EUROPEAN COMMISSION

Brussels, 16.01.2015
C(2015) 61 final

PUBLIC VERSION

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Subject: State aid SA.39669 (2014/N) – Hungary – Development tax benefit scheme

Sir,

1. PROCEDURE

1) By electronic pre-notification on 4 August (SA.39292 (2014/X)), Hungary submitted a summary information sheet pursuant to Article 11(a) of the 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[1] (hereinafter "GBER") on the Development tax benefit scheme which it had put into effect on 17 July 2014 in application of Article 1(2)(a) on the Scope of the GBER and Article 14(1) on Regional investment aid of the GBER.

2) This aid scheme, with an average annual State aid budget exceeding EUR 150 million constitutes a large scheme in the meaning of Article 1(2)(a) of the GBER. Under this provision, aid schemes are exempted only for a period of six months after their entry into force, unless a longer period of exemption is authorised by the Commission following the assessment of an evaluation plan for the scheme to be notified by the

[1] Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty.

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Member State concerned. To obtain that prolongation, following preparatory contacts started in July 2014, Hungary notified the evaluation plan for the scheme on 21 October 2014, which was registered by the Commission under SA.39669 (2014/N).

3) By communication of 6 November (2014/112654), 28 November (2014/121332), 5 December (2014/ 124848) and 9 December (2014/126141) 2014 Hungary replied to the information request issued by the Commission on 22 October 2014 (2014/105943), which was followed by further (informal) information requests on 26 November (2014/120184), 2 December (2014/122592), 4 December (2014/123941) and 8 December 2014 (2014/126186).

2. DETAILED DESCRIPTION OF THE KEY ELEMENTS OF THE NOTIFIED EVALUATION PLAN

4) As required by Article (2)(16) of the GBER and in line with best practices recalled in the Commission Staff Working Document on Common methodology for State aid evaluation[2] (hereinafter: "Staff Working Document"), the notified plan contains the description of the following main elements: the objectives of the aid scheme to be evaluated, the evaluation questions, the result indicators, the envisaged methodology to conduct the evaluation, the data collection requirements, the proposed timing of the evaluation including the date of submission of the final evaluation report, the description of the independent body conducting the evaluation or the criteria that will be used for its selection, and the modalities for ensuring the publicity of the evaluation.

i) *Objectives of the aid scheme to be evaluated*

5) This scheme is the most important Hungarian scheme for regional investment aid which provides for incentives in the form of income tax relief. Its general objective is to address the issue of comparatively low level of employment, capital stock and investment in certain activities with positive externalities. The specific objective of the scheme is to encourage sustainable new investments and job creation by beneficiaries, through which to improve the output and productivity of the corporate sector. As a secondary objective, the scheme is also aimed at alleviating regional disparities by regionally differentiating the intensity of support.

6) The scheme is open to companies, both large and SMEs, operating in several sectors (with some exclusions as foreseen in the GBER) that carry out an initial investment in the following manner respecting at least the following criteria:

   a. Tax relief for the large-scale projects (at least HUF 3 billion in general (and at least HUF 1 billion in certain "favoured municipalities" designated in a governmental

[2] Commission Staff Working Document on Common methodology for State aid evaluation, Brussels, 28.5.2014, SWD(2014) 179 final.

decree), if during the four tax years following the first year in which the tax allowance is used:

i. the average number of workers employed (excluding of the workers employed in foreign branches) exceeds the average number of persons employed during the tax year prior to the commencement of the project, or - at the taxpayer's discretion - the mathematical average calculated based on the three tax years before the commencement of the project by at least 150 workers - or 75 workers if the project is started and operated within the administrative jurisdiction of a favoured municipal government specified in the relevant government decree, or

ii. the taxpayer's annualized wage costs (excluding the wage costs of workers employed in foreign branches) are at least six hundred times greater than the amount of the prevailing minimum wage effective on the first day of the tax year as calculated for the tax year - or at least three hundred times greater if the project is launched and operated within the administrative jurisdiction of a favoured municipal government specified in the relevant government decree - as compared to the annualized wage costs of the year preceding the year in which the project was launched, or - at the taxpayer's discretion - the mathematical average of wage costs calculated from the annualized data based on the period of three tax years before the commencement of the project.

b. Tax relief shall be granted for investment projects valued at HUF 500 million or more at current prices implemented by small and medium-sized enterprises, if during the four tax years following the first tax year in which the tax allowance is used:

i. the average number of workers employed exceeds the average number of persons employed during the tax year prior to the commencement of the project, or - at the taxpayer's discretion - the mathematical average calculated based on the three tax years before the commencement of the project by at least 10 workers in the case of small enterprises or 25 workers in the case of medium-sized enterprises, or

ii. the annualized wage costs of small enterprises or medium-sized enterprises are, respectively, at least twenty-five or fifty times greater than the amount of the prevailing minimum wage effective on the first day of the tax year as calculated for the tax year, or - at the taxpayer's discretion -the mathematical average of wage costs calculated from the annualized data based on the period of three tax years before the commencement of the project.

7) Beneficiaries of the scheme can be divided into five categories: companies expanding rapidly by significant investments, companies investing in job creation, SMEs, activities with positive spill-overs and externalities (R&D, environmental protection) and niche sectors such as food technologies and cinematography.

ii) *Evaluation questions*

8) The plan provides the specific questions to be addressed by the evaluation. The questions related to the direct impact of the measure concern whether the scheme brought about additional improvement in the level of investment, employment, gross value added and labour productivity.

9) The indirect impact of the aid scheme should be evaluated through the question of whether the scheme incurred deadweight loss.

10) With regard to the proportionality and appropriateness of the scheme, the plan includes the two following questions: 1) whether the scheme was more cost-efficient than other support schemes and 2) what the additional fiscal dividend of the scheme is in the long run.

iii) *Result indicators*

11) For the purpose of evaluation of the scheme, the following result indicators will be used for the assessment of the impact of the scheme:

a. On investment: annual investment flows, capitalised cost of commissioned assets, change of non-current, non-financial assets;

b. On employment: wages and salaries, average headcount in Hungary;

c. On Gross Value Added: GVA;

d. On labour productivity: GVA/average headcount and GVA/wages.

These indicators are readily available in corporate tax returns.

iv) *Envisaged methodology to conduct the evaluation*

12) The methodology foresees the comparison of result indicators registered for the group of beneficiaries with result indicators registered for a control group, consisting of only non-assisted firms. The companies in the control group would be non-assisted because they decide not to apply for aid, their investment is not in a region that is assisted under the new Regional Aid Map of Hungary[3], or the investment does not meet one or more of the eligibility criteria defined in the scheme, including elements which are not determined by the GBER (such as the job creation or wage increase requirement).

13) The control groups consist of companies that will be "matched" to the beneficiaries and they will be selected according to the following variables: they should be engaged in the same economic activity and be of the same firm size category as the beneficiaries, they should have an employment level that is stagnant or increasing, they must have

[3] SA.37718 (2013/N) – Hungary - Regional Aid Map, OJ C 6.6.2014 p. 1.

benefitted from comparable level of other (not scheme related) support, they must have carried out investments in the evaluation period (or alternatively, the stock of non-current assets must not be decreasing), and they must have financing costs comparable to those of the beneficiaries'. In particular, the inclusion of the two criteria of employment and investments in the reference period is meant to ensure that the control group would not be systematically different from the group of beneficiaries as declining companies characterised by a contraction on assets and/or employment will be dropped from the control group.

14) The comparison will be analysed using the difference-in-differences approach to measure direct impact, deadweight loss, proportionality and appropriateness by employing the result indicators and the covariate indicators (including *inter alia*: economic activity, firm size, employment levels and trends, non-scheme related support, investment or changes in assets or other financial variables that can be retrieved from balance sheets).

15) Control groups will be used for the first three groups of beneficiaries, (see paragraph 7 of this decision, i.e. companies expanding rapidly by significant investments, companies investing in job creation, SMEs). For the last two categories, i.e. activities with positive spill-overs and externalities (R&D, environmental protection) and niche sectors, such as food technologies and cinematography, there will not be any available control group. There will, however, be the possibility of conducting case studies or omit the evaluation for these groups altogether, as these groups are less significant in terms of both numbers and sum of support.

v) *Data collection requirements*

(16) The data will be collected both from the aid beneficiaries of the scheme and from a control group of enterprises on a yearly basis, from corporate tax returns.

vi) *Proposed timing of the evaluation, including the date of submission of the final evaluation report*

(17) After setting up the database, the first set of data referring to 2015 will be analysed in 2016 and annually from that year on. An evaluation committee will be set up by October 2019 which will operate between November 2019 and June 2020. The final evaluation report will be submitted to the Commission by 31 May 2020.

vii) *Independent body selected to conduct the evaluation, or criteria for its selection*

(18) The evaluation will be carried out and supervised by the State Audit Office (SAO) which is independent of the aid granting authority and the Hungarian government. The SAO has expertise in statistical analysis, empirical assessment methods, data management and the national data landscape. Due to its long-standing cooperation and strong ties with the academia, the State Audit Office will draw upon the expertise of universities and research institutions as well.

viii) *Modalities for ensuring the publicity of the evaluation*

(19) The evaluation methodology and results, including a press statement will be made public on the official website of the Hungarian government (www.kormany.hu). Stakeholders, i.e. eligible firms, will be involved through consultation and a series of personal interviews with CEOs. The Ministry for the National Economy can provide access to anonymized micro data in its research room for the purpose of scientific research.

3. ASSESSMENT OF THE EVALUATION PLAN

(20) The correct application of the GBER is the responsibility of the Member State. The present decision on the evaluation plan does not assess whether the aid scheme to be evaluated was put into effect by the Member State in full respect of all applicable provisions of the GBER. It does therefore not create legitimate expectations, nor does it prejudge the orientation the Commission might take regarding the conformity of the aid scheme with the GBER when monitoring it, or assessing complaints against individual aid granted under it.

(21) Only such aid schemes in the meaning of Article 2(15) GBER[4] are subject to evaluation which fall under the provisions of Article 1(2)(a) GBER[5]. The Commission notes that the annual average State aid budget of the aid scheme concerned estimated by Hungary, namely HUF 82.4 billion or approximately EUR 269 million, exceeds the threshold of EUR 150 million set in Article 1(2)(a) GBER. Article 1(2)(a), Article 2(15) and Article 14(1) GBER form the bases for the exemption of the aid scheme concerned from the notification requirement of Article 108(3) TFEU.

(22) As the Commission explained in recital 8 of the GBER, the evaluation of large schemes is required *"in view of the greater potential impact of large schemes on trade and competition"*. The required *"evaluation should aim at verifying whether the assumptions and conditions underlying the compatibility of the scheme have been achieved, as well as the effectiveness of the aid measure in the light of its general and specific objectives and should provide indications on the impact of the scheme on competition and trade."* State aid evaluation should in particular allow the direct incentive effect of the aid on the beneficiary to be assessed (i.e. whether the aid has caused the beneficiary to take a different course of action, and how significant the impact of the aid has been). It should also provide an indication of the general positive and negative effects of the aid scheme on the attainment of the desired policy objective and on competition and trade

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4 *"'aid scheme' means any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be granted to one or several undertakings for an indefinite period of time and/or for an indefinite amount;"*

5 *"schemes under Sections 1 (with the exception of Article 15), 2, 3, 4, 7 (with the exception of Article 44), and 10 of Chapter III of this Regulation, if the average annual State aid budget exceeds EUR 150 million, from six months after their entry into force."*

respectively. State aid evaluation examines moreover the proportionality and appropriateness of the chosen aid instrument.[6]

(23) In the light of these considerations, Article 2(16) of the GBER defines as evaluation plan *"a document containing at least the following minimum elements: the objectives of the aid scheme to be evaluated, the evaluation questions, the result indicators, the envisaged methodology to conduct the evaluation, the data collection requirements, the proposed timing of the evaluation including the date of submission of the final evaluation report, the description of the independent body conducting the evaluation or the criteria that will be used for its selection and the modalities for ensuring the publicity of the evaluation."*[7]

(24) The Commission regrets that Hungary submitted the formal notification of the evaluation plan belatedly, i.e. outside the 20 working day deadline as required by recital 8 of the GBER. As this late notification was the result of a misunderstanding between Hungary and the Commission services, the Commission accepts this late submission. However, this position does not pre-judge the position of the Commission in future notifications of evaluation plans. The Commission considers that the notified evaluation plan contains the minimum elements outlined in Article 2(16) of the GBER. The Commission regrets that Hungary only formally notified the evaluation plan on 21 October 2014 but takes note that preparatory contacts on the plan were launched before Hungary put the aid scheme into effect.

(25) The evaluation plan offers a concise description of the key objectives of the measures concerned, and provides sufficient information to understand their 'intervention logic'. The scope of the evaluation is defined in an appropriate way. The plan also identifies and justifies pertinent result indicators that integrate the evaluation questions for the individual measures concerned, and explains the data collection requirements and availabilities necessary in this context[8].

(26) The evaluation plan sets out the main methods (the "difference-in-differences" method combined with "matching" between undertakings in the treated group and those in the control group) that will be used in order to identify the direct impact of the aid, and explains why this method is likely to be appropriate for the scheme in question[9].

(27) The Commission has raised the issue of using employment level and investment level both as matching indicators and result indicators, but Hungary undertook to use these indicators only to narrow the range of observations and restrict the results only to

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[6] See the best practices outlined in the Staff Working Document cited in footnote 2 (footnote 3, section 2, second paragraph).

[7] Further guidance on evaluation plans is provided in the Staff Working Document cited in footnote 2.

[8] See also the Staff Working Document cited in footnote 2 (section 3.2).

[9] See also the Staff Working Document cited in footnote 2 (section 3.4).

undertakings (in the control group) showing non negative employment and investment trends. The Commission also acknowledges in the present case the inherent difficulty of identifying control groups consisting exclusively of non-eligible firms under the scheme, given that only a small territory (in the capital Budapest and most of the surrounding county, Pest county) is non-eligible under the new Regional Aid Map of Hungary; thus the scheme applies almost to the entire territory of Hungary.

(28) The proposed timeline of the evaluation is reasonable in view of the characteristics of the measures concerned and the relevant implementation periods for projects supported under the scheme. Eventually, the evaluation will provide useful insight relevant for the assessment that the Commission will carry out for any successor scheme.

(29) The characteristics of the proposed body for the evaluation are appropriate in terms of independence and the skills.

(30) The proposed modalities for the publication of the evaluation results are appropriate to ensure transparency and the involvement of stakeholders.

(31) In view of the above, the Commission considers that the evaluation plan meets all the requirements laid down in the GBER, is established in line with the common methodology proposed in the Staff Working Document, and is suitable given the specificities of the large aid scheme to be evaluated.

(32) The Commission notes the commitments made by the Hungarian authorities to conduct the evaluation according to the plan described in the present decision and to inform the Commission of any element that might seriously compromise the implementation of the plan. Furthermore, the Commission notes the commitment made by the Hungarian authorities to fulfil the obligation to transmit the final evaluation report by 31 May 2020. In addition, the Commission reminds the Hungarian authorities that all plans to modify or prolong this aid scheme have to be notified to the Commission.

(33) Therefore, pursuant to Article 1(2)(a) of the GBER, the Commission decides that the exemption for the aid scheme for which the evaluation plan was submitted is prolonged beyond the initial six months until 31 December 2020.

(34) Alterations to this scheme, other than modifications which cannot affect the compatibility of the scheme under the GBER or cannot significantly affect the content of the approved evaluation plan, are pursuant to Article 1(2)(b) of the GBER excluded from the scope of the GBER.

4. CONCLUSION

(35) The Commission has accordingly decided:

- To prolong the exemption for the above scheme under the GBER until 31 December 2020.

- To publish this decision.

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

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Yours faithfully,
For the Commission

Margrethe Vestager
Member of the Commission