or goods necessary for the large investment's final products. The planned production or contribution to employment of such investment must, however, be significant from the perspective of regional development. The Slovak Government must also decide that this investment is in the public interest.

The “large” investment status enables the authorities to follow a simplified acquisition procedure if the Slovak Republic or the Slovak Land Fund is the owner of the site. This assists in transferring the investment site more quickly to the investor.

No third party can be authorised to claim the title to the land forming a part of the site of the “large” investment. However, a third party's right to receive damages is not affected. For such cases, the investor can contract with the transferor of the land for specific indemnities or other suitable risk allocation provisions to avoid or reduce the investor's exposure to liability.

EXPROPRIATION

“Large investment” status also constitutes grounds for expropriation of land desired for the investment site. The issue of expropriation has become very topical in light of recent green field foreign investments in Slovakia (and in particular in the automobile industry) and the related need of investors to acquire the necessary land for construction of their production facilities.

Expropriation means the complete and definitive deprivation of someone’s ownership rights to real estate and the transfer of such rights to another party (i.e. to the petitioner in the expropriation proceedings). This transfer occurs upon the decision of a state authority - the **Building office** (in Slovak *stavebný úrad*) - in expropriation proceedings under the Act No. 50/1976 Coll. on Zoning and Construction Proceedings (the **Construction Act**). A less dramatic, but still severe, order may be made for the forced restriction of ownership rights, usually in the form of attaching a third party’s right to the owner’s real estate (e.g. encumbrance).

Expropriation represents the most significant restriction on a private individual’s constitutional right to own property. Therefore, real estate may be expropriated only if all other possible means (e.g. agreement) to achieve the transfer or restriction of ownership rights to the real estate have failed.

Also, expropriation will only be valid if all four constitutional conditions for expropriation (see below) are fulfilled, cumulatively. Real estate may only be expropriated:

- **to the necessary extent** – meaning nothing more must be expropriated than what is necessary;
- **in the public interest** – meaning the individual case must contain an element of public interest that would justify expropriation and must fall within one of the reasons for expropriation described in the Construction Act. There are a limited number of reasons for expropriation, e.g. construction of pipelines, gas and energy utilities, railroads, highways, roads and local communications, as well as construction representing large investment. The details of the conditions for considering an investment “large” and in the public interest are described above in the section on large investments;
- **pursuant to the law** – meaning pursuant to the expropriation proceeding contained in a special act – for real estate it is the Construction Act; and
- **for adequate compensation** – meaning for natural or financial compensation; in the latter case the remuneration must be adequate (i.e. it does not have to be equal) in relation to the market price of the real estate assessed by a court-sworn expert (this can often be much lower than the value which the market is actually willing to pay for the real estate).

REMEDIES

All decisions of the Building office may be appealed under general rules on administrative procedure. If the appeal procedure is unsuccessful, the appellant may ask for judicial review of the expropriation decision before a Slovak court. Finally, a constitutional complaint filed with the Slovak Constitutional Court could potentially be used as remedy if all the above-described attempts for remedy fail.

In addition, upon request by a party whose rights have been restricted by the expropriation proceedings, the Building office must fully or partially revoke its expropriation decision, if the expropriated land is not used for the purpose for which it was expropriated within the time limit provided in the expropriation decision (a maximum of two years).

We hope that this bulletin has provided you with a useful summary of the State aid rules. For further information, please contact **Igor Pálka**, **Andrej Glézl** or **Hugh Owen** at **+421 2 5920 2400**.

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