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EU STATE AID RULES FOR IMPORTANT PROJECTS OF COMMON EUROPEAN INTEREST

Akos AMBRUSZ[1]

November 2022[2]

Keywords: important projects of common European interest, IPCEI, state aid to strategic sectors, compatibility

The revised State aid rules on Important Projects of Common European Interest[3] (IPCEI) entered into force on 1 January 2022 (further referred to as 'IPCEI Communication').

IPCEI projects are cross-border projects of common European interest which take the form of breakthrough innovations in key sectors and technologies or large-scale infrastructure investments that would not have been undertaken without public support and which generate positive spill-over effects throughout the EU economy.

IPCEI projects can be set up in all sectors of the economy. Participating enterprises carry out activities supported by the Member States that are strictly necessary to achieve the objective of the IPCEI project. An IPCEI project provides an opportunity for Member States to pool financial resources, act quickly and connect the relevant actors in key value chains.

This article is timely not only because of the new legislation, but also because the French Presidency of the Council of the European Union in the first semester of 2022, in line with the priorities of the Union and the recommendation of the Commission's Expert Group on IPCEI projects[4] has identified four sectors of strategic importance in which it intends to work with the Commission to encourage Member States to develop IPCEI projects. These sectors are:

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[1] Akos Ambrusz is working for the State Aid Monitoring Office (SAMO) within the Prime Minister's Office. The opinion expressed in this article is not the official position of SAMO.

[2] Published in Hungarian in Állami Támogatások Joga 35 (2022/5) -

https://tvi.kormany.hu/download/e/ef/f2000/A%CC%81TJ_35.pdf

[3] Commission Communication on the criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest (2021/C 528/02), OJ C 528/10, 30.12.2021, p. 10. -
https://eur-lex.europa.eu/legal-content/EN/TXT/?toc=OJ%3AC%3A2021%3A528%3ATOC&uri=uriserv%3AOJ.C_.2021.528.01.0010.01.ENG

[4] The report of the IPCEI Strategic Forum set up by the Commission is available at: https://ec.europa.eu/docsroom/documents/37824

microelectronics, cloud services, health and energy.[5] Cross-border projects in these sectors create opportunities for cooperation between Member States and entities across the EU. The aim is to enable stakeholders to overcome significant market failures and societal challenges that would not otherwise be possible. In the strategic areas mentioned above, there have been increasing examples of such initiatives and IPCEI projects in recent years, with Hungarian enterprises as participants.

It should be stressed, however, that despite the common EU objectives, aid granted to companies competing for funds under IPCEI may have a serious potential to distort competition in the internal market and therefore an effective state aid regime for IPCEI projects cannot be avoided. This article describes the rules in force, reviews the specific project design process and aims to provide guidance on the somewhat different assessment criteria that apply in the Commission's procedure. The projects referred to in this article, which have been approved by the Commission as IPCEIs and published in the public database, and the Commission's practice in examining them, are described in more detail in the other articles published in Hungarian in Állami Támogatások Joga.[6]

Overview of the IPCEI regulation

It should be stressed at the outset that the IPCEI scheme is not a stand-alone EU funding instrument, unlike, for example, the Horizon Europe[7] programme for research, development and innovation. The IPCEI Communication is a compatibility legal basis allowing Member States to grant State aid for the implementation of the project developed in accordance with the internal market. In short, the IPCEI is a specific, earmarked aid instrument for the funding of collaborative projects of common European interest, funded from Member States' budgets[8]. Consequently, since the resources needed to carry out the projects come primarily from national budgets and the decision to support the projects concerned is taken by the Member States, IPCEI projects are also subject to the EU State aid rules laid down in Articles 107 and 108 of the Treaty on the Functioning of the European Union (TFEU).

[5] Recovery, Strength and a Sense of Belonging - Programme for the French Presidency of the Council of the European Union, p 47. -

https://wayback.archive-it.org/12090/20221120104852/https://presidence-francaise.consilium.europa.eu/media/qh4cg0qq/en_programme-pfue-v1-2.pdf

[6] https://tvi.kormany.hu/download/e/ef/f2000/A%CC%81TJ_35.pdf

[7] Horizon Europe (Horizon2020 for 2014-2020) is the European Union's funding programme for research, development and innovation, with a budget of €95.5 billion for 2021-2027, awarded directly by the EU institutions.

[8] There is no obstacle to Member States using EU funds [such as Structural Funds or the Recovery and Resilience Fund (RRF)] to finance IPCEI projects.

For IPCEI projects, the scope for examining the concept of State aid as defined in Article 107(1) TFEU is limited[9]:

- Projects are usually linked to economic activity.
- Funding from the national budget is considered to be a public resource imputable to the State.
- The State aid confers an economic advantage that undertakings would not have obtained under normal market conditions, i.e. without State intervention.
- Projects are implemented as a selective measure, as only IPCEI project participants receive support.
- There is also the potential distortion of competition and trade between Member States due to the cross-border cooperation and spill-over effects.

On the basis of the above, IPCEI projects also require the Commission's approval, i.e. Member States are subject to the suspension and prior notification obligations under Article 108(3) TFEU.[10] In the notification procedure, the Commission examines the proposed measure. If the project fulfils the definition of an IPCEI project and if its positive effects outweigh the negative effects (the distortion of competition) in a plausible manner, the Commission concludes that the aid is compatible with the internal market and Member States may implement the joint project.

The Commission authorises aid on the basis of one of the legal bases in Article 107(2) or (3) TFEU. The legal basis for the compatibility of IPCEI projects is Article 107(3)(b) TFEU, which provides that 'aid to promote the execution of an important project of common European interest [...] may be considered to be compatible with the internal market.' Although this provision has been included in the Treaties since 1957, the Commission adopted in 2014 a separate regulation[11] in the form of a Commission Communication[12] on aid for transnational projects of

[9] In the joint decision SA.46578 (2018/N), SA.46705 (2018/N), SA.46595 (2018/N) and SA.46590 (2018/N) (249), the Commission concluded that if the entities participating in the IPCEI project fulfil the definition of a research and knowledge dissemination organisation (research organisation) within the meaning of the R&D&I Communication [(2014/C 198/1), OJ C 198/1, 27.6.2014, p. 1] and only carry out an ancillary economic activity (i.e. no more than 20% of their actual total annual capacity) within the meaning of Article 107(1) of the TFEU, they cannot be considered as undertakings, i.e. as beneficiaries of the aid measure.

[10] The IPCEI Communication also encourages Member States implementing an IPCEI project to submit the documentation for the notification jointly and simultaneously.

[11] Previously, the Commission's 2006 Framework for Research and Development [(2006/C 323/01), OJ C 323/1, 30.12.2006] contained only four short points in Chapter 4 on the notification and evaluation of IPCEI projects. - https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52006XC1230%2801%29

[12] Communication from the Commission on the criteria for the analysing of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest (2014/C 188/2), OJ C 188/4, 20.06.2014, p.4.
https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2014.188.01.0004.01.ENG&toc=OJ:C:2014:188:TOC

strategic importance in the framework of the State Aid Modernisation initiative.[13] However, on the basis of the 2014 Communication, the Commission took decisions in only five cases. Of these, only two infrastructure projects had been approved as IPCEIs before 2017: the construction of the Øresund Bridge between Denmark and Sweden[14] and the creation of a rail and road link between Denmark and Germany (Fehmarn Belt).[15]

Figure 1 - IPCEI infrastructure projects

Source: BBC News[16]

Source: Wikipedia[17]

In recent years, three more IPCEI projects have been approved by the Commission, one in the field of microelectronics[18] and two in the battery value chain.[19, 20] Furthermore, in response to the recently unfolding energy crisis, an IPCEI project[21] covering the entire hydrogen technology

[13] https://ec.europa.eu/competition-policy/state-aid/legislation/modernisation_en

[14] Commission Decisions SA.36558 (2014/NN), SA.36662 (2014/NN) and SA.38371 (2014/NN) - https://ec.europa.eu/competition/state_aid/cases/254460/254460_1594710_203_2.pdf

[15] Commission Decision SA.39078 (2014/N) - https://ec.europa.eu/competition/state_aid/cases1/202016/280910_2147483_492_2.pdf

[16] http://news.bbc.co.uk/2/hi/europe/800447.stm

[17] https://hu.wikipedia.org/wiki/Fehmarnbelt-kapcsolat

[18] Joint Commission Decisions SA.46578 (2018/N), SA.46705 (2018/N), SA.46595 (2018/N) and SA.46590 (2018/N) - https://ec.europa.eu/competition/state_aid/cases1/201952/277354_2120329_283_2.pdf

[19] 'Battery I.' project: decisions of the Commission SA.54793 (2019/N), SA.54809 (2019/N), SA.54794 (2019/N), SA.54801 (2019/N), SA.54806 (2019/N), SA.54808 (2019/N), SA.54796 (2019/N) - https://ec.europa.eu/competition/state_aid/cases1/202231/SA_54793_209F3582-0000-CD68-A9BA-FBE38B798191_321_1.pdf

[20] 'Battery II.' project: SA.55855 (2020/N), SA.55840 (2020/N), SA.55844 (2020/N), SA.55846 (2020/N), SA.55858 (2020/N), SA.55831 (2020/N), SA.56665 (2020/N), SA.55813 (2020/N), SA.55859 (2020/N), SA.55819 (2020/N), SA.55896 (2020/N), and SA.55854 (2020/N). The public versions of the decisions referred to are not yet available in the Commission database at the time of writing. - https://ec.europa.eu/commission/presscorner/detail/en/IP_21_226

[21] The IPCEI Hy2Tech project is a collaboration between 15 Member States, with €5.4 billion of public funding from national budgets and an expected €8.8 billion of private investment, and is expected to create 20,000 jobs. As part of the IPCEI project, 35 companies operating in one or more Member States, together with more than 300

value chain was approved by the Commission on 15 July 2022. Its State aid assessment has already been carried out on the basis of the IPCEI Communication in force from 1 January 2022.

It should be underlined that the IPCEI Communication in force does not exclude[22] the possibility that aid granted for IPCEI projects may be assessed on the basis of a compatibility legal basis other than the Communication.[23]

As the IPCEI cases approved so far show, the focus is increasingly on projects involving non-infrastructure investment, which is not coincidental. Today, the EU's objectives and the global energy and climate policy have changed significantly compared to the beginning of the decade. In December 2019, the Commission published its Communication on an European Green Deal,[24] outlining policy actions to make Europe the world's first carbon-neutral continent by 2050. Action is needed in all sectors to deliver the European Green Deal. In addition, in February 2020, the Commission published the Digital Compass for Europe,[25] which aims to put digital transformation at the service of people and businesses while contributing to a climate-neutral Europe by 2050. In line with these priorities, the four strategic sectors mentioned in the introduction have been identified where the IPCEI could be a suitable instrument to achieve common objectives.

The simultaneous transition to a green and digital economy also requires the harmonisation of State aid rules, so the Commission reviewed the State aid rules for IPCEI projects under the 'fitness check' launched in 2019 and, following a broad consultation, further clarified the applicable rules in the new IPCEI Communication, which will apply from 2022.

What can qualify as an IPCEI project?

In order to ensure that the activity to be supported fits into the definition of an IPCEI project, the Commission has set out general and specific requirements. The general conditions may be grouped into three categories and must be fulfilled at the same time.

external partners, will implement 41 matching projects to achieve a common goal. - https://ec.europa.eu/commission/presscorner/detail/hu/ip_22_4544

[22] IPCEI Communication, point 8.

[23] For example, if the IPCEI project partly involves aid measure(s) for environmental protection, the aid may be assessed under Article 107(3)(c) TFEU on the basis of the rules of the Guidelines on State aid for climate, environmental protection and energy [(2022/C 80/01), OJ C 80/1, 18.2.2022, p. 1] or the General Block Exemption Regulation

[24] Commission Communication on the European Green Deal, COM(2009) 640 final (11.12.2019) - https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52019DC0640

[25] 2030 Digital Compass 2030: Commission Communication on the European way for the Digital Decade, COM(2021) 118 final (09.03.2021) -
https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A52021DC0118

Under the *first criterion,* only initiatives that meet the definition of a 'project' as defined in the IPCEI Communication are eligible. Accordingly, an initiative can be a 'single project' or an 'integrated project'.

Single project

Although the Communication somewhat misleadingly defines one group of cases covered **as 'single projects'**, IPCEI is not intended to support stand-alone activities/projects of enterprises. The basic condition that the project must be carried out jointly by undertakings from several Member States must also apply to a 'single project'.

Under the Commission's case law, single IPCEI projects may include large infrastructure investments (see the Øresund Bridge and the Fehmarn Belt mentioned above) or where two or more projects for R&D cannot be clearly separated, in particular where the likelihood of technological success of the projects concerned is not independent of each other.[26]

On this basis, if the public funding is only for the R&D project of a single company or for the increase of its production capacity after the research phase, without cooperation between Member States and as part of a complex project, the aid cannot be granted under the IPCEI Communication. Such aid may be granted in accordance with the rules of the General Block Exemption Regulation[27] or sectorial legislation (the R&D&I Guidelines[28] or the Regional Guidelines[29]).

Integrated project

The other group of cases covered by the IPCEI Communication are ***integrated projects*** that are embedded in a common structure, roadmap or programme; have the same objective; and are characterised by a coherent systemic approach. The individual sub-projects of a complex project may relate to different levels of the supply chain, but they must be complementary and have a significant added value in achieving the EU-wide objective.[30] Commission Decisions adopted so far, which are not infrastructure-related, have approved support for integrated projects, and it is expected that approvals will continue to be more numerous for integrated projects than for single projects. Therefore, I focus on integrated projects in this article and refer to the IPCEI project as the integrated project.

[26] IPCEI Communication, footnote 12.

[27] Commission Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, OJ L 187, 24.6.2014, p. 1. - https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014R0651&qid=1684478929084

[28] Commission Communication on the Framework for State Aid for Research and Development and Innovation (2014/C 198/1), OJ C 198/1, 27.06.2014, p.1. - https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A52014XC0627%2801%29

[29] Guidelines on regional State aid (Commission Communication 2021/C 153/01), OJ C 153/1, 29.4.2021, p. 1. - https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021XC0429%2801%29

[30] IPCEI Communication, point 13.

Figure 2 - Scope of the IPCEI Communication

Single project	- Must itself meet all the requirements for IPCEI. - Includes large-scale infrastructure projects and R&D projects where the activities (sub-projects) cannot be separated. - e.g. Øresund bridge, Fehmarn Belt
Integrated project	- A group of individual projects that serve the same purpose and are carried out under a common structure, schedule or programme. - Each sub-project (activity) may be different at the supply chain level, but should complement each other. - e.g. IPCEI microelectronics, IPCEI batteries

Source: Created by the author

The second specificity of the IPCEI project is that the activity to be implemented ***must be important at the EU level***, so it is not just motivated by one company. This condition is fulfilled if the project is quantitatively or qualitatively significant, if it is particularly important in terms of its size or scope, and if it involves a significant technological or financial risk.[31]

Thirdly, the IPCEI project must be ***based on a common European interest***, for which the Commission sets strict conditions, which must be met simultaneously. These are:

- The project contributes in a concrete, clear and identifiable way to one or more EU objectives or strategies[32] and has a significant impact on sustainable growth, addressing societal challenges and creating value at the EU level.[33]
- The project addresses a significant market or systemic failure and cannot be implemented in the same way or at all without public support.[34]
- The cooperation of at least four Member States is needed,[35] and the clearly identifiable benefits and spill-over effects are not only felt in the financing Member States (and not only by the undertakings and sectors concerned), but also at the EU level.[36] It is important to underline that the positive macro-economic effects of the project (e.g. job

[31] IPCEI Communication, point 27.

[32] For example, it contributes to the goals of the European Green Deal, the Digital Compass, the EU Data Strategy, the European Research Area, NextGenerationEU, or the Circular Economy Action Plan.

[33] IPCEI Communication, point 14.

[34] IPCEI Communication, point 15.

[35] Exceptions to this are projects involving interconnected research infrastructure and TEN-T projects, which are of fundamental transnational importance. The 2014 Communication required the participation of two Member States.

[36] IPCEI Communication, points 16 and 18.

creation) are not taken into account by the Commission in order to justify the spill-over effect, but these can be assessed as a circumstance underpinning the importance of the IPCEI at the EU level or the contribution to the common objectives. The Commission's recommendation on the spill-over effect and dissemination of the project results is further detailed in the section on the IPCEI procedure documents below.

- Beneficiary companies must provide significant co-financing (own contribution) and must also demonstrate that the project complies with the principle of no significant harm.[37]
- From a procedural point of view, the project should be designed in a transparent and inclusive way, ensuring that all Member States are informed about IPCEI initiatives, for example through preparatory contacts and meetings, and have the opportunity to participate.[38]

In addition to the general criteria above, the IPCEI project must also meet further requirements, depending on which of the following sub-categories of IPCEI projects it falls into:

a. To qualify as an IPCEI, a ***project for research, development and innovation*** must represent a *major innovation* or provide *significant added value* in relation to the state of the art in science and technology in the sector concerned.[39] Thus, contract research or subcontracting of R&D activities are not eligible, as they typically do not go beyond the state of the art.

   In the light of the above, it is important to note that IPCEI is not intended to support industrialisation (facility development), mass production and commercialisation. The IPCEI is intended to contribute to the promotion of R&D and innovation activities, and therefore the maximum eligible activities under the IPCEI are those at the pre-commercialisation (TRL 1-8) level in the so-called TRL classification.[40]

[37] IPCEI Communication, points 19-20. The do no significant harm (DNSH) principle is that no project should lead to a breach of the environmental objectives of Article 9 of the Taxonomy Regulation (EU 2020/852) as defined in Article 17 of the Regulation.

[38] IPCEI Communication, point 17.

[39] IPCEI Communication, point 22.

[40] Technology Readiness Levels (TRL)
TRL 1 – Basic principles observed
TRL 2 – Technology concept formulated
TRL 3 – Experimental proof of concept
TRL 4 – Technology validated in lab
TRL 5 – Technology validated in relevant environment (industrially relevant environment in the case of key enabling technologies)
TRL 6 – Technology demonstrated in relevant environment (industrially relevant environment in the case of key enabling technologies)
TRL 7 – System prototype demonstration in operational environment
TRL 8 – System complete and qualified

In line with this, it should also be underlined that, in the case of aid for research and development projects under Article 25 of the General Block Exemption Regulation, the eligible activities[41] must also be aligned to the TRL levels: fundamental research (TRL 1), applied/industrial research (TRL 2-4), experimental development (TRL 5-8).

b. A ***project involving a first industrial deployment (hereinafter: FID[42])*** enables the development of a new product or service through *significant research and innovation activity* or an *innovative production (manufacturing) process.*[43] It is important to underline that the first industrial deployment as an activity alone is not eligible for IPCEI funding, but only if the FID is the result of a research and development and innovation activity and contains a significant research and development component that is an integral and necessary element for the successful realisation of the project.[44]

   Practical experience shows that the delimitation of the FID phase in the Commission's assessment is a major difficulty. The end of the first industrial deployment phase can be defined by taking into account the R&D performance indicators that indicate the ability to start mass production.[45] Taking into account the TRL classification, this means that the FID phase can extend up to TRL 8. This is confirmed by the Commission's informal interpretation that public funding of the first industrial deployment is also possible as part of the experimental development under the aid category for a research and development project within the meaning of Article 25 of the General Block Exemption Regulation, if the other conditions of the IPCEI Communication are not fulfilled. In my view, this is to be interpreted restrictively in the light of the concept set out in Article 2(86) of the General Block Exemption Regulation, i.e. FID can only relate to the development and introduction of prototypes and experimental models which are necessarily the final commercial products and which would be too expensive to produce for only the purpose of demonstration and validation.

c. ***Infrastructure projects*** include investments in the environmental, energy, transport, health or digital sectors that are of major importance for the EU's environmental, climate, energy (including security of energy supply), transport, health, industrial or digital strategies.[46] Infrastructure projects are eligible from the completion of construction until

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TRL 9 – Actual system proven in operational environment (competitive manufacturing in the case of key enabling technologies; or in space) - https://ec.europa.eu/research/participants/data/ref/h2020/wp/2014_2015/annexes/h2020-wp1415-annex-g-trl_en.pdf

[41] Commission Regulation (EU) No 651/2014 Article 25(2)

[42] First industrial deployment. The definition refers to upscaling of pilot facilities, demonstration plants or equipment and facilities that are the first of their kind, and includes the steps subsequent to the pilot line, including the testing phase and bringing batch production to scale, but does not include mass production or commercial activities.

[43] IPCEI Communication, point 23.

[44] IPCEI Communication, point 24, third sentence.

[45] IPCEI Communication, point 24, second sentence.

[46] IPCEI Communication, point 25.

the investment is fully operational. It should be stressed that a project to set up pilot production lines is not considered an infrastructure project.[47]

Figure 3 - Targeted areas of IPCEI

IPCEI = special State aid instrument to support the following areas		
Innovation		**Infrastructure**
Research and development	Research and development and first industrial deployment	Construction phase to full operation

Source: Created by the author

Conditions for compatibility

In assessing compatibility with the internal market, the Commission applies *a balancing test* (adequacy, necessity, proportionality, impact on competition, transparency). In doing so, it deems it a positive criterion if:

- the project addresses a clearly identified and significant strategic dependency;
- is co-financed by other EU funds, and independent private investors contribute to the costs;
- the project and its management structure are designed and selected with the involvement of the Commission, the European Investment Bank or the European Investment Fund;
- the project brings about important cooperation between undertakings of different sizes in different Member States, involving different sectorial organisations, and contributes to the development of disadvantaged regions.[48]

According to the rules, an aid measure cannot be considered *appropriate* if the same result can be achieved by other, less distortive policy or aid instruments.[49]

As regards the *necessity and proportionality* of the aid, the Commission assesses whether:

- without the aid, the project would not be carried out or would be carried out on a smaller scale50, and

[47] IPCEI Communication, footnote 33.

[48] IPCEI Communication, point 21.

[49] IPCEI Communication, point 42.

[50] With a narrower scope, at an inappropriate pace, or in other ways that would significantly limit the expected benefits.

- the aid measure is proportionate if less aid would not achieve the same result.[51]

To demonstrate the need, a counterfactual scenario should be prepared, which assesses the situation[52] if Member State would not provide funding for the project. The analysis also includes the possibility that in the absence of public support, the planned project would not be realised at all, i.e. there is no alternative.

The *proportionality* of the aid measure is ensured on the one hand by the fact that Member States' funding can be limited to the minimum necessary, and on the other hand by the fact that the Commission can provide for a claw-back mechanism.[53] In IPCEI initiative, the maximum aid intensity that can be granted to projects in each enterprise is determined by the funding gap in relation to the eligible costs.[54] If the project is more profitable than the rate indicated in the funding gap calculation previously presented to and approved by the Commission, the claw-back mechanism ensures that overcompensation is avoided. In such a case, the amount to be recovered as a result of the claw-back mechanism shall be due to the grantor of the aid from the Member State.

In order to be compatible, the negative effects of the aid measure in terms of *distortion of competition and trade between Member States* must be limited and must outweigh any positive effects in terms of the attainment of objectives of common European interest. As regards the distortive effect on competition, the Commission considers several aspects, taking into account the risks of overcapacity, anti-competitive foreclosure and dominance. The IPCEI Communication also details the assessment of the location of the project, stating that if the aid were to be granted for relocation[55], the negative effects of the aid measure would be unlikely to be outweighed by any other positive effects and would therefore not be authorised by the Commission.[56]

In the interests of *transparency*, the rules require ex-post publication in a register managed by the Commission of individual aid exceeding €100,000.[57] Information on a given project must

[51] IPCEI Communication, point 30.

[52] The credibility of the counterfactual scenario can be verified by internal documents of companies, such as board presentations, analyses, reports and studies.

[53] The claw-back mechanism generally applies for grants of up to €50 million (in present value per Member State and per beneficiary), so projects by SMEs are rarely covered.

[54] For more details on the method of calculating the funding gap, see Edina DOBOS - Eszter HARGITA: On the calculation of the funding gap for the purposes of state aid rules (published in Hungarian in Állami Támogatások Joga – 35 (2022/5). - https://tvi.kormany.hu/download/e/ef/f2000/A%CC%81TJ_35.pdf

[55] Relocation is understood to mean, as in the case of regional investment aid under Article 14 of the General Block Exemption Regulation but without any time limitation, a situation where the aid is conditional on the relocation of the production or any other activity of the beneficiary to the territory of an EU - or EEA - Member State.

[56] IPCEI Communication, point 47.

[57] https://tvi.kormany.hu/kozzetetel

be made publicly available for 10 years and publication must take place within six months of the award of the aid (signature of the grant agreement).[58]

The IPCEI process and the actors involved

The IPCEI project starts as a grassroots initiative, managed by a Member State participating in the IPCEI project. The IPCEI process can be divided into two phases:

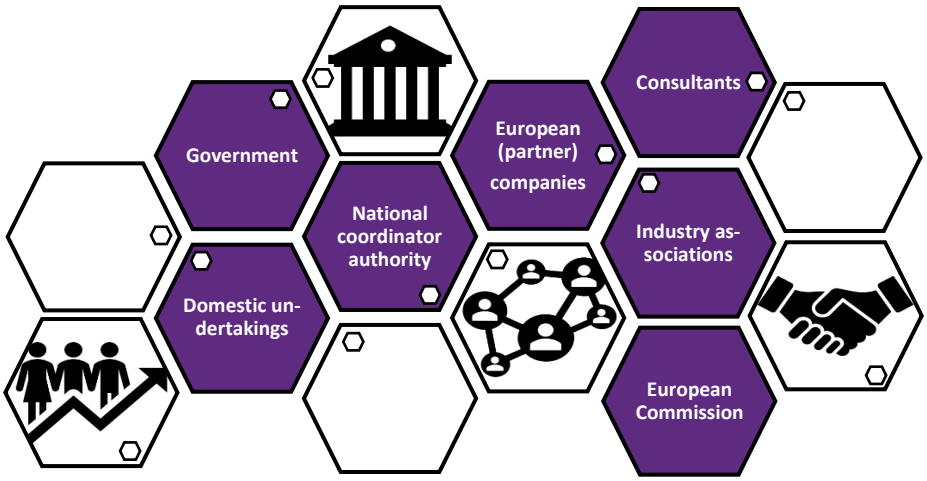
1. The phase of exchanges between Member States open to participation and companies interested in the initiative, which determines which companies from which Member States will cooperate in the IPCEI project. This dimension of the process also requires the 'in-country' tasks related to the initiative (e.g. national call for proposals, national project selection, financing sources, coordination and liaison with Member States)
2. The stage of EU State aid notification to obtain the Commission's approval. This involves a dialogue between the participating Member States, the Commission, and, of course, the potential beneficiaries. In order to prepare the notification, there is the possibility of a pre-notification procedure to clarify the cornerstones of the IPCEI project, which may include an informal hearing between the Commission's working groups and the Member States or companies supporting a subproject in the IPCEI.

The actors in the IPCEI process

The IPCEI process requires active and coordinated cooperation of several actors, including the enterprises concerned and the government (in particular the ministry department in charge of coordination), but also governmental back offices and industry actors (industry associations, consultants).

[58] IPCEI Communication, points 48-49.

Figure 4 - Actors in the IPCEI process



Source: Created by the author

The national resources allocated to IPCEI are finite, so ***companies*** wishing to participate in IPCEI compete with each other for public funding, and funding is generally limited to projects with the greatest potential and best fit with the IPCEI initiative.

The IPCEI process is typically coordinated by a ***designated unit*** within a government ***ministry.***[59] It is responsible for providing information to the enterprises concerned, preparing and carrying out national project selection and pre-qualification, and preparing the government decision. The national coordinating authority liaises with its counterpart in other Member States and with the enterprises participating in the project.

The ***government*** decides on the participation in IPCEI, selects the projects to be supported, arranges the notification of public funding to the Commission and, if the notification is successful, provides national funding for the projects of the companies involved in the initiative.

The procedure cannot avoid the presence of European ***project partners***, as the IPCEI project requires cross-border cooperation, so that domestic enterprises in a given Member State will necessarily implement the IPCEI project together with companies established in another Member State or in the European Economic Area. The joint action is often joined by ***industry associations***, providing a platform for the discussion and exchange of information on technical issues between enterprises. ***External consultants*** also appear as non-project partners to assist with the interpretation of the IPCEI Communication, the preparation of the notification procedure documents, and the calculation of the funding gap to support the resource requirements of each project.

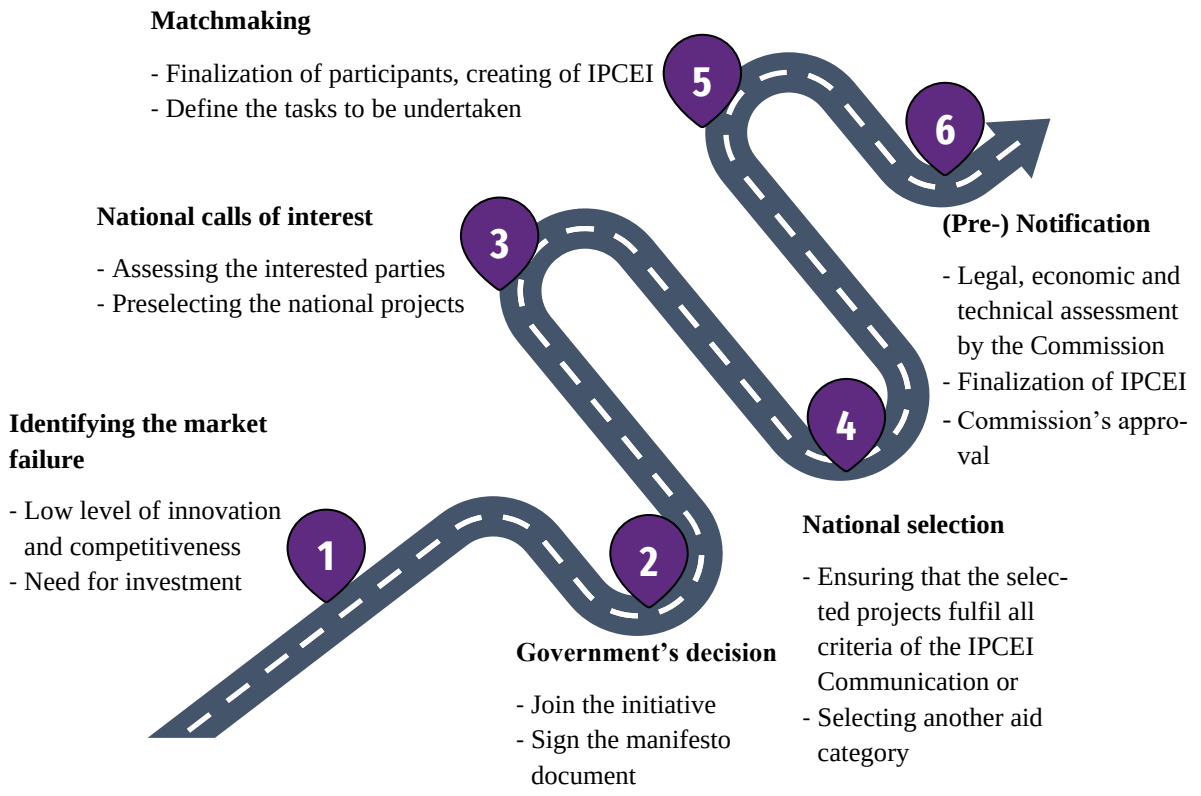
[59] In Hungary, the IPCEI initiatives are currently managed by the Ministry of Technology and Industry, with the assistance of the National Research Development and Innovation Office. The State aid notification is forwarded to the Commission by the State Aid Monitoring Office via an electronic system.

In the procedure, the ***Commission's Directorate-General for Competition*** is responsible for assessing and ensuring that the notified IPCEI initiative and the individual projects under it comply with EU state aid rules.

The IPCEI process

The IPCEI procedure is necessarily different from a notification procedure under which a Member State intends to grant State aid for the implementation of an individual (ad hoc) project.

Figure 5 - Steps of the IPCEI process



Source: Created by the author

As a starting point for the process, it is necessary to *identify the market failure* that the IPCEI project aims to address. This may be a need for investment in a sector or strategic value chain, a low level of innovation, or a lack of international competitiveness.

The next task is to take a *policy decision* on whether the Member State should be involved in an IPCEI initiative. As the IPCEI Communication allows for the support of significant cross-border projects at the EU level, Member States expressing their participation on the basis of a

market failure will publish *a manifesto*.[60] In this manifesto, Member States recognise the need for international cooperation to address the market failure; express their general commitment to support an IPCEI project; and outline how it can contribute to economic growth, employment creation and the achievement of common European objectives in the target area concerned. By signing the Manifesto document, Hungary has joined the European cooperation in the fields of microelectronics and hydrogen value chains, healthcare, and cloud services.

As a third step, the participating Member States launch *open calls for expression of interest* to register and pre-select domestic companies interested in participating. Under this call, enterprises can submit project proposals, which do not in themselves qualify for funding, but only serve as a basis for the national coordinator authority to prioritise projects, develop synergies between national project proposals, and have for subsequent selection. The project proposal must therefore be sufficiently detailed and concrete to provide the national coordinating authority with a clear picture of the potential of the project and of whether the support measure meets the conditions of the IPCEI Communication. In particular, it is important that it is clear at this stage how the project proposed for support will contribute to pioneering innovation beyond the state of the art of science and technology. It should also be clear how the project proposal relates to the joint cooperation and at which stage of the strategic value chain it will be implemented. There is no common format on the content of the call, but in order to consider the above aspects, the project proposal should include the following elements:

- a description of the undertaking and the sector concerned,
- a detailed description of the project (what the market failure is and the solution offered),
- a description of the state of the art and justification of the innovative nature of the project,
- how the company's activities and the partners involved in the project fit with the IPCEI,
- a description of the direct impact of the project on the business and the spill-over effects,
- financing elements (project budget, business plan and funding gap calculation).

In the fourth step of the process, the *national coordinator authority selects the national project proposal(s)* with the highest potential for integration into the IPCEI project, based on its own assessment criteria and the IPCEI Communication criteria. It is necessary to reiterate that if there is an otherwise eligible project among the national proposals that does not meet all the conditions of the IPCEI Communication, the Member State may use other aid categories (under e.g. the General Block Exemption Regulation or the R&D&I Guidelines). In this way, a distinction can be made between direct and indirect participants (partners) in an IPCEI project.

The Commission's approach is to consider as *direct partners* those companies that receive funding under the IPCEI Communication; participate in the preparation of the documents required

[60] See for example:
- IPCEI-Health: https://www.entreprises.gouv.fr/files/files/secteurs-d-activite/industrie/industries-de-sante/manifesto_towards_a_health_ipcei.pdf
- IPCEI-Hydrogen: https://www.bmwk.de/Redaktion/DE/Downloads/M-O/manifesto-for-development-of-european-hydrogen-technologies-systems-value-chain.pdf?__blob=publicationFile&v=8

for the notification of the IPCEI project; and contribute to the integration of the IPCEI in cooperation with other direct (or indirect) partners, committing themselves to actively carry out spill-over activities throughout the project. Therefore, R&D and the first industrial deployment activities carried out by direct partners in projects are subject to a rigorous assessment by the Commission under the IPCEI Communication (in particular, the level of the innovative nature of the project).

An *indirect partner* is any company[61] that does not receive State aid under the IPCEI Communication but is funded by another EU State aid instrument (e.g. the R&D aid chapter of the General Block Exemption Regulation) and therefore does not need to participate in the joint notification procedure. The indirect partner is involved in the development of the IPCEI with the direct partners, may participate in the value chain delimited by the project, and may benefit from the spill-over effects of the activities of the whole IPCEI project (or of the direct partners). Thus, the main characteristic of indirect partner status is the important interaction with direct participants, which should be IPCEI-specific and generated by the project. Such cooperation (its existence, its scope, the division of tasks between the cooperating parties, and the IPCEI project-promoting nature of the indirect partner's activities) must be demonstrated by the direct partners in the notification documents for the Commission's assessment.

The advantage of being an indirect partner is therefore that the company can continue to participate in the initiative,[62] and the IPCEI ecosystem can continue to carry out useful activities in the value chain and can benefit from the advantages of cooperation without being subject to a more rigorous assessment by the Commission under the rigorous requirements of the IPCEI Communication.

Based on the experience gained so far in Hungary, the Commission encourages the integration of certain projects/activities into the IPCEI project through a collaborating company as an indirect partner instead of a direct partnership. In doing so, Member States should ensure compliance with the rules of the General Block Exemption Regulation as regards public funding to indirect participants.

This is the latest stage at which the government should take a decision in principle to ensure the availability of funding for potential domestic projects based on their financial needs in the budgetary planning process. Without a willingness to provide funding, participation in the initiative is questionable, also from the point of view of the companies concerned, since, as I have already pointed out, the IPCEI initiative is funded from national budgets.

After the national project selection, the ***fifth phase*** of the process is the European (international) *matchmaking*, which is the most important stage of the process, as it is the time when the

[61] Research infrastructures and research and knowledge dissemination organisations involved in the project can be considered as indirect partners. For the latter, EU State aid rules may be waived if the research and knowledge dissemination organisation carries out research and development as an independent activity and disseminates its results widely through education, knowledge transfer or publication, and carries out only ancillary economic activities (e.g. contract research), up to a maximum of 20% of its actual overall annual capacity.

[62] The Commission decision approving the IPCEI project also mentions the indirect partners by name.

separate projects are formed into an integrated IPCEI project. This step can best be compared to consortium building, where participants establish the framework for cooperation; identify missing project elements, as well as possible overlaps and synergies; define the tasks to be undertaken; and link the national projects into a value chain.

Both direct and indirect partners are involved in the contact phase, at which point the Commission's working groups can be involved to provide legal, technical and procedural guidance.

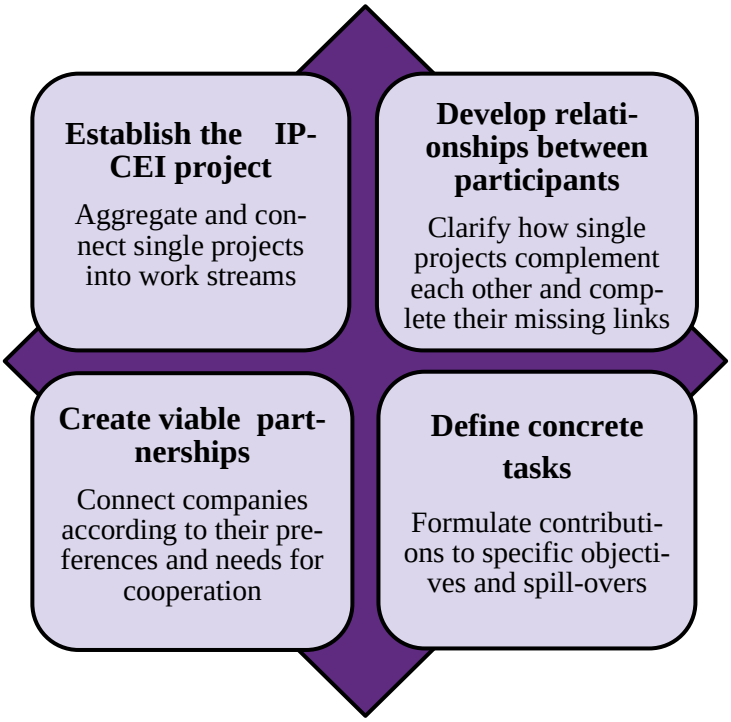
A common process document is developed by the participants to coordinate internal tasks and the decision-making process for the establishment of the IPCEI.[63] The internal governance structure of the project is also to be set out in the Commission's decision approving the project.[64] The matchmaking phase is therefore an appropriate stage for further screening of projects that have passed the national selection. It also provides an effective way for companies competing to participate in the IPCEI, in particular SMEs, to communicate directly with each other and to establish cooperation with partners in the value chain.

The process will culminate in a final decision on the companies and projects participating in the IPCEI project. The Member States, led by one of the Member States coordinating the initiative, will then compile the documentation required for the Commission's State aid notification (see details in a separate section below).

[63] As part of the process, a common electronic platform is often set up, accessible to all participants, where companies can browse each other's profiles and project datasheets to indicate their project focus and partner needs.

[64] See for example points 85-98 of IPCEI Decision on Microelectronics and points 37-53 of IPCEI Decision on 'Battery I.'

Figure 6 – Goals of the matchmaking phase



Source: Created by the author

As a sixth step, Member States submit to the Commission the draft of the joint notification and the related national support plans (*pre-notification*), which are sufficiently developed to allow the Commission to provide meaningful feedback on any modifications needed to successfully approve the IPCEI initiative. It is a common experience that the Commission may indicate at this stage of the procedure that it considers that certain project elements/activities do not fulfil the IPCEI requirements (e.g. they do not include R&D) and therefore proposes to integrate the company(ies) concerned as indirect partners in the project and/or provide funding using another aid category (e.g. the General Block Exemption Regulation) under the responsibility of the Member State. During the pre-notification process, the Commission asks questions in informal discussions for each project element, often requesting further clarifications and calculations, in order to ensure that the joint notification is properly documented and its content is correct.

Finally, *notification* is initiated by Member States when it is likely that the Commission will approve all projects of the IPCEI initiative. Therefore, each project should provide clear information on the IPCEI requirements, in particular the major innovative nature or the important added value of the project; its spill-over effects; and the justification for funding, which should be limited to the minimum necessary.

The Commission performs a legal, economic and technical assessment of how a project complies with the terms of the IPCEI Communication. Typically, the Commission carries out a more in-depth analysis in the assessment of large companies with a more significant market position. If the Commission concludes, on the basis of the information provided in the notification dossier, that the objectives (positive effects) pursued by the initiative outweigh the

distortion of competition caused by the public funding and that all the conditions of the IPCEI Communication are met, it considers the aid compatible with the internal market. It is typical for the Commission to take a single decision for all participating Member States, and therefore, on the basis of the cases so far, Commission decisions in IPCEI projects are rather lengthy[65] and contain many technical details.

It is also worth mentioning that IPCEI notifications have been on the rise recently, encouraged by the EU institutions, and the Commission's practice is to split IPCEI notifications into several '*waves' within an* industry, so that an IPCEI initiative can be approved in a blocked manner. Although not explicitly provided for in the legislation, practical experience shows that it is possible for an IPCEI project that is already established and ongoing to be joined by another Member State or project.[66] In such an exceptional case, the Commission examines in particular whether the new individual project is properly integrated into the IPCEI project structure and schedule, whether it represents a significant added value for the achievement of the common objective, and whether the enterprises joining it establish sufficient and sufficiently useful co-operation with the initial participants.

IPCEI notification documents

The Member States participating in the project send the State aid notification to the Commission separately, but the notification has a common part and the templates are the same. The ***overall description*** (*so-called chapeau text*) is a common, i.e. one document, while the ***individual project descriptions*** that make up the IPCEI are different, i.e. specific to a Member State and company. For their preparation, companies use common template documents provided by the Commission.

The chapeau document can be up to several hundred pages long and is usually drawn up by the coordinating Member State on the basis of information provided by the other participating Member States. Under the individual project description, companies prepare a detailed text description (*project portfolio*), a *funding gap questionnaire,* and a product description (*PRODCOM or NACE document*) for their project. The individual project description must be specific and sufficiently detailed, and therefore companies also share confidential business information with the Commission.[67] The national coordinator authorities can only provide general

[65] The publicly available decisions so far set out the content of the projects and the Commission's assessment in hundreds of points.

[66] By Decision SA.56606, the Commission has authorised Austria to join the 2018 IPCEI microelectronics project ex-post in 2021. The Austrian State will provide €146.5 million in grants to three companies that will carry out additional R&D and innovation activities in the existing IPCEI project. - https://ec.europa.eu/commission/presscorner/detail/en/ip_21_1343

[67] Confidential business secret information must be kept confidential by the Commission and may not be disclosed to third parties or made public without the agreement of the Member State (undertaking concerned).

information on the requirements of the project fiche, which is the responsibility of the companies and the consultants involved.

The ***project portfolio***[68] is a well-structured textual description that includes a detailed technical description of the project the company intends to carry out (Chapter 1), a breakdown of the State aid, the total cost and financing of the project (Chapter 2), and evidence that the project complies with the State aid rules of the IPCEI Communication (Chapters 3-8).

This document should detail how the project meets the requirement for a *spill-over effect.* The Commission's assessment focuses on the dissemination commitments for the dissemination of IPR and non-IPR results of the R&D activity and the dissemination commitments for the first industrial deployment phase, both at the level of the individual project partners and at the level of the integrated project.

The spill-over effect can take different forms of dissemination activities, such as conferences; seminars; workshops; digital platforms (dedicated websites, press and promotional material, social media); collaboration with end-users and research organisations; scientific publications; and involvement of academics or professors, including funding for their training and activities.[69] The commitments contained in each project portfolio should be set out in detail in the chapeau document, indicating the venue, the theme of the events, the participants, the list of scientific publications and journals, the form of research collaborations, and the role of the academic and research organisations to be involved.

IPCEI requires innovation that goes beyond the state of the art in science and technology, so companies typically aim to protect the intellectual property of the research results achieved in the project. To demonstrate the spill-over effect, the chapeau document should therefore refer to the project partners committing to grant third parties (IPCEI companies, research organisations, SMEs, etc.) a licence to exploit the research results and patents under fair, reasonable and non-discriminatory conditions.[70] In the first industrial deployment phase, dissemination activities include the use of open infrastructure[71] (to provide access to SMEs, start-ups and research organisations) and cooperation for knowledge transfer (exchange of know-how), support services for the development of project ideas by indirect partners, validation of project results, and training. Some IPCEI initiatives also include dissemination activities beyond the targeted sector.[72]

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[68] See for example https://www.entreprises.gouv.fr/files/files/enjeux/strategies-d-acceleration/project-portfolio-template-piiec.pdf

[69] See points 126-146 of IPCEI Decision on Microelectronics, and points 151-172 of the 'Battery I.' IPCEI Decision.

[70] These are known as FRAND conditions (fair, reasonable and non-discriminatory conditions).

[71] See points 162-164 of the IPCEI Decision on Microelectronics, and points 173-177 of the 'Battery I.' IPCEI Decision.

[72] See points 147-151 of the IPCEI Decision on Microelectronics and points 178-182 of the 'Battery I.' IPCEI Decision.

The ***funding gap calculation*** provides the justification for the proportionality of the aid, and the Commission uses this as a basis for determining the maximum possible level of public financing. A funding gap exists if the project would not be realised without public intervention or would not be realised under such conditions because the project would not be recovered over its useful lifetime due to insufficient operating results.[73] The funding gap is the difference between the eligible costs[74] of the IPCEI project (in present value) and the operating profit (in present value).

In calculating operating profit, the present value of operating expenditure and revenue over the useful lifetime is calculated, i.e. the time span includes not only the R&D and first industrial deployment phase, but also the mass production phase up to the manufacture of the final product. However, mass production is not eligible for aid under the IPCEI rules.

Operating expenses may include, for example, staff costs, material costs, contractual services, telecommunications, energy and maintenance costs, rent and administrative costs. The scope of operating revenues is determined by the nature of the project (mainly fees paid to the enterprise and the inclusion of residual value), with the exception of public, municipal funding that is considered as public aid, which cannot be taken into account as positive cash flow

The relevant (useful) lifetime to be used in the calculation of the deficit can be determined on the basis of the accounting rules for the sector concerned. In summary, the funding gap is the difference between the positive and negative cash flows over the useful lifetime of the project, discounted to their present value, reflecting the rate of return the company needs to make to carry out the project, taking into account the risks incurred.[75] The rules allow the aid to cover the entire funding gap.

Figure 7 - Formula for calculating the funding gap

funding gap = eligible costs – operating profit

operating profit = operating revenue – operating expenditure

eligible costs ≥ maximum state aid ≤ funding gap

Source: Created by the author

[73] The operating result is not defined in the IPCEI Communication. It is the difference between the discounted operating revenues and the discounted operating costs over the useful life of the investment, if this difference is positive, as defined in Article 2(39) of the General Block Exemption Regulation.

[74] The eligible costs that can be linked to a project are set out in the Annex to the IPCEI Communication.

[75] IPCEI Communication, point 33.

In the ***list of products*** to be annexed to the notification, enterprises record the products they intend to market after the IPCEI project, based on the code list[76] for the collection of statistical data on Community industrial production or related to activities according to the common statistical classification of economic activities.[77] For the purpose of assessing the impact on competition, undertakings shall also identify the five most important competing enterprises inside and outside the Union producing the products concerned. In addition, the document must provide data for the assessment, broken down by code list, on the production value of the undertaking over the last seven years and indicate the amount and form of aid to be granted under the IPCEI project.

Summary

The IPCEI is a regulatory instrument in the field of EU State aid law that, in addition to public funding, can effectively mobilise private investment where there are market failures, in particular in the large-scale deployment of innovative technologies. From the public side, the positive aspect of participating in an IPCEI project is that it provides insight into the EU's priority industries due to the size of the projects, their innovative nature and their international cooperation aspects. Through the IPCEI, the national coordinator authority provides the participating Member States with the opportunity to learn about the vision of the market and the industry's long-term future from the most important European players in the field, which can also be useful to the economic development authorities of the State.

While the fact that up to 100% intensity is available makes IPCEI aid very attractive for many companies, it is important to note that the IPCEI notification process is extremely complex and notifications are subject to very thorough scrutiny by the Commission, so many projects do not make it to the end of the process.

It is very important that companies expressing an interest in an IPCEI project should familiarise themselves with the Commission's expectations before applying by reviewing the relevant rules, as there are mandatory requirements that cannot be met ex-post (e.g. up-to-date internal decision-making documents). Failure to understand the rules will lead to the failure of projects. The basic requirements and some practical issues of the rules for IPCEI projects are summarised in the table attached to this article.

[76] The PRODCOM list is based on Council Regulation (EEC) No 3924/91 [OJ L 374, 31.12.1991, p. 1]. The code list is available at:

https://ec.europa.eu/eurostat/ramon/nomenclatures/index.cfm?TargetUrl=LST_NOM_DTL&StrNom=PRD_2021&StrLanguageCode=EN&IntPcKey=&StrLayoutCode=HIERARCHIC

[77] The NACE code list is set out in Annex I to Regulation (EC) No 1893/2006 of the European Parliament and of the Council [OJ L 393, 31.12.2006, p. 1].

Annex

Table 1 - Frequently asked questions about the IPCEI regulation

Scope of the IPCEI project	
What is an important project of common European interest (IPCEI)?	The IPCEI is an EU State aid regulatory instrument. The EU State aid rules allow public funding to be granted to joint (integrated) projects between companies if they complement each other and contribute to the achievement of the EU's strategic objectives. An IPCEI project is assessed and authorised by the European Commission under the terms of the IPCEI Communication.
What activities does IPCEI support?	IPCEI projects can be set up in any sector. The integrated project must include ambitious R&D activities (beyond the state of the art). First industrial deployment is eligible, but mass production is not. The integrated project may also cover essential infrastructure investments up to the scale and duration of the project. However, first industrial deployment without R&D&I activities and activities for industrialisation (development of facilities, commercialisation) are not eligible.
Can independent projects by companies also receive aid?	The IPCEI is not intended to support individual projects by companies. An IPCEI project requires the coordinated action of at least four Member States or companies active in their territory. The integrated project must be embedded in a common structure, roadmap or programme and have the same objective.
What basic conditions must be met?	The IPCEI project addresses a market failure and the benefits of the project are not limited to the company concerned or the Member State that financed it (spill-over effect). The IPCEI project is based on a common European interest, and the activity to be carried out must be important at the EU level: the project must be significant in terms of quantity or quality, particularly important in terms of size or scope, or involve a significant technological or financial risk.

Should the sub-projects that make up the IPCEI cover the whole value chain of the sector concerned?	A company's project may be linked to different areas of the value chain, but it must be coordinated with other projects to form an integrated project. The sub-projects of the IPCEI should be complementary and have a significant added value in achieving the EU-wide objectives.
Scope of the IPCEI project	
Who qualifies the content of projects?	The R&D component of the project will be assessed by the Commission's experts in addition to those selected by the Member State. In Hungary, the Hungarian Intellectual Property Office is the competent authority for the classification of R&D&I activities. Based on the technology readiness classification, projects are generally targeted at TRL levels between 5 and 8 and the first industrial deployment should not exceed TRL 8.
Eligibility criteria (national selection procedure)	
What are the conditions for participating in IPCEI project?	IPCEI is an EU State aid regulatory instrument. It is up to the Member States to define the conditions for application in the calls for proposals (calls for expressions of interest), but the company's project must fully comply with the criteria set out in the IPCEI Communication (in particular, the significant novelty of the R&D&I activity and the existence of spill-over effects). If a project cannot be financed under the IPCEI Communication, the Member State may apply other State aid rules (General Block Exemption Regulation, sectorial guidelines).
Is the project proposal eligible for funding?	The national selection process aims to identify and select domestic projects and integrate potential project(s) into the IPCEI initiative. The submission of a project proposal does not in itself entitle the applicant to funding, which is subject to the approval of the European Commission following the national selection, if the IPCEI Communication should apply.
Can a company participate in several projects with different partners?	Yes, undertakings can involve different partners if the projects are aimed at developing different solutions.

Is it possible to submit a project proposal in several countries?	Member States participating in IPCEI are responsible for the selection of project proposals. Project proposals must make reference to the Member State where they are submitted so that the same project cannot be funded in two different Member States. However, companies from different Member States may participate in different national IPCEI calls for different project proposals.
Matchmaking phase / State aid notification (approval) procedure	
How is the integrated project developed?	Once the potential participants have been selected by the Member States, a matchmaking process begins, where companies seek to establish and enhance cooperation with each other. Participants develop an internal governance structure aimed at integrating sub-projects into an IPCEI along the value chain. In IPCEI initiatives, participating Member States seek to ensure that all actors contribute to the implementation of the integrated project.
Who submits the IPCEI project for approval?	During the matchmaking phase, the participating companies develop a joint document (chapeau text), which is submitted to the European Commission by all IPCEI Member States. The description of the sub-projects that set up the IPCEI is contained in the project portfolio that the Member State concerned attaches to its notification.
What is the European Commission analysing?	In the State aid notification (pre-notification) procedure, each undertaking must demonstrate the existence of a market failure and the existence of an activity involving R&D&I that goes beyond the state of the art in science and technology in the offered solution. Companies must demonstrate how the project facilitates spill-over effects. The European Commission verifies that the projects meet all the criteria of the IPCEI Communication.
Funding	
Is the IPCEI funded by the European Union?	No, the IPCEI is an EU State aid regulatory instrument under which projects are funded by the participating Member States from their own budgets.
How much public funding can an IPCEI project receive?	The specific amount of public funding to be granted to an IPCEI project depends on the national budget allocated by the Member State for the project.

How much funding can be expected per project?	The level of public funding per project depends on the funding gap in relation to the eligible costs. Public support should be limited to the minimum necessary, taking into account the minimum profit expected in the sector. It is an advantage if the project is also financed by private investors. If the project becomes more profitable than the amount indicated in the financing gap calculation approved by the Commission, a claw-back mechanism should be put in place to avoid overcompensation.
What project costs are eligible under IPCEI?	Eligible costs are listed in Annex 1 to the IPCEI Communication. Eligible costs include: feasibility and preparatory studies (permits), costs of tangible fixed assets, equipment, buildings and infrastructure up to the size and duration of the project (depreciation costs), patents and intangible assets, know-how, consultancy, contract research.
Spill-over effect	
What is the significance of the spill-over effect?	The Commission will only authorise projects as IPCEIs where each company undertakes concrete actions to disseminate the benefits and results of the project.
How can the dissemination of the benefits of the project be justified?	The spill-over effect can take different forms of dissemination activities, such as conferences; seminars; workshops; digital platforms (dedicated websites, press and promotional material, social media); collaboration with end-users and research organisations; scientific publications; and involvement of academics or professors, including funding for their training and activities. These commitments must be presented in an identifiable way in the notification documentation for each company.
Who controls dissemination commitments?	The implementation of the dissemination commitment will be monitored by the participating Member States, in particular through the management structure set up for the IPCEI project; all dissemination activities will be presented in the annual reports to be submitted to the Commission as the project progresses.

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THE APPLICABILITY OF ARTICLE 346 OF THE TFEU IN CASES OF STATE AID FOR THE DEFENSE EQUIPMENT MARKET

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April 2023[2]

Keywords: state aid to the defence sector, Article 346 of the TFEU

Article 346 of the Treaty on the Functioning of the European Union deals specifically with the defence equipment market. Due to the broad interpretation of this provision, the member states for a long time kept the defence industry - including any state subsidies granted to the industry - de facto outside the scope of the internal market, as well as the relevant rules, including state aid rules. However, the jurisprudence of the European Court of Justice clarified that instead of a general, expansive interpretation, the derogation can only be applied in strictly exceptional situations. At the same time, the need for the continuous operation of the defence market may once again bring to the fore the issues of state aid for the industry.

In order to reflect on when it is possible to waive the application of state aid rules in relation to some measures affecting the defence equipment market, this study presents the judicial interpretation of Article 346 of the TFEU, with particular regard to the cases in which the European Commission contested the Member States' expansive interpretation.

Certain characteristics of the defence industry market

Markets of defence and military industry products (hereinafter referred to as the "defence equipment market"[3]) are characterized by a number of features that distinguish them from other sectors. These differences arise primarily from the nature of the products, which are often related to issues of sovereignty and national security. The importance of the sector is indicated by the fact that a separate directorate-general, the Directorate-General for Defence Industry and Space (DG DEFIS), leads the activities of the European Commission in the field. DG DEFIS is responsible for strengthening the competitiveness of the defence industry and stimulating the

[1] Edina Dobos is an employee of Andersen Zrt. What is described in the study cannot be considered the opinion of Andersen Zrt.

[2] Published in Hungarian in Állami Támogatások Joga 38 (2023/1) - https://tvi.kormany.hu/download/3/24/13000/%C3%81TJ_38.pdf

[3] In the following, the study refers to the defence industry or defence equipment as all production and commercial capacities related to the production of weapons, ammunition, and war materials.

internal defence market, including the development of SMEs. A separate fund was also set up as one of the tools to achieve these goals: the European Defence Fund (EDF) complements and reinforces the efforts of the member states, regardless of size and geographical origin, and supports cooperation between businesses and research actors in the field of research and development of the most modern and interoperable defence technologies and equipment. The fund supports competitive and collaborative projects throughout the research and development cycle to have a greater impact on European defence capability and industry. For the period 2021-2027, a budget of nearly 8 billion euros has been allocated to the European Defence Fund. Of this, 2.7 billion euros were allocated to finance collaborative defence research to address emerging and future challenges and threats, and 5.3 billion euros were allocated to finance collaborative capability development projects complementing national contributions.

On the customer side, the defence equipment market is basically defined by government customers, which are the main or often the only buyers of defence equipment. In this monopsonistic market, government customers can determine the technical-technological development of the sector through the choice of equipment purchased or to be purchased: the size, structure, ownership relations, prices, profitability, efficiency and export sales of the defence industry of the given country[4]. At the same time, this purchasing power can be used as a tool of industrial, technological, employment or regional policy to achieve broader economic and social goals.

The activities of government actors are not necessarily limited to the demand side of the market. Several EU member states have partially or fully state-owned companies that (also) offer products or services in defence markets (e.g. France[5], Italy[6]), while in other countries the defence industry is more privately owned (e.g. Germany[7], United Kingdom[8]). Regardless of ownership, the industry in each country is characterized by a monopoly or oligopoly[9].

However, the peculiarity of the defence equipment market is that security of supply and information security play a much more important role than in civilian markets. In addition, the complexity of the defence programs, the high development costs, the long lifecycle of the development and production programs, and the associated commercial risks basically determine the financing and sectoral expenditure of the industry.

In relation to many products and technologies, however, dual usability exists ("dual use"); in addition to military and security, they can also be used for civilian purposes, which can ensure

[4] Van de Casteele, Koene: State Aid Control and the Defence Exception. In: www.concurrences.com Review Issue No. 3/2007 (Download date: September 2, 2022)

[5] For example, Thales Group

[6] For example, Leonardo Group (formerly known a s Finmeccanica)

[7] For example, Rheinmetall Group

[8] For example, BAE Systems

[9] Regarding the largest manufacturers, see, for example, the SIPRI Arms Industry Database of the Stockholm International Peace Research Institute, which contains aggregated, country-by-country and company-group data on arms manufacturing and military service companies: https://www.sipri.org/databases/armsindustry (Download date: 30 December 2022)

a higher return on development and production costs. In addition, the same actors often simultaneously produce products for the defence industry and other, essentially civil uses, which further increases the importance of issues related to incentives and eligibility for incentives of defense equipment, especially with regard to the applicability of Article 346 of the Treaty on the Functioning of the European Union (hereinafter: TFEU) detailed below.

Regulation of the supportability of the defence sector at the level of the TFEU

The specificities of the defence industry — linked to security interests — are also recognised by the TFEU. Article 107[10] provides the definition of state aid and the basic standards for the provision of state aid[11]. At the same time, it also creates the possibility for the TFEU itself to provide for derogations in certain matters. In relation to the defence industry, it is Article 346[12] that, using the possibility of derogation, can grant such an exemption:

"(1) The provisions of the Treaties shall not preclude the application of the following rules:

a) no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security;

b) any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically military purposes.

(2) The Council may, acting unanimously on a proposal from the Commission, make changes to the list, which it drew up on 15 April 1958, of the products to which the provisions of paragraph 1(b) apply."

[10] Ex Article 87. of the Treaty establishing the European Community (TEC).
If the court decision referred to in this Article was published before entry into force of the TFEU, the current article will provide both TEC and TFEU number of Articles.

[11] "(1) Save as otherwise provided in the Treaties, 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 internal market."

[12] TEC contained the same provisions.

Article 348[13] defines the related procedural rules:

"If measures taken in the circumstances referred to in Articles 346 and 347 have the effect of distorting the conditions of competition in the internal market, the Commission shall, together with the State concerned, examine how these measures can be adjusted to the rules laid down in the Treaties.

By way of derogation from the procedure laid down in Articles 258 and 259, the Commission or any Member State may bring the matter directly before the Court of Justice if it considers that another Member State is making improper use of the powers provided for in Articles 346 and 347. The Court of Justice shall give its ruling in camera"

General conditions for the application of Article 346

According to the literature, for a long time, the member states excluded the entire defence industry from the Community regulations, including those concerning state subsidies, with an implicit or explicit reference to Article 346. The basic assumption was that, based on this provision, activities related to the production and trade of weapons and war materials would automatically be exempted from the scope of Community law. The European Court of Justice itself did not interpret this, but only referred to the provision until 1999[14]. The member states therefore considered Article 346 as a provision limiting the scope of Community law.

[13] Article 258 of the TFEU (ex Article 226 TEC), " If the Commission considers that a Member State has failed to fulfil an obligation under the Treaties, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations.

If the State concerned does not comply with the opinion within the period laid down by the Commission, the latter may bring the matter before the Court of Justice of the European Union."

Article 259 (ex Article 227 TEC): "A Member State which considers that another Member State has failed to fulfil an obligation under the Treaties may bring the matter before the Court of Justice of the European Union.

Before a Member State brings an action against another Member State for an alleged infringement of an obligation under the Treaties, it shall bring the matter before the Commission.

The Commission shall deliver a reasoned opinion after each of the States concerned has been given the opportunity to submit its own case and its observations on the other party's case both orally and in writing.

If the Commission has not delivered an opinion within three months of the date on which the matter was brought before it, the absence of such opinion shall not prevent the matter from being brought before the Court."

Article 347 (ex Article 297 TEC): "Member States shall consult each other with a view to taking together the steps needed to prevent the functioning of the internal market being affected by measures which a Member State may be called upon to take in the event of serious internal disturbances affecting the maintenance of law and order, in the event of war, serious international tension constituting a threat of war, or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security."

[14] Randazzo, Vincenzo: Article 346 and the qualified application of EU law lake defence. In: Brief Issue 22/2014, European Union Institute for Security Studies

Subsequently, in the period between 1999 and 2014, 12 related court judgments were issued, which in each case applied a stricter and more restrictive interpretation than before, while the affected member states would have applied a derogation by referring to Article 346.

First, the C-222/84 Johnston judgment[15] stated that Article 346 should be interpreted more narrowly[16]. The next case that reiterated the need for a narrower interpretation was the 2001 C-187/01 Dory[17] judgment, and then eight other cases related to export sales[18] (hereafter collectively: Military export transactions) put it in the same way: the derogation contained in Article 346 of the TFEU neither can be considered as automatic, nor does it limit the competences of the EU[19], but, like other derogations of the EU Treaty, it can only be used in exceptional cases and must be interpreted strictly. In addition, the Court also stated that the burden of proof rests with the Member State.

From the 2000s, therefore, based on the legal interpretation of the European Court of Justice, when applying the exemption defined by Article 346, the specified conditions must be interpreted strictly, i.e. the following must be met together:

[15] Case C-222/84. No. Johnston v Chief Constable of the Royal Ulster Constabulary judgment [ECLI:EU:C:1986:206 (hereinafter: C-222/84 Johnston judgment)]

[16] According to paragraph 26 of the C-222/84 Johnston judgment, "… which deal with exceptional and clearly defined cases. Because of their limited character those articles do not lend themselves to a wide interpretation and it is not possible to infer from them that there is inherent in the Treaty a general proviso concerning all measures taken for reasons of public safety…"

The judgment in Johnston was reiterated by the Court in Case C-273/97, Angela Maria Sirdar v The Army Board and Secretary of State for Defence [ECLI:EU:C:1999:523], and Case C-285/98, Tanja Kreil v. Bundesrepublik Deutschland [ECLI:EU:C:1999:525].

[17] Case C-186/01. Alexander Dory v Federal Republic of Germany [ECLI:EU:C:2003:146], paragraph 30. According to point 30, measures adopted by the member states within the framework of the legitimate requirements of the national interest are not exempted from the application of Community law as a whole simply because the they were born in the interest of public safety or national defence.

[18] Case C-284/05. European Commission v Finland [ECLI:EU:C:2009 :778]

Case C-294/05. European Commission v Sweden [ECLI:EU:C:2009:779]

Case C-372/05. European Commission v Germany [ECLI:EU:C:2009:780]

Case C-387/05. European Commission v Italian Republic [ECLI:EU:C:2009:781]

Case C-409/05. European Commission v Greece [ECLI:EU:C:2009:782]

Case C-461/05. European Commission v Denmark [ECLI:EU:C:2009:783]

Case C-239/06. European Commission v Italy [ECLI:EU:C:2009:784]

Case C-38/06. European Commission v Portugal [ECLI:EU:C:2010:108]]

[19] Engström, Hanna: Article 356 TFEU: The point of intersection between legal ambition and politics will regarding the Defence Procurement Directive (2009/81/EC)? - https://lup.lub.lu.se/luur/download?func=downloadFile&recordOId=8937078&fileOId=8938275

(Download date: 19. September 2022.)

1. The measure must relate to the manufacture or trade in arms, ammunition and war materials in the 1958 list[20].
2. The measure must be necessary to protect the essential security interests of a Member State ("necessity");
3. The measure must not adversely affect the conditions of competition for products not specifically intended for military purposes ("proportionality").[21]

Fulfillment of the first condition — the 1958 list

Regarding the first condition, it has become clear that the applicability of Article 346 is limited to the listed products[22]. For the first condition to be fulfilled, it is not enough that the member state wants to use a specific product for military purposes. In relation to the so-called dual-use devices, i.e. devices that can be used for both military and civilian purposes, the European Court also made it clear that the article can only be applied to measures related to products specifically intended for military purposes. It is not enough that a member state (subjectively) uses a product for military purposes. A more expansive interpretation of Article 346 for dual- or civil -purpose devices could already clearly affect the market of "civilian" products.

In the Case C-294/05 concerning the Community Customs Code, Sweden's position was that the purpose of Article 346 was to ensure the freedom of the member states in areas affecting national defence and security. Germany, Greece, Finland and Denmark also argued that the very wording of this article – as it refers to "measures it deems necessary" – shows that the Treaty confers considerable discretion on member states. In its judgment, the European Court of Justice decided differently: according to its interpretation, the article itself does not allow the member states to deviate from EU law only on the basis of the "desire for protection". It is the duty of the member state to prove that the provision of the given aid is in its fundamental security interest.

[20] Council Decision 255/58 of 15 April 15, 1958 established the list of weapons, ammunition and war materials falling within the scope of Article 296 (2) of the EEC

[21] See Case C-414/97. European Commission v. Spain [ECLI:EU:C:1999:417]

[22] The list was not officially made public, but it was made available in several publications. Since the list is part of the EU Treaty, its amendment requires a unanimous decision of the Council. The list has not changed since 1958. As an interesting point, it should be noted that since the list was not public, the member states could not be held responsible for applying Article 346 to items not included in it.

At the same time, when the Defence Procurement Directive was announced, a narrower list was made public, in relation to which the Directive provides an expanded interpretation: "However, the list is generic and is to be interpreted in a broad way in the light of the evolving character of technology, procurement policies and military requirements which lead to the development of new types of equipment, for instance on the basis of the Common Military List of the Union."

In the Agusta case[23], the Court examined helicopter purchases. Italy pursued proceedings under Article 346 (at the time of the proceedings, Article 296(1)(b)) regarding light helicopters for police and fire-fighting purposes ("light helicopters").

Examining several contracts concluded between 2000 and 2003, the Commission found that it is common practice for the Italian state to conclude contracts directly to meet the needs of various military and civilian bodies. This was also the case with the direct award of contracts for the purchase of Agusta and Agusta Bell helicopters. The Italian state argued that the helicopters are of dual-use, so they can escape the scope of the public procurement directive by referring to point 346(1)(b) of the TFEU.

Based on the reasoning of the Commission, these instruments were basically for civil use, so it started the procedure according to Article 258 of the TFEU. In its decision, the Court reminded that the derogation must be interpreted strictly in relation to public procurement. Furthermore, it is up to the party seeking to apply the derogation to prove the exceptional circumstances that may justify it[24]. In addition, it stated that although, pursuant to Article 296(1)(b) TEC, member states may take measures to protect their essential security interests, these measures may not alter the conditions of competition in the internal market for products that are not specifically intended for military purposes[25]. If clearly military use cannot be substantiated, the procurement in question must comply with the general rules governing the awarding of public procurement contracts. The Court therefore came to the conclusion that those devices which are clearly intended for civilian use and which can only potentially be used for military purposes cannot be exempted based on point 296(1)(b) of the the TFEU[26]. The Court reflected this judgment in Commission v Italy a few months later, when the Commission asked the Court to interpret that Italy had breached its obligations under EU law by adopting National Code 36.

At the same time, it is not enough that the given device is generally used for military purposes, and therefore military use is likely. In the next case, Case C-615/10 (Finnish tiltable turntable case)[27], the Court again addressed the question of what constitutes a specifically military purpose and further narrowed the scope of application.

The Technical Research Centre of the Finnish Defence Forces also applied a derogation based on Article 346 in a procurement. The object of the purchase was rotary turntable equipment serving as a stand for devices subject to electromagnetic measurements ("tiltable turntable").

[23] C-337/05. Judgment No. European Commission v Italy [ECLI:EU:C:2008:203]

[24] Ibid. Paragraph 43 and 44

[25] Ibid. Paragraph 46

[26] Ibid paragraph 47-49

[27] Case C-615/10. Commission v Italy on the Finnish tiltable turntable decision [ECLI:EU:C:2012:324] (hereinafter: Finnish decision).

See more: Dr. Ágnes Kozák- Demendi: Dr. Kozák-Demendi Ágnes: Védelmi-biztonsági tárgyú beszerzések és minősített beszerzések in: Közbeszerzési Értesítő Plusz 2019. I. évfolyam 2. szám 37-45.o. (Procurements related to defence and security and classified procurements in: Public Procurement Bulletin Plusz 2019. I. volume 2. p. 37-45.)

The technical implementation of the turntable equipment concerned is based on freely available materials, components and assembly. The related design tasks encompassed the selection and assembly of elements to meet the specifications in the tender. Finland defended itself before the Court by saying that the equipment was acquired specifically for military purposes and was specifically intended to simulate military deployments. The Court of Justice defined the conditions under which a product can be considered specifically intended for military purposes pursuant to Article 346 of the TFEU in the case of technical applications with largely the same civilian use. Indeed, it stated that *"even if a product comes within one or other of the categories of materials included in the Council list of 15 April 1958, that product can, if it has technical applications for civilian use which are largely identical, be considered to be intended for specifically military purposes, within the terms of Article 296 EC, only if such use is not solely that which the contracting authority intends to confer on it but also, as the Advocate General has noted in point 48 of her Opinion, that which results from the intrinsic characteristics of a piece of equipment specially designed, developed or modified significantly for those purposes.*" [28] The Court then found that the term "military" used in point 11 of the said list[29], as well as the phrases "insofar as they are of a military nature" and "exclusively designed" used in points 14[30] and 15[31] of the same list, indicate that in these points the mentioned products must, in objective terms, have a specifically military nature[32]. In addition, the Court noted that in recital (10) of Directive 2009/81, it was clarified that, for the purposes of that directive, the term "military equipment" should include products which, although originally developed for civilian use, were later converted for military purposes and are used as weapons, ammunition and tools of war[33]. The Court finally concluded that turntable equipment was covered by point 15 read together with points 11 and 14 of the list. In other words, Article 10 of Directive 2004/18/EC[34] interpreted in the context of point 296(1)(b) should be interpreted as allowing member states to exclude from the scope of the procedures under the said Directive the contracting authority in the field of defence, the awarding of a contract for the procurement of a device (which, although intended specifically for military purposes, may be used for a similar civilian purpose), if the said device can be considered designed and developed specifically for such purposes due to its specific characteristics, including the case of significant transformations, which question must be investigated by the referring court.

[28] Finnish decision, paragraph 40

[29] "Military electronics equipment"

[30] "Special parts and items of material included in his list so far dig thesis are of military nature"

[31] "Machines, equipment and items exclusively designed for the study, utility, testing and control of arms, ammunition and apparatus of an exclusively military nature included in this list."

[32] Finnish decision, paragraph 41

[33] Finnish decision, paragraph 42

[34] Directive 2004/18/EC of the European Parliament and of the Council (31 March 2004) on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts.

In the Fiocchi Munizioni case[35], the General Court of the Court of Justice of the European Union (hereinafter: General Court) investigated the claim of the Fiocchi Munizioni company, an Italian arms and ammunition manufacturer and merchant The subject of this claim was the legality of the state aid provided to Empresa Nacional Santa Barbara, a Spanish state-owned arms manufacturer, between 1996 and 1998. The Kingdom of Spain exempted the aid from the application of the state aid rules by referring to Article 346(1)(b) of the TFEU. According to the Spanish state, Santa Barbara was a state-owned company exclusively engaged in the production of arms and ammunition, with its factories owned by the Spanish Ministry of Defence and whose products were primarily intended to meet the needs of the Spanish Army. According to this argument, it followed that its activity served the national defence interests of the Spanish state.

However, Fiocchi Munizioni disputed the specifically military nature of the Santa Barbara company's activities, as it claimed that the company's products were also sold to civilian customers. For this reason, the company's activities do not only satisfy state security needs, so the financial support paid to it by the Spanish state is not compatible.

According to the Court's interpretation, member states have a wide discretionary right to decide how to protect their fundamental security interests. At the same time, it stated that the derogation according to point 346(1)(b) covers only the products included in the 1958 list.

Both the decisions of the General Court taken in the Fiocchi Munizioni case[36] and in the Finnish decision therefore confirmed the reading that this derogation must be interpreted in a restrictive manner[37]. Therefore, simply because e.g. the amount of necessary medical equipment increases in connection with a conflict, the exemption cannot be applied. In the Finnish decision, the Court also made it clear the exemption can only be applied exceptionally in the case of dual-use devices.

[35] Case T-26/01. Fiocchi Ammunition SpA v European Commission [ECLI: EU:T :2003:248]

[36] Case T-26/01. Fiocchi Ammunition SpA v European Commission decision [ECLI: EU:T :2003:248]

[37] In these cases, the applicability of Article 36 of the TFEU may be justified on the part of the member state, according to which "The provisions of Articles 34 and 35 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."

Fulfilment of the second condition - necessity

While the interpretation questions of Article 346 - assuming a kind of automatic exemption - previously focused primarily on which military products a measure applies to, based on the legal cases of the early 2000s, the focus shifted to proving that the main conditions for the application of this provision of the Treaty are necessity and proportionality[38]. Therefore, the fact that a measure applies to products in the 1958 list and is specifically aimed at military purposes does not in itself mean that the application of Article 346 is justified. Member States must demonstrate that the measures they take are necessary to protect their essential security interests, and that this objective cannot be achieved by less restrictive or distorting means.

In connection with the derogation of point 346(1)(b), the Court of Justice applied the Johnston doctrine for the first time[39] in the judgment of Case C-414/97. The case confirms that the Court has the right to review a member state's decision regarding the reference to point 346(1)(b) of the TFEU, as well as the reasons. The case itself concerned a Spanish law that exempted certain war materials ("hard defence material") and their transfer within the EU from VAT (value added tax), while an EU directive brings all exports, imports and transfers within the EU under the scope of VAT. Spain argued that the VAT exemption was necessary to increase the effectiveness of its armed forces and meet its overall strategic objectives. In the meantime, however, it became apparent that Spain wanted to give its defence industry a competitive advantage by exempting its products from VAT and thus reducing costs. This approach also affected the EU's own resources[40]. In point 24 of the Court's decision, the Court stated that Spain did not prove that the statutory exemptions are necessary for the protection of its fundamental security interests. It follows that VAT exemptions are not necessary to achieve the objective of protecting fundamental interests.

A similar decision was made regarding certain military export transactions. Sweden, Denmark, Finland, Italy, Portugal, Greece and Germany — citing point 346(1)(b) of the EU Treaty — exempted the import of military products from the obligation to pay customs duties. In its decision for Case C-294/05 — referring also to the fact that the Community Customs Code provides for the collection of customs duties after the importation of equipment for military purposes from third countries, such as those that are the subject of the present case — the Court confirmed: "*…although it is for Member States to take the appropriate measures to ensure their internal and external security, it does not follow that such measures are entirely outside the scope of Community law … It cannot be inferred that the Treaty contains an inherent general exception excluding all measures taken for reasons of public security from the scope of Community law. The recognition of the existence of such an exception, regardless of the specific*

[38] Randazzo, Vincenzo: Article 346 and the qualified application of EU law to defence, in: European Union Institute for Security Studies Brief Issue 22/2014 - https://www.iss.europa.eu/sites/default/files/EUISSFiles/Brief_22_Article_346.pdf (Date of download: 19 September 2022)

[39] Engström p. 20

[40] The value added tax, which finances the EU budget, is the so-called element of own resources.

requirements laid down by the Treaty, would be liable to impair the binding nature of Community law and its uniform application".[41]

What's more, the derogation must be interpreted strictly.[42]

Fulfilment *of the third condition — proportionality*

In the Finnish decision, the European Court also referred to the need for proportionality for the first time. Furthermore, in the Albore case, it clearly stated that the measure must be proportionate to a real, concrete and serious security interest. Based on this, the Court's use of the word "necessary" also means that a proportionality test must be applied. In order to verify the fulfilment of the principle of proportionality, it must also be substantiated that the protection of the interest cannot be ensured by other, less restrictive measures[43].

The main changes in the state aid rules in the area of the defence industry

Since the 2000s, there has been a change in the interpretation and application of state aid rules for the defence industry. Previously, the emphasis was basically on preventing the spill-over effect: on keeping within the framework that state aid granted to the defence industry does not affect other industries.

In relation to Article 346, the Defense Procurement Directive of 2009 should be highlighted[44]. The Defense Procurement Directive establishes special public procurement rules for the defence and security sectors, given that the normal public procurement rules could not cover the special aspects of the defence market. One of the most important goals for the Directive is to open up the defence market in the European Union without jeopardising the legitimate security interests of EU member states. The Directive basically applies to all contracts, the subject of which is the procurement of military equipment, related construction works and services, as well as all security-related, sensitive procurement involving classified information. Furthermore, m ember states may still be entitled to request a derogation under Article 346 for certain contracts. However, here too, based on a case-by-case assessment, it must be proven that the conditions for applying the exemption are met.

[41]C-294/05. decision no. 43.

[42]Ibid . Paragraph 44.

[43]Case C-423/98 Alfredo Albore case [ECLI:EU:C:2000:401] paragraph 22.

[44]Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/17/EC

The European Commission also made it clear in a 2013 communication[45] that when applying Article 346 in the field of state aid, the aid measures must also comply with the conditions of necessity and proportionality published in the case law. Accordingly, merely narrowing the range of beneficiaries of a state aid measure to the defence industry / military sector is no longer sufficient for the applicability of Article 346. The Communication specifically addresses the applicability of Article 346 in relation to offset agreements and state aid. From the point of view of state aid law, the most important clauses are the following:

- In order to avoid market distortion, it has been declared that the Commission will take action in particular against offsets, i.e. the economic compensation required for defence purchases from non-national suppliers. According to the Communication, the compensation requirements are discriminatory measures that are contrary to both EU Treaty principles and effective public procurement methods. Therefore, they cannot form part of the internal defence market.
- The Communication also draws attention to the fact that, pursuant to the EU Treaty, member states are obliged to notify the Commission of all state aid measures, including aid in the pure military sector. They may only derogate from that obligation if they can prove that non-notification is necessary for reasons of essential security interests under Article 346 of the TFEU. Therefore, if a member state intends to rely on Article 346, it must be able to demonstrate that the concrete measures in the military sector are necessary and proportionate for the protection of their essential security interests.
- In accordance with the jurisprudence of the Court, according to the Communication, it is also necessary to be able to prove that the measures are limited to what is strictly necessary for this purpose. The obligation to certify the fulfilment of this condition rests with the member states.

Summary

Based on the legal interpretation of the Court, the member states have the right to define the basic security requirements that they consider necessary to protect their national security interests. However, these measures cannot extend beyond what is absolutely necessary and must also meet the requirement of proportionality. It is likely that the member states will still want to be exempted from the scope of the Defense Procurement Directive in connection with some of their procurements by referring to Article 346. The main challenge will therefore be to support the fulfilment of the principle of necessity and proportionality in these cases as well.

[45]Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - Towards a more competitive and efficient defence and security sector, Brussels, 24.7.2013. COM(2013) 542 final (hereinafter: Communication)

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WHAT IS NEEDED FOR A SUCCESSFUL NOTIFICATION PROCEDURE TO SUPPORT LARGE INVESTMENTS?

Eszter HARGITA[1]

December 2022[2]

Keywords: regional investment aid, large investment, Commission notification, Commission approval, anti-cohesion effect, alternative site

One of the key elements of an effective aid policy is to ensure that only those projects are supported that would not have been implemented at all or in the same form without aid. It is presumably unnecessary to explain in detail that this is important not only for compliance with EU state aid rules, but also for the efficient spending of Member States' budget revenues.

In terms of a successful regional development aid policy, this implies that only investments that would not be made at all or not in the underdeveloped region without aid should be supported.

In the investment decision on large investments[3], the aid offered is one of the factors, but often not the decisive one. Investors consider a number of factors, such as the benefits of existing sites, the cost of labour, the availability of skilled labour, the availability and/or the cost of utilities, the availability of transport infrastructure or natural resources, country risk, and exchange rate risk. Thus, some investments would take place in underdeveloped regions without aid. On the other hand, the multinational companies behind large investments want to obtain as much aid as possible, even if it is not strictly necessary for the realisation of the investment. The bargaining power of these companies is very strong, as such investments can bring many benefits to the host state: they can create many direct and indirect jobs, thus increasing tax revenues and technology transfer, as well as expected investments from suppliers following the large investor, which can bring additional jobs and tax revenues to the Member State. Therefore, competition for large investments can develop, with Member States bidding against each other to provide subsidies and additional benefits (tax relief, infrastructure improvements, human resources and training), which could result in significant - often unnecessary - expenditure for the winning state.

[1] Eszter Hargita is working for the State Aid Monitoring Office (SAMO) within the Prime Minister's Office. The opinion expressed in this article is not the official position of the SAMO.

[2] Published in Hungarian in Állami Támogatások Joga 36 (2022/6) - https://tvi.komany.hu/download/f/14/03000/A%CC%81TJ_36.PDF

[3] An investment with an eligible cost of more than EUR 50 million.

Recognising this, since 1998 the European Commission (the Commission) has applied stricter rules for aid to large investments than the general regional investment aid rules[4]. Under the rules applicable as of 2022[5], aid for these investments above a certain level will continue to be subject to Commission authorisation.

The purpose of this article is to summarise, on the basis of the Commission's decisions under the RAG 2014-2021, the aspects that aid grantors, potential beneficiaries and their advisors should bear in mind when granting or expecting to grant aid for a planned investment for which Commission approval is required under the regional guidelines.

When and who should notify regarding aid for large investments?

Under the Regional Guidelines and the Block Exemption Regulation (GBER)[6] regional investment aid for large investment projects must be authorised by the Commission in the following cases:

1. Individual aid granted under a national aid scheme but not exempted by the GBER, because:
   a. the aid amount is above the national limit[7];
   b. the investment fulfils the definition of relocation[8];
2. Individual (ad hoc) aid is not covered by the GBER due to its amount[9];

[4] Multisectoral Framework on regional aid for large investment projects (OJ C 107, 07.04.1998 and OJ C 70, 03.2002); Regional Guidelines 2007-2013 (OJ 2006/C 54/08, 04.03.2006) (hereinafter 'RAG 2007-2013'); Commission Guidelines on national regional aid for 2007-2013 (OJ C 209, 23.07.2013, p. 1) (hereinafter 'RAG 2014-2021')

[5] Guidelines on national regional aid (2021/C 153/01) - hereafter referred to as the Regional Guidelines or Guidelines.

[6] The Block Exemption Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market for the purposes of Articles 107 and 108 of the Treaty (OJ L 187, 26.06.2014, p. 1-78) and its amendments, as applicable in summer 2021 (hereinafter the Block Exemption Regulation or GBER)

[7] Article 4 of the Block Exemption Regulation defines the thresholds up to which the Regulation applies. In the case of regional investment aid, this threshold is the aid that can be granted for investment aid with eligible costs of EUR 100 million. In other words, if a beneficiary planning an investment with eligible costs of €200 million is content with aid for an investment with eligible costs of EUR100 million, the Block Exemption Regulation applies and the Member State does not need to apply to the Commission for authorisation.

[8] A relocation is considered to take place if all of the following conditions are met:

the actual transfer of the same or similar activities;

from an establishment in one EEA Member State to an establishment in another EEA Member State (supported establishment);

a transfer is considered to take place if the product or service serves at least partly the same purpose in the original establishment as in the assisted establishment;

the product or service serves the same type of customer in both the original and the supported establishment;and at least two jobs are lost in the same or similar activities in the original establishment.

[9] See above for an explanation of Article 4 of the Block Exemption Regulation.

3. Aid to the shipbuilding and synthetic fibre sectors[10].

At the time when this article was written, under the Commission's case-law decisions were adopted under points 1a and 2. Given that notifications initiated by Member States only become public once a decision has been taken on the case, withdrawn notifications[11,12] are generally not public. Thus, it cannot be excluded that Member States have also initiated notification procedures in cases 1b (relocation) and 3 (shipbuilding and synthetic fibres), but have not (yet) been successful in these cases.

The notification to the Commission is formally made by the designated government body of the Member State. In the case of Hungary, this is the State Aid Monitoring Office (SAMO) within the Prime Minister's Office[13], in cooperation with the grantor(s).[14] However, as we will see below, in relation to the notification of large investments, there is a lot of information which the aid provider is normally not aware of (e.g. the beneficiary's decision-making process), since in a normal situation (without notification to the Commission) the information that the company intends to carry out its project in Hungary is enough for the aid provider. It is irrelevant who, when and under what procedure within the company decided on this, and what other countries were on the list of potential locations. However, all this information is important in a notification procedure, so there is no chance for a successful notification without close cooperation among the beneficiary, the aid provider and SAMO.

The difficulty of the procedure is illustrated by the low number of Commission approvals: until September 2022 under the 2014-2021 RAG, the Commission has taken only 17 decisions on large investments, of which in one case[15] the Commission took a decision to close the procedure because Member States withdrew the notification and in two cases[16] only the formal investigation procedure was opened at the time this article was written.

[10] Given that the Block Exemption Regulation does not apply to these sectors, the regional guidelines allow aid to be granted from 2014 in the shipbuilding sector and from 2022 in the synthetic fibres sector.

[11] If the approval of the Commission is not expected, Member States may withdraw the notification in order to avoid the potential negative press coverage that could result from a more detailed investigation and/or a decision that prohibits the aid.

[12] Unless the Commission has opened the formal investigation procedure under Article 108(2) TFEU.

See for example: SA.43014 - Aid to REHAU AG& Co – Germany

Reference to cases are given in the Annex.

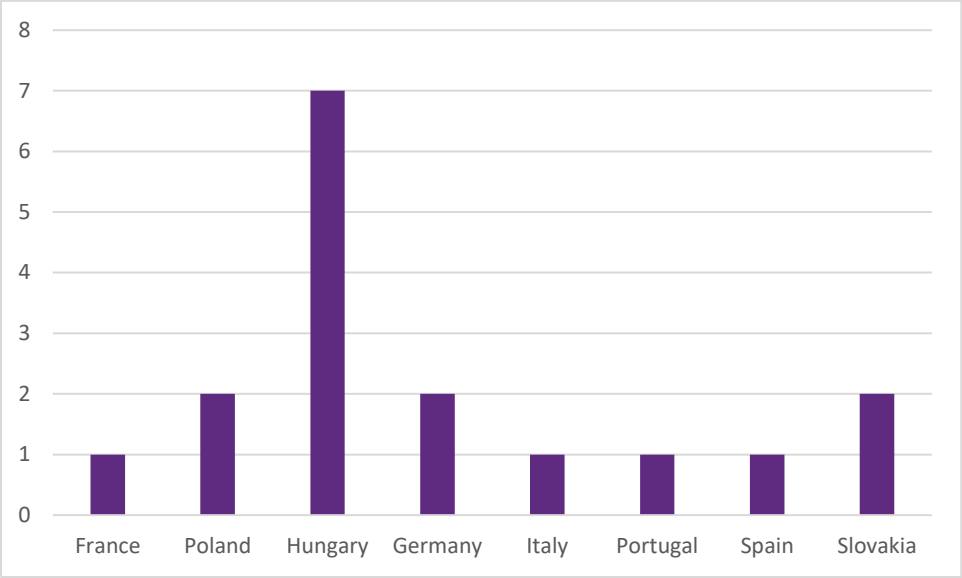
[13] tvi.kormany.hu

[14] The relevant rules are set out in the Government Decree 37/2011 (22.III.2011) on State aid procedures and the regional aid map in the meaning of EU competition law.

[15] SA.43014 - Aid to REHAU AG& Co - Germany

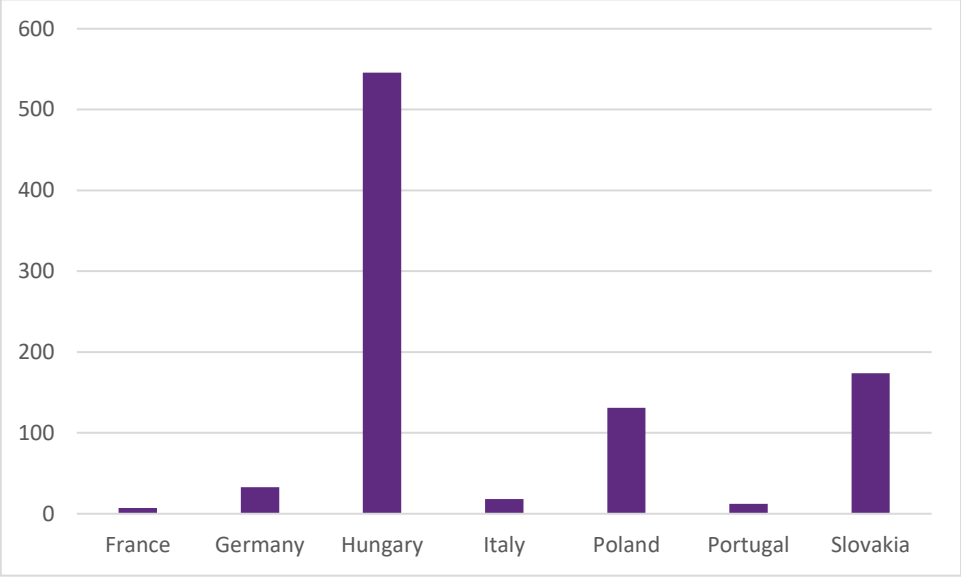
[16] SA.48556 (2018/N - 2019/C) Regional investment aid to Samsung SDI and SA.49579 - Regional investment aid to Peugeot Citroën Automóviles España S.A.

Figure 1: Number of large investment project decisions under the 2014-2021 RAG by Member States



Source: compiled by the author based on the information on the website of the Commission's Directorate-General for Competition [17]

Figure 2: Aid for large investment projects authorised under the 2014-2021 RAG in present value (€ million)[18]



Source: compiled by the author based on the information on the website of the Commission's Directorate-General for Competition

[17] https://ec.europa.eu/competition-policy/index_en

[18] Reference to cases are given in the Annex.

Obtaining Commission approval is not an automatic process; in addition to the abovementioned cooperation, a successful notification is unimaginable without the detailed knowledge of the relevant rules and meeting all the conditions required by the Commission.

When will the Commission authorise the notified aid?

Individual aid notified under the regional guidelines can be authorised if it complies with the common assessment principles. The Commission will first assess whether the minimum criteria are met, i.e.

- whether there is a counterfactual scenario[19] and whether it is credible
- the aid is necessary, appropriate, proportionate, has an incentive effect, and
- contributes to regional development (well-defined objective of common interest).

In addition, it must be demonstrated that the aid does not lead to manifestly negative effects and that its contribution to regional development outweighs its negative effects on trade and competitio

A credible counterfactual scenario and its documentation

To demonstrate the incentive effect, the guidelines recognise two scenarios:

- Scenario 1: without the aid the investment would not be sufficiently profitable for the aid beneficiary anywhere in the European Economic Area (EEA)[20];
- Scenario 2: the investment would have taken place elsewhere and the aid only compensates for the cost disadvantage of the less developed region.

The vast majority of the notifications from Member States fall under Scenario 2[21], where in the absence of aid the investment would have been implemented on an alternative site, so I focus on this scenario below.

Creating a counterfactual scenario is not difficult: you need to find a country where the investment is cheaper to implement and/or operate. But this is not what the Commission requires in the notification procedure.

The emphasis is on 'credibility', i.e. showing the Commission what sites the company actually considered, and that the support offered played a crucial role in the decision-making process and in the final decision. A fictional alternative is not credible.

[19] The counterfactual scenario is used to illustrate what would happen in a situation without aid.

[20] Point 59 of the regional guidelines

[21] Out of the 17 cases mentioned above, only one was a Scenario 1 case (SA.49580 - Investment aid to BorsodChem - Reference to cases are given in the Annex.)

The below made up example to illustrate the difference:

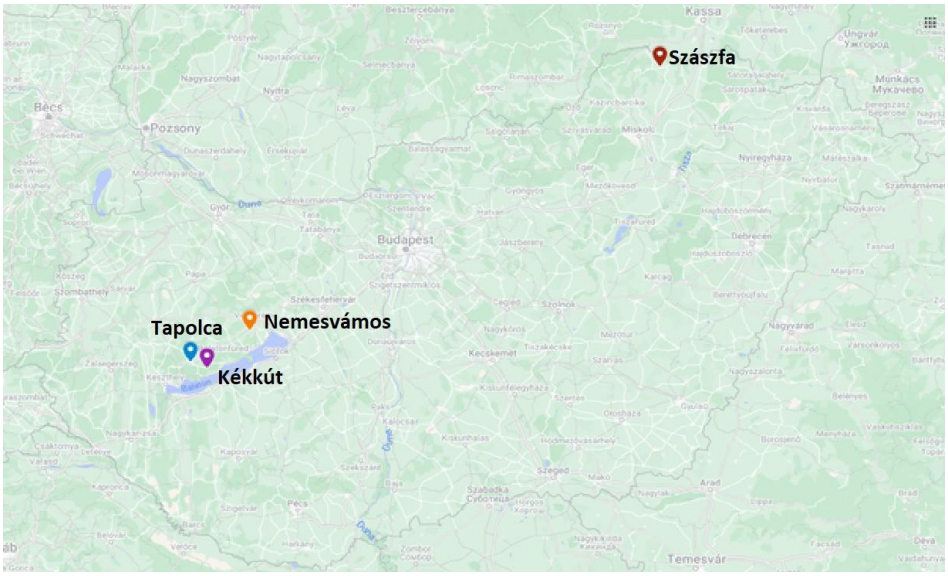
The Mayoress of Kékkút, a town of just 53 inhabitants famous for its mineral water and located in the Káli basin of Veszprém County (Hungary), is offering grants to recently graduated university students who agree to move to Kékkút for 5 years. The amount of the grant will be the difference between the cost of housing in the municipality chosen without the grant and in Kékkút, if Kékkút is more expensive.

In this case, if the applicant has chosen a 147-square-metre property in Kékkút for HUF 65 million, it is not enough to find a 154-square-metre house in Szászfa, Borsod-Abaúj-Zemplén County (HU), for HUF 9.2 million on ingatlan.com[22] to get a large grant; the applicant also needs to prove that he/she has seriously considered moving to Szászfa. This may fail if

1. it is well known that our applicant has a contract for starting working within days at a Hospital in Tapolca (Kékkút-Tapolca 37 km; Szászfa-Tapolca 415 km);
2. according to the Google map timeline, our client has never been to Borsod-Abaúj-Zemplén County, including the settlement Szászfa, in the last five years; or
3. he recently sent his parents several photos of a 120-square-metre property in Tapolca, sold for HUF 76 million, and asked them for financial support to buy it.

The credibility of the above situation would not be improved if our applicant exchanged emails with the owner of the house in Szászfa and travelled to Szászfa for a day to view the property.

Figure 3: Location of Tapolca, Kékkút, Nemesvámos and Szászfa



Source: Google Maps

However, it is possible that before our applicant found the property for sale in Tapolca and the call for application of the mayor of Kékkút, he did a thorough search in Veszprém County

[22] The largest real estate advertising portal in Hungary.

(where Tapolca and also Kékkút can be found), so the list of possible residential properties includes other alternatives.

If, for example, the 138-square-metre house in Nemesvámos, 44 km from Tapolca, which sold for HUF 38 million, is on this list, and our applicant has visited it several times, consulted the owner, talked to neighbours, and had a friend in the profession assess the state of the house, then presumably he only has to explain the deposit on the house in Tapolca that he asked his parents for. A letter from the parents refusing financial help and a statement from the bank proving the availability of up to HUF 40 million (own resources and credit) are likely to be enough evidence that the property in Tapolca was not a realistic alternative.

It is important to underline that it is not enough for the story about the alternative project to be credible and have a realistic alternative site, the selection process must be supported by contemporary internal company documents generated in the company's decision-making process, demonstrating that the options in question were actually explored by the beneficiary in its decision-making process. This means that the beneficiary hoping to receive a grant must keep detailed records not only of the final decision but also of the entire decision-making process, namely its main steps and its outcome. Supporting documents must also be presented to the Commission and the submission of these documents to the Commission cannot be denied on the grounds that they contain business secrets, as the Commission cannot take an informed decision without this information; however, it is bound by confidentiality obligations.

Returning to our previous example....

It is unlikely that the mayor of Kékkút (for simplicity's sake, in our example also referred to as the "aid grantor") will be convinced that our applicant was seriously considering buying a house in Nemesvámos if she sees the following timeline:

15 July	Letter to parents to ask for financial help in buying a house in Tapolca
20 July	Submission of the aid application in Kékkút
25 July	Request for information by the aid grantor
1 August	Visit to Nemesvámos
15 August	Parents' declaration refusing financial assistance

The story is more plausible if the chronology is as follows:

5 July	Letter to parents to ask for financial help in buying a house in Tapolca
20 July	Parents' declaration refusing financial assistance
1 August	Visit to Nemesvámos
15 August	Submission of the aid application in Kékkút

Documenting the path to the final decision is a major challenge for many companies because some decisions and instructions within the company are verbal, i.e. not all steps are in writing. In some corporate cultures, verbal instructions from senior management are implemented immediately and there is no need for subordinates to request a written briefing. In such cases, if the company does not put emphasis on proper documentation, it is very difficult to reconstruct the often years-long pre-decision process and to prove that the right steps have been taken, especially if the potential beneficiary has undergone personnel changes in the meantime so that previous emails and calendar entries are not available.

Typical decision-making process

The SAMO's experience shows that companies' investment decisions are generally motivated by additional demand resulting from a medium-term market analysis (e.g. to maintain or increase market share) and/or from their existing contracts, or by internal restructuring. Investment decisions are usually taken in at least two steps.

In most cases, in the first step, the main decision-making body "only" decides on the establishment, reorganisation, etc. of capacities to meet certain market or internal efficiency needs, and the assessment of possible locations is entrusted to a specific unit (e.g. a dedicated task force).

The designated entity first establishes a long list of potential locations based on a set of objective criteria and assesses them against certain criteria. The representative of the beneficiary does not usually visit the potential sites on the long list, but rather collects information through his own companies, consultants and/or the internet, based on the criteria provided. Such criteria may include

- distance from customers and suppliers,
- the availability and price of suitable land and infrastructure,
- the availability and cost of labour,
- proximity to railways/highways/airports,
- transport costs,
- customs duties, taxes,
- the availability of state aid,

- the country risk,
- etc.

The ranking of the long list (usually the top two, rarely three) provides the final list of possible sites (the short list). For these sites, the company carries out a much more in-depth analysis, visiting the sites; consulting the land owner, potential developers, and the local municipality[23]; talking to aid grantors; and, of course, making financial calculations for the different sites, showing the payback period and the rate of return on investment. The final results of these analyses are summarised in a short or longer document and presented to the (final) decision-making forum(s). At the end of this process, the decision on the final location of the investment is taken. Of course, it may also happen that a site that was not on the long list is selected for the final round. In this case, a thorough justification is needed as to why the site was not previously considered by the designated entity and why it was included in the later decision-making phase in order to avoid the Commission's suspicion that the site was only included on the list in the hope of obtaining more funding.

There are four issues I think are important to highlight about the decision-making process:

1. The investment should not start[24] until the final decision of the highest decision-making body has been taken, as this would completely undermine the story presented by the company. At the same time, there is very often no time to wait for the final decision of the board of directors before making preparations for the investment (e.g. purchase of land, archaeological excavation work on the land, establishment of a Hungarian subsidiary), as these processes can take longer. In this case, it is important that the preparatory steps progress equally for all sites in the final round; or, if they do not progress equally, there should be a reasonable explanation.

   For example, in the case of the land in Hungary purchased before the final decision, possible explanations could be that a) the land could be sold at no or minimal loss or used within the group in the event of a decision unfavourable to Hungary, or b) the land is available at another potential location.

2. The document submitted to the final decision-making body, which will presumably contain the financial calculations for the finalists, will be the basis for determining the maximum amount of aid that can be granted. The principle of proportionality requires that the aided investment should not receive more aid than the difference between the present

[23] After all, a major investment could attract hundreds of thousands of new workers to the settlement, and many foreigners may arrive with their families, so housing, education and healthcare will also need to be provided.

[24] Article 2(23) of the GBER. "start of works" means the earlier of either the start of construction works relating to the investment, or the first legally binding commitment to order equipment or any other commitment that makes the investment irreversible. Buying land and preparatory works such as obtaining permits and conducting feasibility studies are not considered start of works.

value of the projects calculated for the finalists[25]. If the difference is much larger than the maximum aid available in a given area[26], the final decision-maker (and the Commission) is likely to expect arguments to justify the choice of a less financially advantageous location. Such considerations may include, for example, positive externalities due to the existing location (e.g. availability of skilled labour, easier training, good relations with government), proximity to customers and suppliers (both physically and in terms of time zone), exchange rate risk, etc..

3. The ultimate decision-makers are accountable to shareholders and will look at all options to make the investment as profitable as possible. Therefore, the credibility of the alternative scenario is severely undermined if the document presented to the decision-makers does not mention the subsidies available for the investment in the alternative site. Of course, not all locations are eligible for subsidies, as not all countries operate aid schemes or, in the competition for potential sites within the EU, subsidies are not available in the more developed country[27]. In such cases, it is useful to document the fact that no aid is available, for example by submitting a document to the Board indicating that no application for aid has been submitted for a particular location because it is not eligible under the EU State aid rules.

   If the location is outside the EEA, aid offered there can and must be taken into account. It is not always easy to prove that some form of aid has been offered in the alternative non-EEA location. There are countries where the aid is based on verbal offers and these are not put in writing as would be required by the Commission.

   For example, in case SA.53903 (2019/NN) - Regional aid to LG CHEM2 (Poland)[28], where the alternative site was in China, the Commission argued that the Chinese offer was unstamped. In their reply to the Commission, the Polish authorities explained that such an offer letter before the signature of the contract constituted a rather special and unusual event, as offer letters are neither a customary nor a necessary procedure in China[29], as agreements are usually concluded orally. Although the text of the Commission's final decision has not been published at the time of writing this article, it can be

[25] All relevant costs and benefits should be taken into account in the calculations, including for example administrative and transport costs, training costs not covered by training aid, as well as wage differentials, investment costs and revenues over the useful life of the project.

[26] The maximum aid intensity for large investments (so-called adjusted aid amount) can be calculated according to the following formula: maximum aid amount = $R \times (50 + 0.50 \times B + 0.34 \times C)$,

where: R is the maximum aid intensity applicable in the area concerned established in an approved regional map and which is in force on the date of granting the aid, excluding the increased aid intensity for SMEs; A is the initial EUR 50 million of eligible costs, B is the part of eligible costs between EUR 50 million and EUR 100 million and C is the part of eligible costs above EUR 100 million.

[27] See point 97 of the regional guidelines

[28] https://ec.europa.eu/competition/state_aid/cases1/202048/287640_2212606_24_2.pdf

[29] Point 44(c) of the opening decision cited in footnote 44 above.

assumed that the Commission has accepted this reasoning, as the aid was approved in March 2022, according to press reports.[30]

SAMO's experience shows that many issues can be avoided if the beneficiary tries to obtain aid offers from the authorities in the country of the alternative site in the form expected by the Commission.

4. It is advisable to carry out the same detailed analysis for successive investments over time as for a single project.[31] Of course, this does not exclude the possibility of using the results of previous analyses. But an approach that applies the results of a decision taken a few years earlier to a current investment, saying that the site was the best at that time and thus must be the best now, so it is a waste of money to carry out another comparison, is questionable and may discredit the alternative site, as many circumstances may have changed since then.

   To illustrate the situation with a real-life example: if you bought a particular brand of mobile phone for one of your children two years ago, you will presumably not automatically buy the same one for your other child this year, but will first look at the current range of options. Of course, it is possible that you will buy the same phone a second time if your research shows that the same phone again offers the best value for money.

Contributing to regional development

The third minimum requirement is to demonstrate a contribution to regional development, since the primary objective of regional aid is to improve economic and social cohesion by reducing disparities in the level of development between areas.32 Accordingly, in the case of individual investments notified, the notification procedure must include a detailed demonstration of the contribution of the investment to the development of the region lagging behind.

In the notifications handled by the SAMO, the following criteria were most often used to demonstrate the contribution to regional development.

Direct and indirect job creation:

- Number of jobs directly created by the aided investment: the share of workers with tertiary education is important.
- The number of indirect jobs created indirectly by the investment: additional jobs may be created by suppliers in the immediate vicinity of the investment due to increased demand as a result of direct job creation, and the construction and subsequent operation

[30] https://ec.europa.eu/commission/presscorner/detail/en/IP_22_1861

[31] See for example
- SA.58633 - Regional investment aid for SKBM Hungary - Hungary
- SA. 63328 - Regional investment aid for SK On Hungary Kft - Hungary Reference to cases are given in the Annex.

[32] Point 42 of the Regional aid Guidelines

of the investment may also create significant employment. The number of indirect jobs can be estimated or calculated using a ratio specific to the sector (e.g. if in the automotive sector the creation of 1 direct job creates 1.5 indirect jobs, 300 direct jobs will create 450 indirect jobs), which can be justified by reference to sectoral studies.

- The position of the assisted firm as an employer in the region concerned (e.g. the largest employer in a disadvantaged area).

Knowledge transfer:

- Various training (national and foreign) opportunities for the future employees.
- The location of (part of) the research and development activity of the aided firm in the region.
- The active participation of the beneficiary in the national vocational training provides young people with skills that can be used outside the enterprise, thus improving their employability.
- Cooperation with local secondary and higher education institutions contributes significantly to increasing the local skilled workforce,
- Research carried out in partnership with higher education institutions increases local innovation opportunities.

Technology transfer:

- As a result of the investment, the technology used by the aided undertaking can also be used by local suppliers, thus improving the productivity and efficiency of the enterprises.

Clustering effect:

- Cooperation between companies in the same industry can increase efficiency, which has a positive impact not only on the individual company but also on the entire industry and supply chain. In Central Europe and Hungary, it is particularly important in the automotive and battery sectors.

Duration of the investment:

- The implementation and useful life of the investment represents a long-term commitment to the region, and any further investments undertaken will also have a positive impact on the region.

Environmental aspects:

- Going beyond the requirements of environmental regulations, achieving sustainability, operating at zero emissions, using environmentally friendly technologies, or increasing afforestation (to compensate for deforestation in the project area, where appropriate) are all factors that contribute to the development of the region.

Social responsibility:

- Involvement of the potential beneficiary in various types of social activities by supporting the various institutions and activities in the region concerned (support for local associations and/or schools, promotion of healthy lifestyles, support for educational programmes and cultural life, protection of the environment, etc.).

In addition to these criteria, the Regional Guidelines 2022-2027 also require evidence that the supported investment contributes significantly to the EU's key policy objectives of digital transition or transition towards environmentally sustainable activities, including low-carbon, climate-neutral or climate-resilient activities.[33]

Potential negative effects on trade and competition[34]

The notification must also demonstrate that the aid will not lead to obvious negative effects and that any negative effects on competition and trade between Member States will be outweighed by the positive effects of the aided investment. If this is not the case, the aid will not be authorised by the Commission.

The Commission considers the following cases manifest negative effects that cannot be offset by the positive effects of the investment and will therefore not authorise the aid in such cases:

1. The planned aid exceeds the amount calculated on the basis of the reduced aid intensity.
2. The action to be supported or the conditions of the aid infringe EU law in some way. For example, non-compliance with environmental standards, requiring the use of Hungarian suppliers because this infringes the freedom of establishment, imposing an export bonus condition in return for aid.
3. In particular, in Scenario 1 cases, the investment leads to an increase in capacity in an absolutely declining market.

   In such cases, overcapacity reduces margins and competitors' investment in the product market concerned, and can lead to a situation where some firms are forced out of the market or prevent other players from entering it.[35]

   To determine whether this condition is fulfilled, the geographic and product market must be defined. The definition of the relevant product market includes the definition of the relevant product, the relevant competitors and the relevant customers/consumers.[36] The relevant product is typically the product which is the subject of the investment project. Where the project concerns an intermediate product and a significant part of the products

[33] Point 105 of the Regional Guidelines

[34] This chapter is based on Junginger-Dittel, Klaus-Otto [2014]: New Rules for the Assessment of Notifiable Regional Aid to (Large) Investment Projects under the Regional Aid Guidelines 2014-2020 in European State Aid Law Quarterly, Volume 13 (2014), Issue 4, Page 677 - 688.

[35] Point 136 of 2014-2021 RAG

[36] See for example SA.32009 (2011/C ex 2010/N) - Germany - LIP - Aid to BMW Leipzig

is not placed on the market, the relevant product could be the downstream product in the production and distribution chain.[37] The relevant product market includes the product concerned and its substitutes considered to be such, either by the consumer (by reason of the product's characteristics, prices, or intended use) or by the producer (by reason of flexibility of production installations).[38]

If the aided investment takes place in a growing market, the Commission's assessment is that the market-distorting effect of the aid is likely to be less. The degree of market underperformance is generally assessed by reference to the GDP of the EEA in the three years preceding the start of the project (benchmark). It can also be measured on the basis of projected growth rates for the next three to five years.[39]

For Scenario 2 cases, if the aided and the alternative location belong to the same geographic market for the product concerned, the negative effects of the investment would still exist without the aid, so, since the aid will result in the investment taking place in a less developed region, the positive effects of the aid are likely to outweigh the limited negative effects on competition if the other requirements of the regional guidelines are fulfilled.

4. Existence of significant market power in the case of aid under Scenario 1.

   To evaluate the existence of substantial market power, the Commission will take into account the position of the aid beneficiary over a period of time before receiving the aid and the expected market position after finalising the investment. The Commission will take account of market shares of the aid beneficiary, as well as market shares of its competitors and other relevant factors. For example, it will assess the market structure by looking at market concentration, potential barriers to entry, buyer power and barriers to expansion or exit.[40]

   The Commission does not set an absolute value to be applied for all markets, but assesses the market position and the potential negative effects on a case-by-case basis.

   In Scenario 2 cases, since the investment will take place in any case, the situation without aid is no different from the situation with aid in terms of significant market power.

5. In Scenario 2 cases, the investment is located in a region that is no less developed than the alternative scenario (anti-cohesion effect).

[37] In the case of BorsodChem, for example, the investment was for aniline production. The company used aniline primarily for the production of its own MDI, so the Commission considered aniline to be an intermediate product and the relevant product for which the market analysis was carried out was MDI. See SA.49580 - Investment aid to BorsodChem, paragraphs 139 and 140.

[38] Point 124 of the regional guidelines

[39] Point 131 of the regional guidelines

[40] Point 133 of the regional guidelines

Given that such aid would be contrary to the very essence of regional aid, the Commission considers it to have a negative effect that cannot be offset by any positive effects.[41]

However, the anti-cohesion effect will not be fulfilled if the investor can demonstrate that the exclusion of a more developed or similarly developed region from the list of possible locations is made at an earlier (i.e. not final) stage of the decision-making process for reasons such as language, political instability, serious doubts about the reliability of the bureaucratic and legal environment in the other region, lack of sufficient infrastructure, labour or land, or that the investment project could not be carried out in a timely manner, etc.

In order to make sure that there is no anti-cohesion effect, the Commission usually asks for a list of potential sites under consideration by the investor, checks the group's existing sites, press reports and other publicly available information. In addition, it may request information from other Member States on any discussions the investor may have held there. However, the Commission can only do the latter if it opens a formal investigation procedure and the Member States concerned volunteer to provide information.

The issue of anti-cohesion effects does not arise in Scenario 1 cases, where there is no alternative site.

6. The investment is being relocated from another EEA Member State and there is a causal link between the aid and the relocation

   The ban on aid for relocation aims to exclude the granting of regional investment aid for the relocation of a company's activities from one Member State to another Member State.[42]

   In examining the causal link, the Commission must identify the cessation of activity or plans to cease activity, as well as the new investment. Second, it must verify whether there has been a specific transfer of activity between the two sites, i.e. whether the same geographic area and customers will be served by the original and the new site. The third step is to establish the causal link between the aid and the relocation of the activity, which may be based, for example, on counterfactual scenarios, i.e. no causal link, inter alia, if the activity relocated or to be relocated was loss-making in the first place and would have ceased to exist even in the absence of relocation and aid.[43]

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[41] Thus, for example, Debrecen (HU) cannot be an alternative location for Kassa (SK) and vice versa, given that both locations have a maximum aid intensity of 50% according to the Hungarian and Slovak regional aid map in force at the time of writing this article (https://competition-policy.ec.europa.eu/state-aid/legislation/modernisation/regional-aid/maps-20222027_en).

[42] Ambrusz et al: (2018) State aid. Dialóg Campus Kiadó, Budapest. ISBN 978-615.5920-28-8, p. 251.

[43] Zoltán Bartucz (2017), State Aid Law Vol.9 No.2 One step forward, two steps back: the reregulation of relocation in the summer 2017 amendment of the block exemption regulation, footnote 4 - https://epa.oszk.hu/02400/02450/00030/pdf/EPA02450_allami_tamogatasok_joga_2017_02_041-054.pdf.

Access date: 15.08.2021.

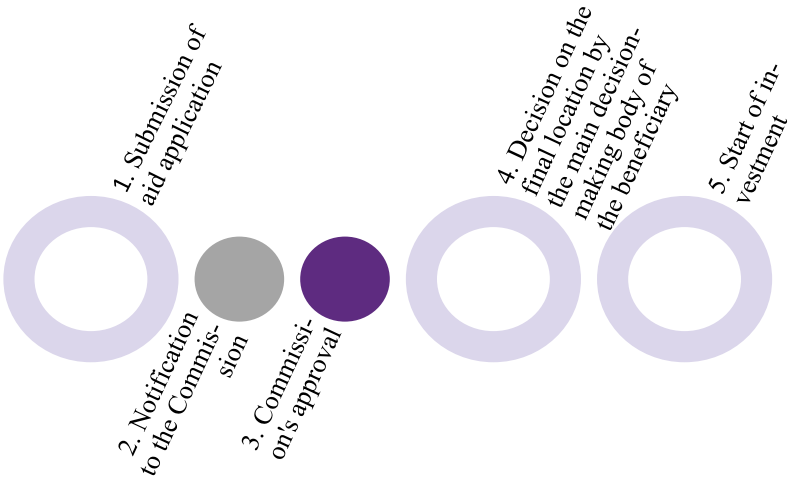
A causal link will not normally be established if it can be shown that the activity of the closed establishment has been relocated to a region other than the region concerned. However, a causal link is likely to be established if, for example, the aid offer clearly indicates that the aid is granted because of the relocation of production.

The Commission authorisation procedure[44]

The Commission's authorisation procedure, also known as the notification procedure, usually starts with a so-called pre-notification. In the pre-notification phase, according to the Hungarian practice, Hungary sends the Commission the completed notification forms[45] and all the documents mentioned above supporting the information contained in the forms. The forms are completed together with the beneficiary.

The key questions are when to make a (pre-)notification, when to make a final decision and when to start the investment. The textbook answer is that the correct order is as follows:

Figure 4: The timing of the European Commission's notification procedure



Source: graphic created by the author

Another reason for the above order is that in the absence of a Commission decision, it is not possible to clearly state to decision-makers that the investment will receive aid. It can only be communicated that the Member State intends to grant aid, but this is subject to the Commission's approval.

However, given that the notification procedure can take many months, the ideal order of events shown above is not always possible. The final decision on the investment site is often taken

[44] State aid in practice (Manuscript) 8. Regional aid: methodology for the notification of large investments

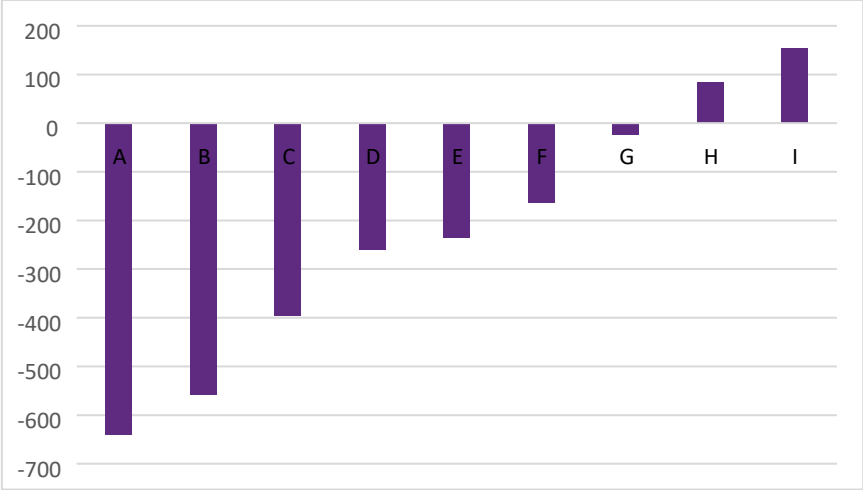
[45] So-called Supplementary Information Sheets - https://ec.europa.eu/competition-policy/stateaid/legislation/modernisation/regional-aid_hu

before the Commission's decision, but there are some cases where the investor waits for the Commission's final decision.[46]

With regard to the above order, it is important to note that the order of points 1), 4) and 5) is not reversible, i.e. the application for aid must always be submitted before the final decision and the start of the investment, and the start of the investment cannot precede the final decision.

The experience of the SAMO shows that a pre-notification prior to the final decision on the site gives the beneficiary an opportunity to get an impression of the problems the Commission may have with the aid requested. This can also be communicated to the final decision-makers. At the same time, the statistics below show that there is still a chance of a positive Commission decision even if the order of the Commission's approval and the final decision is reversed.

Figure 5: Time in days between formal notification and start of investment in cases where the beneficiary did not wait for the Commission's approval decision before starting[47]



Source: compiled by the author based on the information on the website of the Commission's Directorate-General for Competition

The pre-notification is generally followed by a meeting with the Commission, where the aid beneficiary and the Hungarian authorities (the aid provider and the SAMO)[48] explain to the Commission the reasons for the planned investment, the process and content of the investment decision, the role of the aid proposed by the Hungarian government in the company's decision and the positive regional effects of the investment. The meeting can provide an opportunity to

[46] See for example

SA. 45584 - Regional investment aid to Mondi SCP (Slovakia)

SA. 44547 - Regional investment aid to STMicroelectronics S.r.l. (Italy)

SA.48382 - Regional investment aid to MOL Petrolkémia Zrt. (Hungary)

Reference to cases are given in the Annex.

[47] Based on the cases in the Annex. A negative number means that the investment was started before the formal notification to the Commission.

[48] The body responsible for the EU competition assessment of state aid - tvi.kormany.hu

engage in a dialogue with the Commission on the case: the Commission can raise questions it may have on the basis of the documents submitted and the presentation, and the Member State (and the beneficiary) can provide answers to those question.

Following the pre-notification meeting, the Commission will usually ask further questions in writing. Optimally, the questions raised will allow the notification documentation to be completed and the so-called formal notification under Article 108(3) of the Treaty on the Functioning of the European Union to be made.

After the formal notification, the Commission has two months[49] to take a decision or ask for further information. Experiences of Hungary show that the Commission usually asks further questions 2-3 times after the formal notification before taking a decision. The decision following the formal notification can be either a) an authorisation decision or b) a decision to open the so-called formal investigation procedure.[50] The latter occurs when the Commission has doubts as to the compatibility of the planned measure with EU law. At the end of the formal investigation procedure, the Commission may either (a) authorise the aid, (b) prohibit it or (c) attach conditions to it in its decision.[51]

The questions asked by the Commission are generally in-depth and substantive, taking a significant amount of time to answer (usually at least 1-2 months). In many cases (typically for companies in the Far East), differences in corporate cultures, decision-making processes or even aid procedures applied by authorities in non-EEA countries can make it significantly more difficult to demonstrate the credibility of investment decisions to the level required by the Commission, which also increases the duration of the notification procedure. Accordingly, in the practice of the Hungarian authorities, a notification procedure usually takes 8-10 months, but there are also much longer procedures[52]. However, the beneficiary may start the investment at its own risk after the aid application has been submitted, but no aid can be paid until the Commission has taken a final (positive) decision.

[49] Article 4(5) of the EU State Aid Procedural Regulation (Regulation (EU) No 2015/1589)

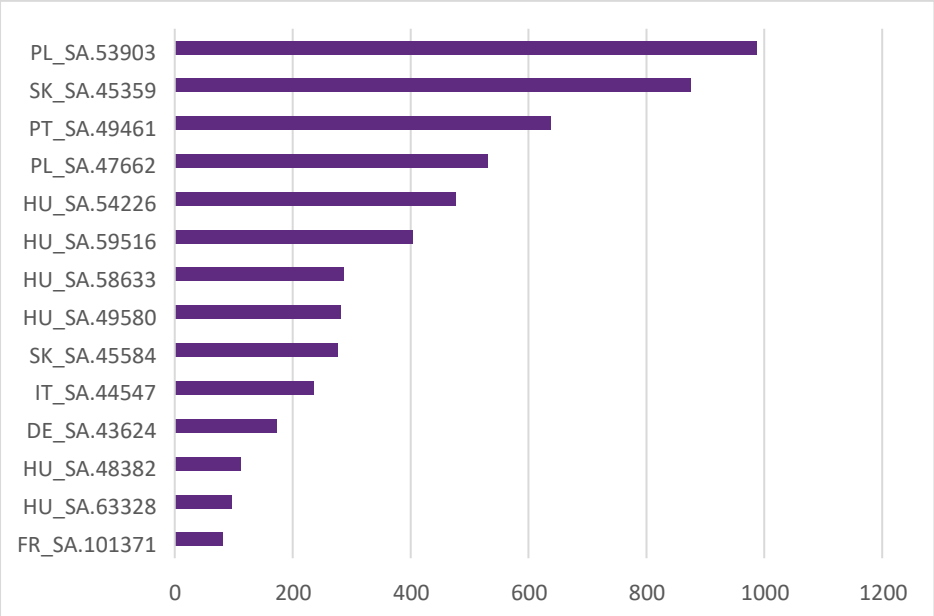
[50] Article 4 of the EU State Aid Procedural Regulation (Regulation (EU) No 2015/1589

[51] Article 9 of the EU State Aid Procedural Regulation (Regulation (EU) No 2015/1589)

[52] For example, SA.36754 (2014/NN - 2014/C) Aid to AUDI HUNGARIA MOTOR Ltd - a procedure initiated by Hungary in June 2013. The aid was authorised by the Commission three years later, on 11 July 2016, following a formal investigation procedure.

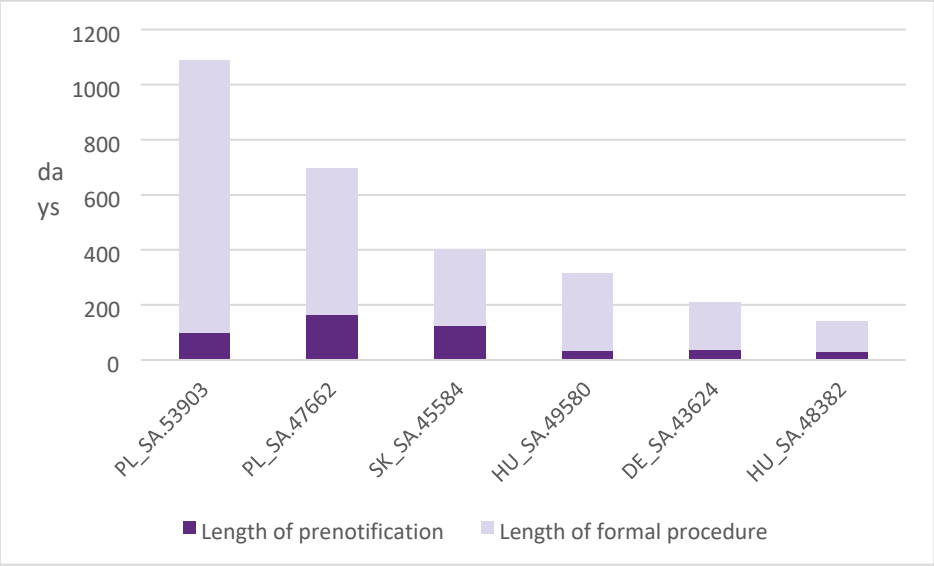
In the case SA.48556 (2018/N - 2019/C) Regional investment aid to Samsung SDI, Hungary formally notified the case to the Commission on 16 May 2018. Although a formal investigation and two extension decisions have already been adopted, at the time of writing, the Commission has not yet taken a final decision on whether or not to authorise the aid (https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_48556).

Figure 6: Length of notification procedures in days from formal notification to Commission decision[53]



Source: compiled by the author based on the information on the website of the Commission's Directorate-General for Competition

Figure 7: Length of notification procedures in days (pre-notification and notification)[54]



Source: compiled by the author based on the information on the website of the Commission's Directorate-General for Competition

[53] Reference to cases are given in the Annex.

[54] Cases referred to are given in the Annex. The author has assumed that the date of the notification is the date of notification in the Commission's State Aid Register (https://ec.europa.eu/competition/elojade/isef/index.cfm?clear=1&policy_area_id=1%2C2%2C3), if it predates the date of notification in the decision itself.

When does the Commission refuse to authorise the aid?

Unfortunately, there are many factors that may make it impossible to obtain Commission approval. I highlight below those that are the most obvious ones:

1. If the firm is not considering any alternative sites in its decision-making process because it has an existing site, has established good relations with the authorities, or has sufficient vacant land available for an expansion and, accordingly, plans only a "simple" expansion investment in the existing site without checking any other alternative, there is no chance of a successful Commission notification because it is impossible to prove the incentive effect of the aid given the lack of a credible alternative location.
2. There is an alternative site, but the preferred site is in a more developed region or in a region at the same level of development[55] as the alternative site. In such cases, there is an anti-cohesion effect and the aid will not be authorised by the Commission.
3. The alternative site is more developed, but the financial analyses do not support the need for the aid requested, i.e. the difference between the net present values of the projects on the preferred and the alternative sites is less than the aid requested. In this respect, it is worth pointing out that the Commission will scrutinise the submitted net present value and payback calculations and may carry out its own calculation if it is not convinced that they are well-founded.
4. Finally, it is also possible that the alternative site is more developed and the calculations justify the need for the subsidy, but it was never a real alternative in the company's decision-making process. This is indicated, for example, if the name or country of the alternative site does not appear in any internal decision-making documents of the company and/or the supporting documents are prepared well after the decision on the final location was taken. The situation is even worse if a name of a site appears in the decision-making documents instead of the 'ideal alternative site', which would fail because of the reasons described in points 2 or 3 above.

* * *

To sum up, the notification procedure for a large investment is rather complicated and the conditions for approval are very strict, as the limitation of aid in net extra costs severely limits the amount of aid that can be granted.

A key to a successful procedure is the proper decision-making process of the company concerned and how well it is documented.

It follows from this that large investors hoping to receive aid must be fully aware of the Commission's expectations and comply with them in their decision-making process. Failure to do so could have disastrous consequences for the award of aid, as these documents cannot be produced retrospectively.

[55] Development is measured by the aid intensities set out in the so-called regional aid map. - https://competition-policy.ec.europa.eu/state-aid/legislation/modernisation/regional-aid/maps-2022-2027_en

Annex - List of cases in this article

	SA. number	Title	Decision	Link
1	SA.43014	Aid for REHAU AG + Co.	Notification was withdrawn (no aid was granted)	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_43014
2	SA.43624	Aid to Hamburger Rieger GmbH	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_43624
3	SA.44547	Italy - LIP - Aid to STMicroelectronics s.r.l. (M9)	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_44547
4	SA.45359	Regional investment aid to Jaguar Land Rover - LIP - SK	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_45359
5	SA.45584	LIP - Investment aid to Mondi SCP	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_45584
6	SA.47662	LIP – Aid to LG Chem Wrocław Energy Sp. z o.o.	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_47662
7	SA.48382	Regional investment aid to MOL Petrolkémia Zrt	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_48382
8	SA.48556	Regional investment aid to Samsung SDI - LIP	Formal investigation was opened	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_48556
9	SA.49461	Regional investment aid to NAVIGATOR TISSUE CACIA, S.A. - LIP	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_49461
10	SA.49579	Regional aid to PCAE (Peugeot Citroën Automóviles España S.A.)	Formal investigation was opened	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_49579
11	SA.49580	LIP - Hungary - Regional investment aid to BorsodChem	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_49580
12	SA.53903	Regional Investment Aid to LG CHEM 2 - LIP	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_53903

	SA. number	Title	Decision	Link
13	SA.54226	Regional investment aid to Toray Industries - Hungary	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_54226
14	SA.58633	Regional investment aid to SBKM	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_58633
15	SA.59516	Regional investment aid to Volta	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_59516
16	SA.63328	Regional investment aid to SK Big factory	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_63328
17	SA.63470	Regional investment aid to Rubin NewCo 2021 Kft.	Formal investigation was opened	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_63470
18	SA.101371	Regional investment aid for a large investment project by Goodyear	Approved	https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_101371

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GLOBAL MINIMUM TAX ANALYSIS FROM A TAX INCENTIVE PERSPECTIVE

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April 2023[2]

Keywords: cash subsidy, tax credit, global minimum tax, top-up tax, development tax credit

The OECD pointed out[3] years ago that international tax rules have become outdated and are lagging behind the technological developments of recent decades. In the case of digital services, for example, profits are typically not generated where the company has an actual, revenue-generating presence. The OECD's fight against aggressive tax planning is a long-standing process that in the framework of the initiative against tax base erosion and profit shifting (BEPS), aims to ensure that the taxation of multinational companies is linked to value creation, where they carry on the actual, profit-generating activities.[4]

The aim of this paper is to provide a brief overview of how the GloBE rules deal with state aid.

Framework of the GloBE rules

The OECD has identified a number of action points within the framework of the BEPS project, some of which have been adopted into its legislation by the European Union (e.g. the ATAD rules against tax avoidance practices).

Under pressure from the OECD, as a follow-up to the BEPS project, serious work began under the Inclusive Framework, which brings together at least 130 jurisdictions, where – in the fight against aggressive tax planning – the aim was to develop a Two-Pillar Solution.[5]

The first pillar (Pillar One) refers to the largest and most profitable multinational companies and would redistribute part of their profits between the countries where they sell their products and provide their services, and where their consumers are located.

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[1] Adrienn Miavecz works at Andersen Zrt. The opinion expressed in this article cannot be regarded as the official position of Andersen Zrt.

[2] Published in Hungarian in Állami Támogatások Joga 39 (2023/2) - https://tvi.kormany.hu/download/8/e8/13000/A%CC%81TJ_39.pdf

[3] https://www.oecd.org/tax/beps/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm

[4] https://www.oecd.org/tax/beps/

[5] https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf

The second pillar (Pillar Two), the Global Anti-Base Erosion Model Rules (GloBE), aim to establish a set of rules through which an extra tax would be collected when the effective tax rate of a multinational company is below the minimum level. The 15% global minimum tax thus determined affects a larger group of multinational companies (groups with an annual consolidated revenue of more than EUR 750 million). The rules for Pillar Two's final model were published by the OECD on 20 December 2021.[6]

Under the Inclusive Framework, a common approach to Pillar Two[7] will be followed, as declared by the participating members:

- Members are not required to adopt the GloBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two, including in light of model rules and guidance agreed to by the members.
- Inclusive Framework members accept the application of the GloBE rules applied by other IF members including agreement as to rule order and the application of any agreed safe harbours.

In parallel, in December 2021, the European Commission published its proposal for a directive on a global minimum tax ('the proposal for a directive'). The proposal for a directive is based on the OECD's Pillar Two Model rules and aims to reform tax competition between countries and prevent tax benefits derived from artificially low-taxed jurisdictions.[8]

In 2022, for Pillar Two, the OECD published an explanation of the Model Rules ('Commentary') as well as an illustrative example library to support its application.[9,10]

Finally, in December 2022, EU Member States reached an agreement on the implementation of the second pillar and adopted the proposal for a Directive (the 'Directive').[11]

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[6] Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two) /Tax challenges arising from the digitalisation of the economy – Global base erosion model rules (second pillar) (OECD model rules)

[7] https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf

[8] Council directive on a global minimum level of taxation applicable to multinational groups in the EU, COM/2021/823 Final, hereinafter referred to as the 'proposal for a Directive on global minimum levels of taxation' (Proposal for a Directive)

[9] Tax Challenges Arising from the Digitalisation of the Economy – Commentary To the Global Anti-Base Erosion Model Rules (Pillar Two)

[10] Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Examples

[11] Council Directive (EU) 2022/2523 of 14 December 2022 establishing a global minimum level of taxation applicable to MNE Groups and Large Domestic Groups in the Union (Directive) - https://eur-lex.europa.eu/legal-content/HU/TXT/?uri=uriserv%3AOJ.L_.2022.328.01.0001.01.HUN&toc=OJ%3AL%3A2022%3A328%3AFULL

The Directive stipulates that the introduction of GloBE rules in the Union must be carried out in accordance with the OECD model rules as closely as possible to ensure that the rules implemented at the EU level are also recognized according to the OECD model rules.[12]

The Directive requires the application of GloBE from 2024. Based on the final provisions, the member states have until 31 December 2023 to adopt the GloBE rules into national law and create the implementation rules.

Application and purpose of GloBE rules

The personal scope of GloBE applies to multinational (MNE) or large-scale domestic groups whose consolidated annual revenue reaches or exceeds the consolidated revenue threshold of EUR 750 million in at least two of the four financial years immediately preceding the financial year under review.[13]

The aim of the regulation is to impose a top-up tax (hereinafter referred to as the "Additional tax") through certain mechanisms in cases where the effective tax burden of a company or group of companies in a given jurisdiction is below 15%. In such a case, the jurisdiction will be considered a low-tax jurisdiction and an additional tax liability will arise according to the methods determined by GloBE (Income Inclusion Rule (IIR) and Undertaxed Payments Rule (UTPR)).

The GloBE system provides for several types of exemptions and transition rules. The main rules – without a detailed rule description – are illustrated in the table below:

[12] Directive(6)

[13] Directive Chapter I.2. Article

Table 1 - GloBE subjects, exemptions

Entities covered by GloBE	Excluded organisations	Other exemptions	Transitional measures
MNE Group[14] Consolidated turnover: €750 million or more in the preceding 4 years in at least 2 years	**Entities carrying out activities in the public interest:**[15] Governmental entity, an international organisation, a non-profit organisation, a pension fund **Investment funds:** - ultimate parent investment fund - a real estate investment firm which is the Ultimate Parent Entity	**Deminimis exclusion:**[16, 17] By derogation, if the average qualifying revenue of all group members in the jurisdiction is < €10 million (or they are loss-making) and the qualifying income or loss is < €1 million (or loss)	**Start-upexclusion (first 5 years):**[18] - has group members in up to six jurisdictions; - the net book value of tangible assets held by all its members in all jurisdictions is EUR <50 million;
Large-volume domestic group of companies A purely domestic group with a consolidated turnover: €750 million or more in at least 2 years within the preceding 4 years	An entity that is **owned at least 95% by Excluded Entities** and engages in investment/ancillary activities An entity that **is owned by at least 85% of the Excluded Entity** and derives income from dividends/capital gains or losses excluded from GloBE	**Safe harbour rules:**[19] Top-up tax deemed to be zero if the effective level of taxation fulfills the condition of (internationally accepted) exemption rule	- Transition rule for deferred **tax assets, deferred tax liabilities** and transferred assets[20] - Substance-based income exclusion[21]

Source: Created by author

[14] Directive Chapter I.2. Article

[15] Directive Chapter I.2. Article

[16] The 'de Minimis' Exclusion in this study Globe and not the de minimis aid known from EU State aid rules.

[17] Directive Chapter V, point 30. Article

[18] Directive Chapter IX, 49. Article

[19] Directive Chapter V 32. Article

[20] Directive Chapter IX 47. Article

[21] Directive Chapter IX 48. Article

Calculation of GloBE

In order to determine the relationship between state aid, tax benefits and GloBE, it is necessary to briefly describe the logic and methodology of calculating the tax base and the taxes covered by GloBE (hereinafter: covered taxes).

Effective tax rate[22]

The top-up tax is determined as the difference between the minimum tax rate (15%) and the calculated effective tax rate (ETR).

Thus, under GloBE's rules, an ETR must be calculated for each fiscal year and jurisdiction. ETR is calculated by the following formula:[23]

$$\text{Effective tax rate} = \frac{\text{adjusted covered taxes of the constituent entities in the jurisdiction}}{\text{net qualifying income of the constituent entities in the jurisdiction}}$$

Covered taxes[24]

For the purposes of GloBE, covered taxes are, in principle, direct taxes that a group member records in its financial statements with respect to its income or profits (i.e. corporate taxes or equivalent taxes). To determine what can be considered a covered tax, it is necessary to examine the underlying characteristics of the tax. The tax designation or tax collection mechanism is not decisive for the GloBE classification. Any tax recorded in the financial statement that is charged on the income or profit of the constituent entity is considered a covered tax. However, a tax such as sales tax, which is imposed on gross income or revenue without any deduction, cannot be considered a covered tax.[25,26]

GloBE's system defines certain adjusting items for covered taxes.

From the point of view of tax relief, the following adjustments are relevant (direction of modification indicated by initial sign):[27]

+/- total deferred tax adjustment amount as set out in Article 22 (the amount of deferred tax expense with respect to the generation and use of tax credits)

+ any amount of credit or refund in respect of a qualified refundable tax credit that was accrued as a reduction to the current tax expense,

[22] Directive Chapter V, point 26. Article

[23] Directive Chapter V, point 26. Article 1

[24] Directive Chapter IV, point 20. Article

[25] Commentary on Article 4.2, point 23

[26] Commentary on Article 4.2, item 27

[27] Directive Chapter IV, point 21. Article

- any amount of credit or refund in respect of a non-qualified refundable tax credit that was not recorded as a reduction to the current tax expense

- any amount of covered taxes refunded or credited to a constituent entity that was not treated as an adjustment to current tax expense in the financial accounts, unless it relates to a qualified refundable tax credit

The application of the above modifiers is provided in the remaining chapters of the study.

The GloBE tax base

The denominator of the ETR is the qualifying income or loss of a constituent entity adjusted by items prescribed by GloBE before any consolidation adjustments for eliminating intra-group transactions.[28]

For example, as a main rule, the tax base under GloBE is reduced by dividends or other distribution received or accrued in respect of an ownership interest (the "excluded dividend").

Regarding tax credits, when computing the qualifying income or loss, qualified refundable tax credits should be treated as income. This means that if a tax credit that reduces the calculated corporate tax can be taken into account as a qualified refundable tax credit, then the amount of the tax credit applied to the corporate tax (regardless of the fact that the tax credit does not appear in the P&L statement) must be returned to the tax base.

In calculating recognised profits or losses of a group member, non-qualified refundable tax credits should not be treated as income, but rather treated as a reduction to the covered taxes for the period the refund or credit is claimed.[29]

Qualified refundable tax credit

In the context of GloBE, it is necessary to explain what constitutes a qualified refundable tax credit (QRTC).[30]

QRTC is treated as income by GloBE rules and does not reduce the constituent entity's c overed taxes in the year the tax credit is claimed. The QRTC has beneficial treatment under GloBE, as it is treated as income that results in higher ETR (the ETR is not eroded). However,

[28] Directive Chapter III, point 15. Article 1

[29] Directive Chapter III, point 16. Article 5

[30] Directive Chapter 1 3. Article 38:

"(a) a refundable tax advantage which, by design, is payable to the group member in the form of cash payments or equivalent cash within four years of the date on which the group member becomes entitled to refundable tax relief under the laws of the crediting jurisdiction; or

(b) where the tax reduction is partially refundable, that part of the refundable tax relief which is payable to the group member in the form of cash payments or equivalent cash within four years of the date on which the group member becomes entitled to the refundable tax relief"

non-QRTCs are excluded from income and treated as a reduction to covered taxes in the period the refund or credit is claimed. Therefore, non-QRTCs receive an unfavourable tax treatment for covered taxes, it cannot be included in the numerator for the purpose of calculating ETR.

According to the Commentary, the QRTCs must actually encourage certain business activities, should have practical significance for taxpayers claiming tax incentives (e.g. research and development), and the state must finance the activities/expenditure through these tax incentives, similar to direct state aid. If a tax benefit regime fulfils these conditions, it will be treated similarly to direct government grants (i.e. recognised as income) under GloBE.[31]

According to the Commentary, QRTC must have the following features:[32]

- It must become refundable within four years of granting;
- The unused refund may be payable in cash or cash equivalent (e.g. short-term government debt instruments) that are not exclusively offset against the covered tax;
- If the tax credit only reduces covered taxes, it cannot be classified as a QRTC;
- To the extent that the tax credit system provides for an election for the tax reduction or part thereof in the form of a refund, the tax credit should qualify as a QRTC only to the extent of the refundable portion.

The Commentary also highlights that the refund mechanisms established by tax credit regimes should be of practical importance to taxpayers (qualitative assessment). By way of example, the Commentary mentions that a regime that is exclusively available (or specifically tailored) to profit-making taxpayers may include a refund element. However, practically speaking, profitable taxpayers can never be in a position where their credit exceeds their tax liability and becomes refundable. Conversely, tax credit regimes will not be "non-qualfied" if the credits are typically claimed by profitable taxpayers.

One of the main difficulties is the lack of clear guidance on how to deal with the types of tax credit regimes applicable in each jurisdiction under GloBE.

In October 2022, the OECD published a study (the 'Study') on tax credit schemes and the potential transformation of tax relief regimes for the period following GloBE implementation.[33]

[31] Commentary on Article 3.2.4, point 110

[32] Commentary, Chapter 10, para. 135

[33] Tax Incentives and the Global Minimum Corporate Tax, Reconsidering Tax Incentives After the GloBE Rules https://www.oecd.org/publications/tax-incentives-and-the-global-minimum-corporate-tax-25d30b96-en.htm Retrieved 12 February 2023.

In early 2023, the World Bank also published an implementation study (hereinafter referred to as the Implementation Study), which, among other things, evaluates various tax relief systems from a GloBE compatibility perspective.[34]

Chapter 5 of the Implementation Study provides guidance on individual tax benefits. It points out, however, that the GloBE assessment of a given measure depends on the design of the detailed rules of the specific tax measure.

French R&D tax relief

From the point of view of QRTC, it is worth examining the tax relief scheme that encourages R&D activities, which can serve as an example of a QRTC under the rules of GloBE, since it has a refund mechanism that can give it the character of direct state aid.

France grants companies a tax incentive to carry out research and development activities (Crédit d'Impôt Recherche, 'the CIR'). In addition, the Finance Act 2022 introduced a new tax credit to promote innovation in the country: the Collaborative Research Tax Credit (CICo).[35] CICo brings significant benefits to companies that enter into research cooperation agreements with certified Research and Knowledge Dissemination Organizations (ORDCs).

The scientific or technical research operations eligible for CICo are the same as the ones eligible for the R&D tax credit i.e. fundamental research, applied research and experimental development.

For CIR, the tax reduction is 30% up to a recognised cost of EUR 100 million and 5% above eligible costs of EUR 100 million. For CICo, the tax reduction is 40% for expenditures invoiced by qualified ORDC entities, with an annual limit of €6 million.

The R&D tax credit and CICo can be offset against the corporate income tax payable by the taxpayer with respect to the calendar year during which the expenses are paid. Any excess credit can be carried forward and offset against the tax liability of the taxpayer during the following three years. Credits unused after three years will be refunded to the taxpayer. In addition, for example for start-up companies, R&D tax credits are immediately refundable, i.e. they act as quasi-grants.

There is no official information available on whether French R&D tax benefits qualify as QRTCs in GloBE's system or not, but based on the attributes described above, they have the main characteristics that GloBE prescribes for QRTCs.

[34] https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099500009232217975/p169976034c92506a0a1190bc5e3a05e3ed
Retrieved 2 February 2023. The Global Minimum Tax: From Agreement To Implementation - Policy Considerations, Implementation Options, and Next Steps

[35] Andersen publication, page 36: R&D Incentives Reference Guide, France

Assessment of the Hungarian development tax incentive

The aim of the GloBE reform is to limit international tax competition. Closely related to this objective is that the set of rules will recognise a rather narrow range of tax advantages, thereby preventing international tax competition through tax incentives.

Among the tax benefits provided by the Hungarian corporate tax system, the development tax incentive (DTC) is a particularly important[36] incentive. Its key features, which are relevant to GloBE, are as follows:

- It incentivizes capex-investment.
- The DTC can be claimed from the calculated corporate tax up to a maximum of 80%.[37]
- The taxpayer can utilize the DTC in the tax year following the start-up of the investment - or, upon election, in the tax year of launching the investment - and in the following twelve tax years, up to the sixteenth tax year following the tax year of the notification or submission of the request.
- Unused DTCs cannot be carried forward beyond a specified period and cannot be re-funded.

The DTC - similar to the other corporate income tax credits - does not comply with QRTC requirements as it does not have a refund mechanism that would give it the character of direct State aid. This is confirmed by the *Tax Code 2022/7. - Global minimum tax refundable tax benefits* article[38] that QRTCs are currently not included in the Hungarian tax system.

In practical terms, this means that when utilizing the DTC, the calculated effective tax rate of companies will be lower. A lower ETR may result in an additional tax liability in the form of a top-up tax liability (however, the amount depends on the actual GloBE position).

However, it is important to note that unused tax credits granted prior to the implementation of GloBE are likely to be subject to transition rules.[39]

Transition rules

As a general rule, a deferred tax adjustment that is part of covered taxes should not include (i.e. eliminate) the amount of deferred tax expense with respect to the generation and use of tax credits. However, the transitional provisions of the Directive specify that the deferred tax assets and deferred tax liabilities reflected or disclosed in the financial accounts of all the constituent entities in a jurisdiction for the transition year shall be taken into account (with certain sub-exceptions) in the transition year and subsequent financial years. The deferred tax amount may

[36] Section 22/B of the Act LXXXI of 1996 on Corporate Tax and Dividend Tax (CIT Act)

[37] Section 23 (2) of the CIT Act

[38] https://ado.hu/ado-kodex-folyoirat/

[39] Tax journal 12-13/2022. - Dr. Szilvia Boris Tormáné: Development tax credit, what will happen to you?

be computed at the lower of the minimum rate and the applicable domestic rate (e.g. in Hungary, 9%). The transition provision also provides that the effect of a valuation adjustment[40,41] or accounting recognition adjustment relating to a deferred tax asset shall not be taken into account.

It sets limits for certain categories of deferred taxes covered by the transitional provision. Deferred tax assets arising from items excluded from the computation of qualifying income or loss when such deferred tax assets are generated in a transaction that takes place after 30 November 2021.

Deferred tax assets are recognised in the financial accounts for the carry-forward of unused tax credits to the extent that it is probable that future taxable profit will be available against which the tax credits can be utilised.

Unused tax credits granted will be subject to the transitional provision in principle, i.e. if a deferred tax asset under the applicable accounting system can be recognised in the year of transition, the development tax credit may be claimed through a deferred tax liability (i.e. it would not impair the ETR). This is confirmed by the OECD Administrative Guide ('Administrative Guide') published in February 2023.[42]

Under the Administrative Guide, the deferred tax adjustment rule does not apply to pre-existing deferred tax[43] assets that have been created for tax credits under the transitional arrangements (if the recognition criteria is met).[44]

From the DTC's perspective, this practically means that tax credits claimed prior to the implementation of GloBE, for which taxpayers become eligible, can be brought into the GloBE system through a deferred tax. Those DTCs where taxpayers obtain eligibility after the transition (e.g. notification submitted after the transition) are likely to be lost for taxpayers who fall under GloBE. In other words, in practice, even if the taxpayer under the scope of GloBE claims the tax credit in the corporate income tax, by applying GloBE, it will have to repay part or even all of the tax credit utilized that reduced the ETR in the form of a top-up tax — albeit in a different schedule.

At the time of writing, Hungarian adoption of GloBE rules has not been published, and no domestic legislation is in effect.

[40] Directive IV. Chapter 4(4)(e)

[41] Directive Chapter IX Article 47

[42] Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), 2023 February
https://www.oecd.org/tax/beps/agreed-administrative-guidance-for-the-pillar-two-globe-rules.pdf
Retrieved 5 February 2023.

[43] Directive IV, Chapter 22. Article 5, point (e)

[44] Administrative Guide Chapter 4, comment on point 4.1.2