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**PUBLIC VERSION**

**WORKING LANGUAGE**

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**Subject: N 177/2007 Slovenia Tax allowance for research and development in Slovenia.**

Dear Sir,

## **1. PROCEDURE**

- (1) By e-mail dated 3 April 2007, registered by the Commission on the same date, the Slovenian authorities notified to the Commission the above-mentioned measure
- (2) By letters dated 12 June 2007 and 19 July 2007, the Slovenian authorities provided additional information in reply to the request of information from the Commission dated 27 April 2007.

## **2. DESCRIPTION OF THE SCHEME**

### **2.1. Objective**

- (3) The aid in question aims at encouraging and supporting fundamental, industrial research and experimental development activities, additional in relation to the normal activities of the companies operating in Slovenia. It is

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granted as a tax allowance at regional level, the actual tax rate depending on the regional development of the area where the company is located.

## **2.2. Legal basis**

- (4) Draft Decree on regional tax allowances for research and development.

## **2.3. Aid instrument.**

- (5) Aid is granted in form of reduction of the tax base. The normal corporate tax rate in Slovenia amounts to 23% of the tax base in 2007 and it will be brought to 22% in 2008, 21% in 2009 and will remain at 20% in 2010 and subsequent years. The State aid at issue is a regional tax allowance, set by law at a maximum of 20% of the normal tax base. The regional tax allowance is applied selectively if firms are based or carry out their activities in areas of the country with a per capita GDP up to 15% lower than the national average (10% of the tax base) or more than 15% lower (20% of the tax base). The tax base can be reduced by up to 20% of eligible costs for research and development and the result is then taxed at a rate of 23%. The regional tax allowance thus comes to a maximum of 4.6% of the tax base (i.e. maximum 20% of 23%).

## **2.4. Budget and duration**

- (6) The annual amount of budget planned is € 6,7 million and the overall amount is €40 million. The aid measure is intended for being applied, as from 1.06.2007 (only in case of approval by the Commission) until 31.12.2012.

## **2.5. R&D stages**

- (7) The R&D stages eligible to receive public financing are the following:
- Fundamental research, that means experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundations of phenomena and observable facts, without any direct practical application or use in view;
  - Industrial research, that is the planned research or critical investigation aimed at the acquisition of new knowledge and skills for developing new products, processes or services or for bringing about a significant improvement in existing products, processes or services. It comprises the creation of components of complex systems, which is necessary for the industrial research, notably for generic technology validation, to the exclusion of prototypes;
  - experimental development, that means the acquiring, combining, shaping and using of existing scientific, technological, business and other relevant knowledge and skills for the purpose of producing plans and arrangements or designs for new, altered or improved products, processes or services. These may also include, for example, other activities aiming at the conceptual definition, planning and documentation of new products, processes and

services. The activities may comprise producing drafts, drawings, plans and other documentation, provided that they are not intended for commercial use.

## **2.6. Eligible costs and aid intensity**

(8) Eligible costs are the following:

- personnel costs;

- costs for building and land, to the extent and for the duration used for the research project. With regard to buildings, only the depreciation costs corresponding to the life of the research project, as calculated on the basis of good accounting practice are considered as eligible. For land, costs of commercial transfer or actually incurred capital costs are eligible;

- cost of contractual research, technical knowledge and patents bought or licensed from outside sources at market prices, where the transaction has been carried out at arm's length and there is no element of collusion involved, as well as costs of consultancy and equivalent services used exclusively for the research activity. These costs are eligible up to a maximum of 70% of eligible costs;

- costs of instruments and equipment to the extent and for the period used for the research project, calculated with respect to the amortization quota and to the duration of the project;

- expenditures for consultancy, for collaboration with universities and research organizations, for the use of laboratories, for the acquisition of patents and know-how;

- overheads directly incurred as a result of the research project;

- other operating expenses, including costs of materials, supplies and similar products incurred directly as a result of the research activity;

- Aid for technical feasibility studies preparatory to industrial research or experimental development activities.

(9) Regarding the aid intensity, the State aid is a reduction by maximum 20% of the tax base, which is then taxed at a maximum of 23%. It corresponds to an aid level of  $0.20 \times 0.23 = 0.046$  (4.6%). No bonuses are foreseen.

(10) The aid in question can not be cumulated with other public aid for the same eligible costs and activities.

## **2.7. Beneficiaries**

(11) The recipients of the aid in question are all firms located in some 87.3 a) areas in Slovenia carrying out research activities. All firms that perform their activities or work in or through business units in Slovenia subject to the regional tax allowances for R&D are eligible to the aid. The foreseen number of beneficiaries is over 1000.

- (12) Companies in difficulty within the meaning of the Community guidelines for the State aid for the rescue and for the restructuring of companies in difficulty<sup>1</sup> are not admitted to the benefits of this scheme.

### **2.8. Incentive effects.**

- (13) According to the Slovenian authorities, the incentive effect will be evidenced at the level of each large company<sup>2</sup> or for SME being granted aid in excess of 7,5 million € before it benefits from aid. The incentive effect will be measured on the basis of quantitative and qualitative variables according to the R&D&I framework (increase in R&D expenditure, increase in the number of staff devoted to research activities and increase in the scope of the research project), and will be communicated to the Commission at the time of the transmission of the annual report on the application of the notified measure.

### **2.9. Evaluation study.**

- (14) The Slovenian authorities have provided an evaluation study on the expected impact of the tax relief in the development of the R&D activities of companies in Slovenia. The study shows that in Slovenia the share of innovating companies (among all companies active in Slovenia) is around 26.9%, one of the lowest in Europe, compared to the average 41.5% in Europe. However, Slovenian companies that do innovate, tend to cooperate significantly with other countries (about 58%), especially European countries (33%). State aid in form of tax reductions can contribute to accelerate and increase the pace of innovation, linking fiscal deductions to research and development activities. According to studies of nine OECD countries every Euro of tax incentives for R&D produces at least one Euro of research and development by business. This study also contains the finding that, in the three countries which make the greatest changes to their tax credits, increases in these credits have led to increases in private R&D activities, while a reduction of credits led to a reduction in firms' R&D expenditure. Tax allowances in Slovenia are basically an instrument which is similar to those in other countries. As the economic environment in Slovenia is similar to that in other Member States of the EU and other OECD countries, Slovenian authorities expect that the incentive effect in Slovenia will also be similar to the results repeatedly obtained from the various studies mentioned above.

## **3. ASSESSMENT**

### **3.1. Legality**

- (15) By notifying this measure before implementing it, the Slovenian authorities have fulfilled their obligations under Article 88(3) of the EC Treaty. Considering the nature of the aid in question, the Commission has assessed it

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<sup>1</sup> Published in the OJ C244 of 1.10.2004, p.2

<sup>2</sup> Non-Sme, cf. point 6 R&D&I Framework

on the basis of the Community framework for state aid for research and development and innovation<sup>3</sup> (hereafter: the R&D&I Framework).

### **3.2. Elements of aid.**

*Direct aid to companies through tax allowances.*

- (16) The notified scheme is financed through the state budget, as it is a reduction of fiscal resources due to the tax allowances and therefore it involves public resources.
- (17) The contributions granted to the beneficiary undertakings constitute an economic advantage because they allow the beneficiaries to reduce the costs that they should normally bear in order to develop their R&D projects.
- (18) Moreover the advantage is a selective one since it only concerns certain firms in certain areas that operate in Slovenia.
- (19) Finally, the measure can also affect trade between Member States, because the beneficiaries participate, or may participate, in such trade thus the measure strengthens their position versus the position of their competitors in intra-Community trade.
- (20) Therefore, the notified measure constitutes aid within the meaning of Article 87(1) of the EC Treaty.

*Indirect aid to companies through cooperative or contractual research with public research organizations.*

- (21) According to point 3.2 of the R&D&I Framework, in the case of collaboration projects carried out jointly by undertakings and research organizations, the Commission considers that no indirect State aid is granted to the industrial partner through the research organization due to the favorable conditions of the collaboration if one of the following conditions is fulfilled (see point 3.2.2. of the R&D&I Framework ): (i) the participating undertakings bear the full cost of the project, (ii) the results which do not give rise to intellectual property rights may be widely disseminated and any intellectual property rights to the R&D&I results which result from the activity of the research organization are fully allocated to the research organization, (iii) the research organization receives from the participating undertakings compensation equivalent to the market price for the intellectual property rights which result from the activity of the research organization carried out in the project and which are transferred to the participating undertakings. Any contribution of the participating undertakings to the costs of the research organization shall be deducted from such compensation.

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<sup>3</sup> Official Journal C 323 , 30/12/2006 P. 0001 - 0026

- (22) In case of research on behalf of undertakings (contract research or research services, see point 3.2.1. of the R&D&I Framework), there will normally be no State aid passed to the undertaking through the research organization, if one of the following conditions is fulfilled: (i) the research organization provides its service at market price; or (ii) if there is no market price, the research organization provides its service at a price which reflects its full costs plus a reasonable margin.
- (23) In this case, the Slovenian authorities have assured that the participating undertakings bear the full cost of the project or pay to the research organizations the market price for their activities and/or the results which do not give rise to intellectual property rights may be widely disseminated and any intellectual property rights to the R&D&I results which result from the activity of the research organization are fully allocated to the research organization. Similarly, in case of research on behalf of undertakings, the research organization provides its service at a market price.
- (24) This would be in compliance with point 3.2 of the R&D&I Framework and therefore the Commission can exclude that any indirect aid is granted to companies through the cooperation with research organisations.

### **3.3. Compatibility.**

#### FORM OF AID

- (25) As requested in point 5.1.6 of the R&D&I framework in respect of fiscal aid measures, the Slovenian authorities have provided an evaluation study to prove that the aid scheme at issue can be expected to have an incentive effect by stimulating higher R&D&I-spending by undertakings.

#### STAGES OF RESEARCH

- (26) Points 2.2 e) f) and g) of the R&D&I Framework provide a definition of fundamental and industrial research and of experimental development activities.
- (27) The Commission observes that the subsidized stages of research in this scheme are only fundamental, industrial research and experimental development activities, pursuant to the definition of Points 2.2 e), f) and g) of the R&D&I Framework and therefore they are compatible with the R&D&I Framework.

#### AID INTENSITIES

- (28) According to point 5.1.6 of the R&D&I framework, the aid intensity of an R&D&I fiscal State aid measure can be calculated either on the basis of individual R&D&I projects or, at the level of an undertaking, as the ratio between the overall tax relief and the sum of all eligible R&D&I costs incurred in a period not exceeding three consecutive fiscal years.
- (29) In this case, aid intensities are calculated on the basis of individual R&D&I projects.

- (30) According to point 5.1.2 of the R&D&I framework, the aid intensity, as calculated on the basis of the eligible costs of the project, shall not exceed: 100 % for fundamental research, 50 % for industrial research and 25 % for experimental development.
- (31) In the case at issue, the aid intensity, as specified in points 5) and 9) above, is well below the maximum thresholds set in point 5.1.2 of the R&D&I Framework. In fact, the tax base of the company can be reduced by up to 20% of the eligible costs. The result is then taxed at a rate of 23% , resulting in a level of aid of 4.6%.

#### ELIGIBLE COSTS

- (32) According to point 5.1.4, the following costs are eligible to aid: personnel costs, costs of instruments and equipment to the extent and for the period used for the research project. costs for building and land, cost of contractual research, technical knowledge and patents bought or licensed from outside sources at market prices, where the transaction has been carried out at arm's length and there is no element of collusion involved, as well as costs of consultancy and equivalent services used exclusively for the research activity, additional overheads incurred directly as a result of the research project and other operating expenses, including costs of materials, supplies and similar products incurred directly as a result of the research activity.
- (33) In this scheme, the eligible costs as described in point 2.6 of the R&D&I Framework are in conformity with those established in point 5.1.4 of the R&D&I Framework. They have to be clearly filed by the company in a form to be presented to the competent authorities in order to obtain the tax allowance. Only up to 20% of eligible costs can be deducted from the tax base of eligible companies.

#### INCENTIVE EFFECT

- (34) According to point 6 of the R&D&I Framework, when assessing an aid scheme, the conditions relating to the incentive effect shall be deemed to be satisfied if the Member State has committed itself to grant individual aid under the approved aid scheme only after it has verified that an incentive effect is present and to submit annual reports on the implementation of the approved aid scheme. For aid below 7,5 million € the incentive effect is presumed to be present in so far as the project has not been started before the grant of the aid. In the annual reports, the Member State must demonstrate how it has assessed the incentive effect of the aid before granting the aid through the use of the quantitative and qualitative indicators given above. The following indicators can be used: increase in project size, increase in scope, increase in speed and increase in total amount spent on R&D&I
- (35) In this specific case, the incentive effect will be measured on the basis of qualitative and quantitative elements, such as: increase in the total project costs (without decreased spending by the aid beneficiary by comparison with a situation without aid); increase in the number of people assigned to R&D&I activities and increase in scope. The companies claiming the tax

relief will fill in a form indicating these elements. The control authority will verify the correctness of the information provided.

- (36) On this basis, the Commission considers the conditions related to the incentive effect are satisfied and the measure complies with point 6 of the R&D&I Framework.

#### ANNUAL REPORTING AND INDIVIDUAL NOTIFICATIONS.

- (37) In accordance with point 10 of the R&D&I Framework, annual reports for R&D&I-aid measures shall contain for each measure, including the granting of aid under an approved scheme, the following information: the name of the beneficiary, the aid amount per beneficiary, the aid intensity, the sectors of activity where the aided projects are undertaken. In case of fiscal aid, the Member State must only provide a list of those beneficiaries who have received an annual tax relief in excess of 200 000 €
- (38) In this case, the Slovenian authorities have undertaken to provide an annual report on the implementation of the scheme at issue, indicating the name of the beneficiaries, the aid amount per beneficiary, the aid intensity and the sectors of activity where the aided projects are undertaken, for those beneficiaries who have received an annual tax relief in excess of €200 000.
- (39) They will also explain in the annual report how the incentive effect has been respected for aid given to large undertakings, notably using the indicators and criteria mentioned in Chapter 6 of the R&D&I Framework.
- (40) In compliance with point 10.1.3 of the R&D&I Framework, whenever aid for R&D&I is granted on the basis of aid schemes without falling under the duty for individual notification, and exceeds 3 million € the Slovenian authorities will also provide the Commission, within 20 working days starting from the granting of the aid by the competent authority, with the information requested in the standard form laid down in the Annex to the R&D&I Framework.
- (41) The Slovenian authorities have undertaken to notify individually the aids above the thresholds indicated in point 7.1 of the R&D&I Framework.
- (42) As provided by point 10.1.2, the full text of the aid scheme will be published on the internet and its address will be communicated to the Commission. The scheme will not be applied before the information is published on the internet
- (43) The Commission can therefore conclude that aid granted for R&D activities complies with the applicable competition rules and it is therefore compatible with the common market.

#### 4. CONCLUSION

- (44) In light of the above, the Commission considers that the aid measure is compatible with the R&D&I Framework which specifies the application of Article 87 (3) (c) in the fields of Research, Development and Innovation.



- (45) The Commission reminds the Slovenian authorities that all plans to alter or modify this aid scheme have to be notified to the Commission.

If this letter contains confidential information, which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: [http://ec.europa.eu/community\\_law/state\\_aids/index.htm](http://ec.europa.eu/community_law/state_aids/index.htm)

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Yours faithfully,  
For the Commission

*Neelie KROES*  
Member of the Commission