



Guidelines on state aid: the basics

South Baltic Programme 2014-2020

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Introduction

The state aid basic guidelines are intended to help the applicants and other programme bodies of the South Baltic Programme 2014-2020 to understand basic concepts and rules of state aid. Providing state aid is usually more time-consuming and difficult than assistance in a way that means it is not state aid. It is very important to think about project's compliance with state aid rules at early stages in order to minimise the worst-case scenario – claw back subsidy. We hope that these guidelines will be helpful. Applicants who intend to pre-assess a project will also receive assistance with these guidelines. We have tried to lay down the information in a simple and clear way.

What is State aid?

State aid rules ensure that public resources are invested well and promote a level playing field. Through dedicated European Commission regulations state aid rules apply to all Member States. Each Member State has to take measures to ensure both efficient and productive way of spending public funds by supporting innovative, high-growth entities and investments which have "added value". Acting that way allows to spend more taxpayers' money in other areas, such as education or health. The state aid regime also prevents governments from providing financial perks to entities in a way which could distort market competition. It removes competition abuses and creates an open and competitive market. The entity activity financed with state aid resources is always privileged on the market. It can offer market products or services at a price lower than other entities and its competitiveness is increased.

Art. 107.1 of the *Treaty on the Functioning of the European Union* (TFEU) defined State aid as

„(...) any aid granted by a Member State or through State resources (...) 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 internal market“.

This definition clarifies different elements which constitute state aid:

- existence of an undertaking;
- financing by State resources;
- grant of an advantage;
- selectivity of the measure;
- potential effect on competition and trade within the Union.

Is this an undertaking? Is this an economic activity?

The state aid rules generally apply only where a beneficiary of the aid is an "undertaking". **Undertaking is defined as an entity engaged in an economic activity**, regardless of its legal status and the way in which it is financed.¹ Thus, status of entity as an undertaking depends entirely on the nature of its activity. The **definition of the undertaking uses only a functional approach** (economic unit). Taking this

¹ Joined Cases C-180/98 to C-184/98 Pavlov and Others [2000] ECR-I-6451, paragraph 74.

into consideration, the key to perceiving an entity as an undertaking is **its activity and not its legal form**. Public authorities and non-profit organisations can also be subject to state aid regulations.

This takes three important consequences:

1. the legal form of an undertaking is not decisive;
2. **the application of state aid rules as such does not depend on whether the entity is set up to generate profit**². Non-profit organizations and public bodies can be undertakings, depending on the activities they are involved in.
3. the classification of an entity as an undertaking always depends on a specific activity.

Economic activity means offering goods or services on a market³. Whether a market exists may differ from one Member State to another and evolve over time. It is not necessary to generate profit to be engaged in economic activity. If other entities in the market offer the same goods or services on a competitive market, this is an economic activity. The distinction between economic and non-economic activity is that any activity consisting of offering goods and services on a market is an economic activity.⁴ What is **decisive is the nature of the activity**.

Is it subject to state aid rules? “The four test”.

There are four conditions which, fulfilled simultaneously by activity, constitute its state aid relevance.

Those are:

1. granting assistance by state or through state resources;
2. favouring certain undertakings (an advantage);
3. selectivity;
4. distorting or threatening to distort competition and affecting trade between Member States.

1. Transfer of State resources

European Structural and Investment Funds are considered State resources as the national government influences the way they are spent. State resources are all the resources of the public sector⁵. Even if resources are not owned by a public authority, but are under public control and are available to national authorities to transfer directly or indirectly to beneficiaries, they are considered state resources. This means that advantages gained directly or indirectly from state resources can constitute state aid. Advantage can be granted to entities performing economic activity on a market and, hence, offering goods or services at a price lower than other entities operating on the same market.

² Joined Cases 209/78 to 215/78 and 218/78 Van Landewyck [1980] ECR 3125, paragraph 21; Case C-49/07 MOTOE [2008] ECR I-4863, paragraphs 27 and 28.

³ A medium that allows buyers and sellers of a specific good or service to interact in order to facilitate an exchange.

⁴ Case 118/85 Commission v Italy [1987] ECR 2599, paragraph 47 to 55; Case-35/96 Commission v Italy [1998] ECR I-3851, paragraph 36; Joined Cases C-180/98 to C-184/98 Pavlov and Others [2000] ECR I-6451, paragraph 75.

⁵ Case T-358/94 Air France v Commission [1996] ECR-II-2109, paragraph 56.

Structural funds, i.e. resources from the European Union, are considered to be state resources if they are transferred by the discretion of national authorities to selected beneficiaries. In case of ETC programmes, the condition that structural funds be used in a discretionary manner is fulfilled.

2. Advantage

Advantage is, essentially, something that an undertaking would not get in the normal course of business.

Only the effect of the measure on the undertaking is relevant, neither the cause nor the objective of the state intervention.⁶

An advantage takes place whenever the financial situation of an undertaking is improved as a result of state intervention or not⁷. The existence of an advantage is not ruled out by the mere fact that competing undertakings in other Member States are in a more favourable position⁸. The presence of an advantage is based on an analysis of the financial situation of an undertaking in its own legal and factual context with and without the particular measure. This means that two counterfactual financial scenarios in a given period have to be assessed *ex-ante* based on a financial analysis.

An advantage takes place when an activity does not generate profit but the market position of an undertaking improves due to the co-financing of its activity.

This is the most difficult criterion to assess. Detailed case-by-case examination is often necessary in order to determine whether an advantage takes place.

3. Selectivity

State measure which favours certain undertakings or the production of certain goods, types of undertakings, sectors or regions is selective. General measures which are effectively open on equal basis to all undertakings operating within a Member State are not selective.

This criterion is always fulfilled in ETC programmes.

4. Effect on trade and competition

The presence of state aid stipulates two distinct elements are necessary to state that public support for an undertaking is prohibited. If the public measure “**distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods**” and “**affects trade between Member States**” it is considered state aid. A measure granted by state is considered to distort or threaten to distort competition when it is liable to improve the competitive position of the recipient in comparison

⁶Case-173/73 Italy v Commission [1974] ECR 709, paragraph 13.

⁷ Commission Decision 2004/339/EC of 15.10.2003 on the measure implemented by Italy for RAI Sp.A, OJ 2004L119, 23.04.2004. p. 1, recital 69; Opinion of advocate general Fennelly, Case C-251/97 France v Commission [1999] ECR-I-6639, paragraph 26.

⁸ Case 173/73 Italy v Commission [1974] ECR 709, paragraph 17.

with other undertakings with which the recipient's competes.⁹ For practical purposes, a distortion of competition is thus assumed as soon as the state grants financial advantage to an undertaking in a liberalised sector where there is, or could be, competition¹⁰.

State measure which is assumed to distort competition is also liable to affect trade between Member States: *"where state financial aid strengthens the position of an undertaking as compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by aid"*¹¹.

When a subsidy granted to an undertaking maintains or increases the undertaking's supply to the local market and makes it more difficult for operators from other Member States to enter this market it can be considered that such a public measure affects intra-EU trade.

It is not necessary to define the market or to investigate in detail the impact of the measure on the competitive position of the beneficiary and its competitors when establishing a distortion of competition or an effect on trade¹².

Don't ignore it. Check it.

State aid can be complicated. To avoid problems and save time in the future it is very important to think about state aid early on during project preparation. The table below will help to pre-assess any project idea in the context of state aid from different perspectives.

It will be beneficial to reconsider both a project idea and its implementation using this tool. It will also benefit you to seek advice and assistance from relevant bodies, e.g. national bodies, Joint Secretariat or Managing Authority.

How to avoid state aid?

There are few possibilities to avoid state aid in a project, e.g.:

- the project can be redesigned so that the activities which meet all four test are removed or replaced by other activities;
- activities can be implemented based on an open competitive tender, which respects EU public procurement rules, meaning also purchase or sell of goods or services at full market value.

You should note that some types of assistance are not state aid, i.e.:

⁹ Case 730/79 Philip Morris [1980] ECR 267, paragraph 11. Joined cases T-298/07, T-312/97 etc. Alzetta [2000] ECR II-2325, paragraph 80.

¹⁰ Joined cases T-298/07, T-312/97 etc. Alzetta [2000] ECR II-2325, paragraphs 141 to 147. Case C-280/00 Altmark Trans [2003] ECR I-7747.

¹¹ Case 288/07 Friulia Venezia Giulia, [2001] ECR I-1619, paragraph 41.

¹² Case 730/79 Philip Morris [1980] ECR 267, paragraph 11. Case 211/2005 Italy v Commission [2009] ECR II-2777, paragraphs 157 to 160. Joined cases T-298/07, T-312/97 etc. Alzetta [2000] ECR II-2325, paragraph 95.

- measures available equally to all undertakings in the same situation in the entire Member State;
- support for general infrastructure projects which are not commercially exploitable and do not benefit specific users e.g. public roads, infrastructure of public use;
- aid to bodies which are not involved in any economic activity.

Table 1. State aid assessment process.

		WHAT DOES IT MEAN?	
CONDITIONS	UNDERTAKING	<ul style="list-style-type: none"> ■ entity engaged in an economic activity ■ functional approach: activity not legal form ■ set up to generate profit and non-profit organizations 	
	ECONOMIC ACTIVITY	<ul style="list-style-type: none"> ■ offering goods or services on a market, nature of the activity 	
	TRANSFER OF STATE RESOURCES	<ul style="list-style-type: none"> ■ any resources of the public sector 	YES
	ADVANTAGE	<ul style="list-style-type: none"> ■ something that an undertaking would not get in the normal course of business, ■ more favourable position, effect of the measure 	
	SELECTIVITY	<ul style="list-style-type: none"> ■ favour certain undertakings or the production of certain goods, not open to all undertakings 	YES
	DISTORTION OF COMPETITION	<ul style="list-style-type: none"> ■ economic activity distorts or threatens to distort competition, favouring certain undertakings or the production of certain goods, ■ economic activity improves the competitive position of the recipient 	
	AFFECTING STATE TRADE	<ul style="list-style-type: none"> ■ more difficult for operators from other Member States to enter the market, ■ economic activity strengthens the position of undertaking 	

Have you answered YES to all questions? → STATE AID

Have you answered NO to at least one question? → NOT STATE AID