



Foreign Direct  
Investment in Central  
and Eastern Europe

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# Foreign Direct Investment in Central and Eastern Europe\*

## Part 1

### Introduction

For many years, a succession of multinational companies have made decisions to invest in or relocate to Central and Eastern Europe. The countries that have found themselves the subject of the amorous advances of such investments have competed vigorously to attract their attention, to get the investor to the altar, and to exchange solemn vows. The process of courtship is long and complex, however, and each of the countries has had to adopt more and more colourful plumage to attract its mate. Since the run up to their accession to the EU in 2004, the presence of an extremely strict and matronly chaperone has cooled things somewhat as the courtship must now take place under the EU's watchful eye.

Enough of marital metaphors – in each case, the “usual suspects” in recent years have been the Czech Republic, Hungary, Poland and Slovakia with their respective fortunes waxing and waning from year to year. With each large investment, the governments and populations of each of these countries wait with bated breath for the decision of the investor. That decision can be vital to a region's (or even a country's) fortunes, and the future employment prospects of hundreds or thousands of people may hang in the balance. A large automotive project, for example, can bring with it a long chain of suppliers, and so enormous financial benefits and jobs to a country.

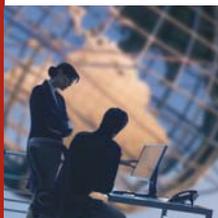
Most investors that we have spoken to undertake a CEE tour, filling in their matrix of factors to take into account in each country, be they labour costs, tax rates, site availability and suitability and, of course, the availability of investment incentives. In view of what is at stake for all parties involved, we consider it vital to try to provide some sort of guide to foreign direct investment (**FDI**) in CEE.

This publication is addressed to senior project managers (and, ultimately, board members) of companies who are considering investing in the Czech Republic, Hungary, Poland or Slovakia (the so-called **Visegrad 4**). It is designed to facilitate decision-making and to begin to draw together information which generally tends to be available only on a country-by-country basis. We recognise of course that investors also increasingly consider other countries in C&SEE, such as the Ukraine, Romania, Bulgaria and Croatia. For the purposes of this publication, however, we continue to focus on the traditional Visegrad 4 – in any event, despite many other attractive features such as low labour costs, none of the Ukraine, Romania, Bulgaria and Croatia has as advanced a programme for the offering of investment incentives, as the Visegrad 4.

#### Warning!

Rules change, time limits and thresholds change, and of course governments change. The information in this brochure will in every case need to be double-checked at all times to ensure that it is up to date.

This publication is not a competition, nor does it seek to portray any country in any more favourable light than another – it simply seeks to set out as objectively as possible some of the key points of interest for an investor looking to invest in CEE.



\* For the purposes of this publication, “foreign direct investment” is used generally in a more narrow sense, i.e. a greenfield or brownfield project in a country, commonly comprising a manufacturing, technological, logistics, research or IT facility or centre.

# Part 2

## Trends in FDI

Various bodies, such as the Economist Intelligence Unit, have observed trends that have taken place in foreign investment in CEE, including, for example:

- the move from traditional manufacturing to service industries (banking, IT, telecoms etc.) in the late 1990s and early 2000s and the recent move back to manufacturing (for example, the recent major FDI in automobile plants in the Czech Republic and particularly Slovakia); and
- subject to the above, the change from predominantly greenfield and brownfield investment to more existing foreign investors reinvesting profits in CEE.

These trends can be prompted by macro-economic conditions or cycles (labour markets and costs being such that Western European manufacturers feel that they simply cannot survive unless they restructure their cost base by moving to a cheaper location), current trends (outsourcing call centres etc.), or political considerations, such as the Lisbon Strategy (see Part 3). In each case, however, the unavoidable conclusion must be that the final decision to invest or relocate can be undertaken only if it makes sound financial sense.

## Recent levels of FDI

According to a survey by Ernst & Young<sup>1</sup>, the region including the Czech Republic, Hungary, Poland and Slovakia together, with Estonia, Latvia, Lithuania and Slovenia (the other four CEE states which acceded to the EU on 1 May 2004), is now regarded by international executives as the second most attractive foreign investment locale after Western Europe and is the most favoured place for investment in the manufacturing industry. 40% of respondents to the survey with declared relocation projects indicated that CEE was their preferred choice, followed by only 22% for China and 7% for India. In relation to manufacturing related projects, the figures were 30% for CEE, 23% for China and only 16% for Western Europe.

This view is supported by the figures produced by the OECD: between 2000 and 2004 the CEE's share of total inward European FDI increased from 17% to 31%, reaching a total of USD 18.8 billion in 2004. In relation to the four states discussed in this brochure, the amount of actual investment in 2004 was USD 1.1 billion in Slovakia, USD 4.2 billion in Hungary, USD 4.5 billion in the Czech Republic and USD 6.2 billion in Poland (*source: OECD*). In fact, according to the Vienna Institute for International Economic Studies and the Economist Intelligence Unit, around 70% of exports in these four states is now accounted for by foreign-owned firms.



<sup>1</sup> Ernst & Young's 2005 European Attractiveness Survey.

## Choosing a country for investment

For any company looking to locate or relocate within the CEE, many different factors may be relevant to the decision of which country to choose; and, depending on the nature of the business and the proposed project, an investor will no doubt give different weight to different factors. A project manager will no doubt be considering a number of possible real estate sites within several countries, be they sites advertised by the relevant countries or sites identified through their own sources. For example, if the project will lead to a high turnover of bulky products it may be crucial for the factory to be situated near good transport facilities, whereas the choice of a site for a project involving research and development or service industries may depend much more on the availability of skilled labour locally. Many high-volume projects, e.g. dealing with steel, will require the site to include a railway siding with access to high-speed rail corridors.

From a country point of view, low labour costs and low tax rates may be crucial. On the other hand, many investors believe that labour costs in traditionally low-cost countries will shortly reach EU norms (though statistics have shown this has not generally been the case), or that another neighbouring country may easily lower its tax rates on demand to match low rates offered in some countries (although this is easier said than done), or that the preferred target country may raise taxes after the next election. With regard to incentives being offered, many investors consider incentives a non-crucial factor, whereas in other projects their availability may directly tip the balance in one country's favour. Clearly, the list of factors to consider will vary widely depending on the requirements of the project and of the investor.

Short of crystal ball gazing, reading tarot cards, consulting oracles and mediating with spirits, the most an investor can do is work out what its key "drivers" are, weigh out those factors, allow some margin for increasing labour costs, take a view on the likely stability of tax rates, work out which site in the end will offer the most realistic prospect of commencing business within the shortest possible timeframe (and with the least potential obstacles) and, where appropriate, negotiate as much "here and now" incentives as comfortably as possible for the purpose of avoiding adverse EU Commission scrutiny. This is not to say that any decision to invest or relocate is speculative, however – detailed planning and research is crucial and no board will, or should, give the go-ahead for an investment unless all of the factors described in this brochure have been vigorously and diligently researched and presented to the board in a coherent fashion.

'... the final decision to invest or relocate can be undertaken only if it makes sound financial sense.'

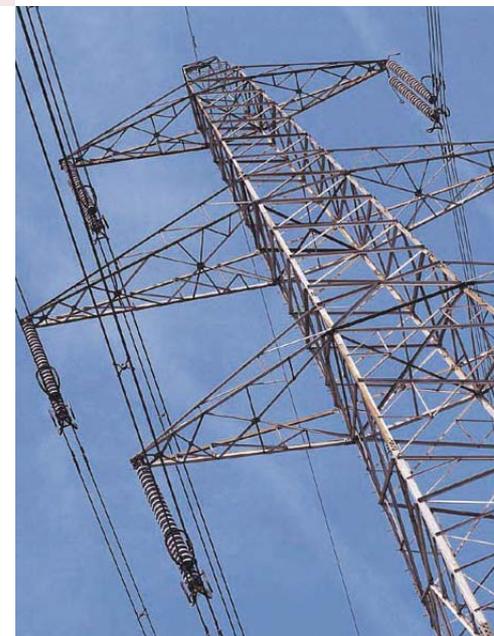


There are areas where lawyers and financial advisers can only provide “soft” guidance. One of these areas is politics. There are numerous examples of investors (all over Europe, not only in the CEE) being sidelined and forced to watch in dismay and frustration as squabbles develop, with politicians scoring points off each other while billion dollar investments wait in the wings. Frequent dismissals of ministers and officials is a turn-off, as are public spats about who has mishandled which investor and why. Clear and decisive action is necessary – otherwise is it surprising if an investor eventually gets tired of waiting and watching and wanders over the border to the gleefully open arms of another country?

We have set out in Table A several factors which may be relevant for an investor. One factor which we have not included is the availability and cost of utilities. In relation to this investors should note that the majority of utility companies in the four states are effectively privatised. Therefore, when considering its contracts for gas, water, electricity etc., an investor should remember that it is dealing with private companies who will not be offering incentives as a state-owned body might.

It is not our role as legal advisers to provide a detailed economic analysis of the issues mentioned below and this type of information quickly becomes out-of-date. However there are a number of sources of up-to-date information and analysis, for example the various state agencies which manage investment, and independent bodies such as the Economist Intelligence Unit, which should always be consulted by an investor to assess the markets in which it is considering investing.

There are, nevertheless, a few aspects of FDI where the involvement of lawyers is crucial. The two main areas are the negotiation and receipt of incentives from the various governmental bodies and the acquisition of the land where the project will be based. We will look at these issues in greater detail in Parts 3 to 6 below.



‘Clear and  
decisive action  
is necessary ...’

Table A: Key factors for FDI investors

Real estate costs	Czech Republic	Hungary	Poland	Slovakia
Cost of land	<i>(This will very much depend on the region in which the investment is planned and the size of the site.)</i>			
Taxes	<p>Transfer tax payable by the transferor at the rate of 3% of the price determined by a sworn expert, or the consideration, whichever is higher.</p> <p>Real estate tax is payable annually. The rate depends on the type of real estate and territory, but is minimal.</p>	<p>Transfer tax of 10% is generally payable upon the purchase of land.</p> <p>Local taxes of up to HUF 900/m<sup>2</sup> or 3% of the adjusted market value as a real estate tax and up to HUF 200/m<sup>2</sup> land tax are also payable.</p>	<p>Real estate tax depending on type, location, purpose and use of real estate, payable annually.</p> <p>Stamp duty payable when submitting official applications or issuing certificates or permits.</p>	<p>No tax payable on the purchase of land.</p> <p>Property tax paid annually on any real estate owned – rate depends on type of real estate and territory.</p>
Construction costs	<i>(These will very much depend on the nature of the project.)</i>			
Taxation	Czech Republic	Hungary	Poland	Slovakia
Corporation tax	24%	16%	19%	19%
VAT (general rate)	19%	25% (20% from 2006)	22%	19%
Personal income tax rate	15% – 32%	18% – 38%	19% – 40%	19%
Export tax	VAT payable on import from a non-EU country, import from EU countries subject to common EU VAT rules.			
Labour issues	Czech Republic	Hungary	Poland	Slovakia
Minimum monthly wage (USD)	291	254	256	200
Average gross monthly wage (2004) (USD)	694	724	503	467
Forecasted average monthly wage in 2009 (according to the EIU) (USD)	969	955	655	711
Social security costs	Approx. 12.5% for employees and 35% for employers.	Approx. 13.5% for employees and 33.5% for employers.	Approx. 48% for employers.	Approx. 28.7% for employers (depending on the type of employment) and 12.4% for employees.
Level of employment protection legislation	Although some strict pro-employee rules prevail, post-command economy style labour codes are being adapted to provide pro-employer flexible working structures. Detailed advice on these issues is available from A&O offices.			
Other employment costs	Detailed advice should be sought, as, for example, the mandatory or typical voluntary retirement, death, disability, and medical benefits paid by employers will depend upon the relevant industry sector and region of investment.			
Recorded unemployment (2004)	9.8%	6.1%	19.6%	14.3%



Availability of support from the state				
<i>Please see Parts 3 to 5</i>				
Availability of EU Structural and Cohesion Funds	Czech Republic	Hungary	Poland	Slovakia
<i>Amount allocated for period 2004-2006 (EUR million)</i>	2,621	3,207	12,810	1,757
Transport	Czech Republic	Hungary	Poland	Slovakia
<i>Road</i>	<i>Highway construction programme to be completed by 2010, to increase coverage to over 1,000km. Currently 518km of highway.</i>	<i>Highway construction programme to be completed by end of 2007, to build 180km of new highway. Currently 494km of highway.</i>	<i>Highway construction programme to be completed by 2013, to build 1,500km of new highway and 1,550km of new motorway.</i>	<i>Highway construction programme to be completed by 2010, to increase coverage to over 800km. Currently over 300km of highway, mostly in the west.</i>
<i>Rail</i>	<i>Currently over 9,600km of railway. Rail network jointly operated by a state-owned body and a public company. Most important railway routes under reconstruction to increase traffic speed.</i>	<i>Currently around 7,800km of railway.  By 2007 the entire rail transportation system should be opened to foreign railway companies.</i>	<i>Approximately 24,000km of railway and 1,500 railway stations mainly operated and maintained by one state-owned company, PKP.</i>	<i>Over 3,600km of railway. Rail network owned by two state-owned companies (passenger and freight service (freight being privatised)).</i>
<i>Air</i>	<i>There are nine public international airports and seven private international airports. Main airports are at Prague, Brno, Ostrava and Karlovy Vary.</i>	<i>Only one international airport at Budapest (being privatised). Several smaller airports can be used for cargo transport.</i>	<i>There are five important international airports, including Frederic Chopin Airport in Warsaw (currently building a new terminal).</i>	<i>The two main airports are Bratislava (in the west) and Košice (in the east) (both being privatised). There are four other international airports which can be used for freight transport.</i>
<i>Water</i>	<i>Linked to European waterway network by a single connection (the Labe Vltava Waterway) allowing access to Hamburg and ports on the Danube.</i>	<i>The Danube is the main means of water transport, but other waterways are used. The main ports along the Danube are Budapest, Dunaújváros, Győr, Csepel, Baja and Mohács.</i>	<i>Border with the Baltic Sea. There is also a plan to join a Polish port to the transeuropean North-South transport corridors, including a connection to Berlin and a connection between Gdańsk and Odessa.</i>	<i>Some use of water transport, mostly along the Danube. Three ports (Bratislava, Komárno and Štúrovo), all on the south-west border. A project to develop the Váh Waterway and a number of new ports is underway.</i>
Access to target market(s)	Czech Republic	Hungary	Poland	Slovakia
	<i>The whole CEE region is situated in the centre of the pan-European market, with each of the four states having particular geographical benefits.</i>			
	<i>The Czech Republic borders the Western European markets of Germany and Austria.</i>	<i>Hungary is closest to the Southern European market, and also has good access to Western Europe through Austria.</i>	<i>Poland borders the major Western European market of Germany and the Baltic Sea, together with access to the Ukraine and the Baltic and CIS markets.</i>	<i>Slovakia has borders with the other three CEE states, and access to the Ukraine and the CIS markets. Its capital city is extremely close to Vienna.</i>

Economic stability	Czech Republic	Hungary	Poland	Slovakia
<i>Forecasted average annual real GDP growth between 2005 and 2009 (according to the EIU)</i>	4.4%	3.7%	4.1%	5.3%
<i>GDP per capita in 2004 (according to the EIU) (USD at market exchange rates)</i>	10,450 (estimate)	10,000 (estimate)	6,344	7,550 (estimate)
<i>Forecasted per capita GDP in 2005 / 2006 (according to the EIU) (USD at market exchange rates)</i>	2005 – 12,520 2006 – 14,480	2005 – 11,160 2006 – 12,100	2005 – 7,730 2006 – 8,260	2005 – 9,710 2006 – 11,280
<i>Inflation (average in 2004)</i>	2.8%	6.8%	3.5%	7.5%
<i>(forecast for 2005)</i>	2.0%	3.8%	2.1%	2.7%
<i>Interest rates (average in 2004)<sup>2</sup></i>	4.75%	6.8%	5.88%	4.8%
<i>Currency</i>	<i>Czech Koruna (CZK)</i>  <i>1USD = 24.7CZK (as at 1.11.05) (source: Bloomberg)</i>  <i>Aiming towards adoption of the Euro in 2010</i>	<i>Hungarian Forint (HUF)</i>  <i>1USD = 208.7HUF (as at 1.11.05) (source: Bloomberg)</i>  <i>Aiming towards adoption of the Euro in 2010</i>	<i>Polish Zloty (PLN)</i>  <i>1USD = 3.31PLN (as at 1.11.05) (source: Bloomberg)</i>  <i>Aiming towards adoption of the Euro in 2012</i>	<i>Slovak Koruna (SKK)</i>  <i>1USD = 32.6SKK (as at 1.11.05) (source: Bloomberg)</i>  <i>Aiming towards adoption of the Euro in 2009</i>
<b>Regulatory framework</b>				
<i>Detailed advice should be sought on the regulations applicable to the particular type of project, for example in relation to the protection of patents and copyright.</i>				

Sources: EUROPA, the Main Statistical Office on Economic and Social Situation in Poland, UKIE, PAIZ, Slovak Statistics Office, Slovak Ministry of Finance, British Chamber of Commerce in Hungary, Hungarytrade, CzechInvest, American Chamber of Commerce in the Czech Republic, OECD, Czech Trade Focus, US News And World, British Chamber of Commerce in Poland, GUS, the Ministry of the Economy and Labour of Poland, the British Chamber of Commerce in Slovakia, eubusiness.com, the Economist Intelligence Unit, the British Embassy in Hungary and Eurostat.

<sup>2</sup> These are likely to have changed for 2005 – please check current rates.

# Part 3

## Focus on incentives I: EU rules

### Introduction

Various countries around the world seek to attract foreign investors by offering them subsidies, tax breaks, preferentially priced land and many other types of financial and non-financial assistance and advantages (**incentives**). Such incentives can be of real benefit to an investor and can play a very important role when deciding where to locate or relocate.

The Visegrad 4 are no different in this respect; nevertheless, following their accession to the EU on 1 May 2004, each of these countries must ensure that any incentives it grants to a specific investor comply with EU law. It would be a fundamental mistake to assume, however, that because the four countries are part of the EU, the incentives they will offer and the procedure an investor will have to follow to receive them will be the same or even similar. Sometimes a simplistic view is that “EU law will dictate that each country may offer the same amount of incentives?”. On the contrary, four very different systems have developed – indeed many countries take pride in treating the offering of incentives as something of an art form which they do better than their neighbours. Some countries (due to budgetary constraints) may offer less than the maxima that the law allows for, whereas others (in their enthusiasm to attract investment) may be tempted to try to offer more than they are legally entitled to offer. It is therefore crucial for any investor considering investing in, or relocating to, one or more of these countries to understand both the underlying EU rules and the different approaches taken in each of the jurisdictions.

In this publication we will concentrate on the rules which are applicable to new investment projects in the four CEE states.



### General prohibition

One of the fundamental principles of EU law is the promotion of competition (or, to put it another way, the prohibition of behaviour which is anti-competitive) within the EU internal market. Each year the European Commission spends a great deal of time and money investigating (and taking to court) undertakings it believes have behaved in a way which is anti-competitive and seeking to prevent companies which have dominant positions in their markets from abusing those dominant positions.

Rather unsurprisingly, the giving of incentives to particular businesses is regarded as anti-competitive by the Commission. Undertakings operating in the same market will be competing on price and the quality and range of their products. If one of these companies is granted aid by a state (be it “free” money, tax allowances or any other preferential treatment) then it will be able to reduce its prices, improve the quality of its products or gain some other competitive advantage without having improved its efficiency or having invested its profit in research and development, for example.



Under EU law there is, therefore, a general prohibition on any Member State granting any kind of incentives capable of distorting competition and affecting trade between Member States; so-called **state aid**. To ensure there are no loopholes, the concept of aid is interpreted by the Commission and the European courts very broadly to cover any public aid that:

- is granted by the state or through state resources;
- confers an economic benefit selectively on the recipient (whether a specific undertaking or a whole sector);
- distorts or threatens to distort competition; and
- affects trade between Member States.

This very broad interpretation leads to the following conclusions: (i) aid granted by state-owned or controlled companies, local or regional authorities or even private bodies (where they are benefiting from/redirecting public resources) is covered; (ii) the purpose of the aid is irrelevant when applying the relevant state aid rules; and (iii) the form of the aid is irrelevant, as both direct and indirect assistance will be covered.

‘... the giving of incentives to particular businesses is regarded as anti-competitive by the Commission.’

When considering the third of these, it is very important to understand that anything offered by a state could constitute state aid and potentially be prohibited, for example:

- subsidies, contributions and grants;
- coverage of all or part of the interest on loans repayable by the aid recipient;
- coverage of part of a debt repayable by the aid recipient;
- temporary financial support;
- issue of a state or bank guarantee;
- a tax or social security payment allowance;
- the sale of immovable assets owned by the state or a municipality at a discount;
- free or subsidised advisory services; or
- rescheduling of tax payments,

and it can never be possible to give a definitive list of everything which could be caught.

## Exemptions

However, the promotion of competition within the internal market is not the only policy promoted by the EU. Another is the improvement of the standard of living in the poorer regions of the Member States to seek to reduce and eventually eliminate the internal disparities of income and opportunity between the regions.

This and other policies have led to a number of exemptions to the prohibition on state aid, including exemptions for aid granted across industries and regions for research and development, training, employment, environmental protection, etc. (**horizontal aid**) and exemptions for aid to facilitate the development of certain economic activities (**sectoral aid**).

These exemptions are interpreted narrowly by the Commission and the courts and any proposed aid must fulfil the following conditions:

- the duration, intensity and scope of the proposed aid must be *proportionate* to the level of intended benefit;
- the outcome of the aid must be *in the Community's interests* and not simply in the interests of the relevant Member State;
- the measures undertaken must *not conflict* with any other provisions of the EC Treaty; and
- the aid must meet the *conditions* set out in the Commission's detailed policy guidelines and must not exceed the limits set out (limits may be the maximum percentage of the investment costs which the state may meet (**aid intensity**) or an absolute maximum figure which the state can grant).

Probably the key exemption for an FDI investor is the exemption for aid to promote economic development in areas where the standard of living is abnormally low or where there is serious unemployment compared to the EU average (**regional aid**). Because the grant of the aid is linked to the region of the investment, the Commission has determined which regions may receive aid and how much aid each of those regions can receive. The current percentage of the total investment costs which may be granted by the state in the regions of the four CEE countries are set out in Table B. Investors should note that the aid intensity figures given in Table B relate to regional aid specifically and that different levels will apply to other types of aid.

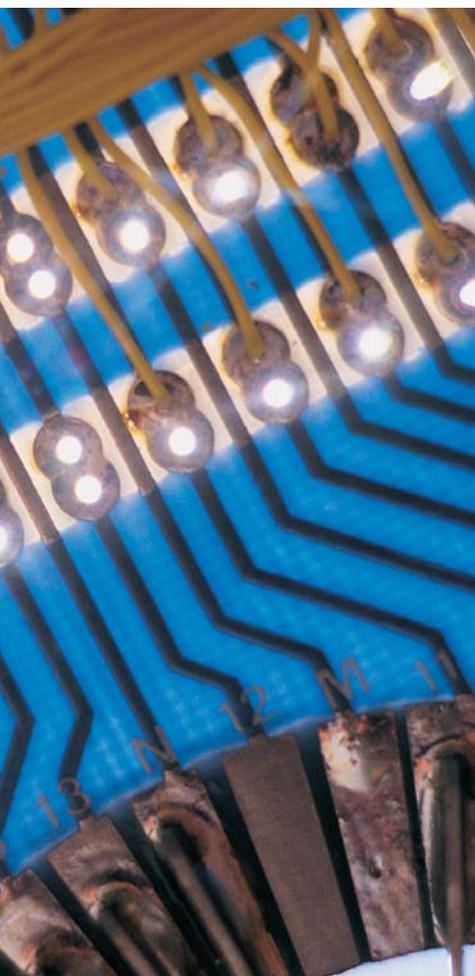
Note that it is extremely important to understand exactly how to calculate the value of the investment costs in determining to which figure the percentages mentioned below should be applied. The costs which may be included in calculating the investment made will depend on the type of aid granted and the type of investment; for example, in relation to a new construction project the eligible costs will include the costs of land, construction and new machinery. Investors should not be tempted to include a wide range of non-eligible costs in calculating how much aid they might be allowed and advice should be taken in calculating these figures, especially as the information provided regarding eligible costs must be transparent, itemised and accompanied by documentary evidence. Beware quoting high headline figures on a proposed project, as this will quickly lead to disappointment and confusion if the eligible costs are far lower.

'Investors should not be tempted to include a wide range of non-eligible costs ...'



Table B: Percentage of investment which can be granted as regional aid by a state<sup>3</sup>

Czech Republic		Hungary		Poland		Slovakia	
Prague	20	Budapest	35	Warsaw	30	Bratislava	20
Jihozápad	46	Pest County	40	Poznań	30	West Slovakia	50
Severovýchod	48	West-Dunántúl	45	Gdansk-Sopot-Gdynia	40	East Slovakia	50
Jihovýchod	48	North-Hungary	50	Wrocław	40	Central Slovakia	50
Střední Morava	49	North-Alföld	50	Kraków	40		
Severozápad	49	South-Alföld	50	Rest of Poland	50		
Střední Čechy	50	Mid-Dunántúl	50				
Moravskoslezsko	50	South-Dunántúl	50				



‘Beware quoting high headline figures on a proposed project ...’

There is particularly good news for small or medium-sized enterprises<sup>4</sup> looking to invest in any of these regions as, under EU law, the percentage of the investment which a state may grant as aid is increased by a further 15% (except in relation to areas with a higher standard of living (for example Bratislava and Prague) where the increase is only 10%). For large-scale investments<sup>5</sup>, however, the percentage of the investment which a state can make will be *decreased* depending on the size of the investment (i.e. the larger it is, the smaller the percentage a state can grant – see the “Multisectoral framework on regional aid for large investment projects”). There are also EU rules relating to economically sensitive areas (e.g. the automobile and steel industries) where the percentage of investment which can be made by a state is reduced or aid may be prohibited.

#### Training aid

A further exemption which an FDI investor may well want to take advantage of is the exemption for training aid, under which a state may grant aid for the training of employees. Again, the percentage of the investment costs which the state may pay will depend on a number of factors, including the type of training, the size of the enterprise and its geographical location. As mentioned above, the eligible costs which can be used to calculate the investment made by the investor are specified and include the trainers’ and trainees’ personnel and travelling costs and the cost of materials and supplies used for the training.

The advantage of this type of aid is that, provided it meets all of the criteria in the relevant Commission regulation and does not exceed EUR 1,000,000, it does not have to be cleared by the Commission and must only be notified (see below).

<sup>3</sup> The EU is divided into different NUTS (Nomenclature of Territorial Units for Statistics) regions; there are NUTS I, NUTS II and NUTS III regions; the intensity of regional aid depends on NUTS II regions, which are territories with a population of between 800,000 and 3,000,000.

<sup>4</sup> Enterprises which meet the following criteria: (i) having fewer than 250 employees; (ii) having either an annual turnover not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million; and (iii) being independent.

<sup>5</sup> Investment projects with deductible costs of at least EUR 50 million.

## Notification and clearance

There are two systems under which aid may be granted to an investor by a Member State: either individual aid can be given or aid can be given under an aid scheme. In essence, an aid scheme is set up by the Member State and sets out the aid which investors will receive and the conditions which they will have to meet to receive it. The scheme is submitted to the European Commission for approval and once that approval is received, any grant made in accordance with the rules of the scheme does not need further clearance from the EU (although the relevant Member State will have to submit a description of the aid to the Commission after it has been granted). Two examples of the use of aid schemes are in the Czech Republic and Hungary and details of these schemes can be found in Parts 4 and 5. To some extent aid schemes are also used in Poland.

Any Member State intending to grant individual aid must notify the proposed aid measures to the European Commission and must refrain from implementing those aid measures until Commission clearance has been issued (the so-called **stand-still** obligation), unless the aid does not exceed EUR 100,000 over a three-year period (the **de minimis** exemption), falls within the training aid exemption, or falls within one of a number of other specific narrowly defined exemptions (details of which can be obtained from our local offices), when only a summary description of the aid must be submitted to the Commission within 20 working days following the implementation of the aid.

Where the usual notification and clearance procedure applies, the Commission may respond in two ways to an application for clearance:

- grant clearance to the proposed package of aid; or
- launch an in-depth investigation of the proposed aid measures.

An investor should be aware that an in-depth investigation may take up to 18 months and may have one of three results:

- the aid package may be granted clearance;
- aid may be granted clearance provided that certain amendments are made to the package (for example reducing the amount of aid, altering the timing of aid etc.); or
- clearance may be refused.

In the second or third of these scenarios either the investor or the relevant state may appeal against the decision within the relevant time limit, although any investor must be aware that this can be a very long and expensive process.



‘... the Lisbon Strategy encourages investments in research and development and innovative technologies ...’

'If the Commission concludes that the aid cannot be exempted, it *will* issue a decision to the state directing it to recover the aid *from the recipient investor ...*'

## A change in strategy

Given the constantly changing nature of the world economy and the changes taking place within the EU itself, the Commission's approach to state aid has altered over time. Over the last few years, the Commission has become very aware that the EU currently invests much less of its GDP in research and development than the US, Japan and its other main "competitors". It has therefore introduced the so-called Lisbon Strategy which encourages investments in research and development and innovative technologies, rather than into straightforward manufacturing. This change in strategy applies to the approval of state aid and it is intended that the specific rules relating to state aid for research and innovation will be updated in 2005 and 2006.

## Why should an investor care?

The investor may believe that it does not need to care about these EU rules, as it is the state which is prohibited from granting illegal aid and which must seek clearance, but that would be to take far too simplistic a view.

As mentioned earlier, it can also be tempting for an eager state to offer more incentives than it should and for an eager investor willingly to accept what is offered; however, this could be fatal to the success of a project, and investors should beware.

If incentives are not properly notified or are granted before the Commission's investigations are completed and clearance has been given (i.e. in breach of the standstill obligation), the Commission has the power to request information from the state which granted the aid. The Commission may issue interim injunctions requiring the state to suspend the payment of any aid until the Commission has ruled on its compatibility with the relevant rules. If the Commission concludes that the aid cannot be exempted, it *will* issue a decision to the state directing it to recover the aid *from the recipient investor*, together with interest at a commercial rate running from the time the aid was granted. The really bad news for an investor is that it is unlikely to be able to rely on its presumption that the aid was properly notified and cleared, and there is a 10-year limitation period for the recovery of unlawful aid. Aid possibly granted unlawfully may be brought to the Commission's attention by the recipient's competitors, who may also bring claims in national courts, seeking damages for the competitive detriment they suffered from the grant of the unlawful aid.

Even if the state represents to the investor that such investment does not constitute prohibited state aid, the investor should never blindly rely on this as, if the relevant state is wrong, the investor is unlikely to have any recourse. Even if it could build a legal case against the state, most investors would wish to avoid, for practical and many other reasons, suing the country where the investor has made a large investment (though this option cannot always be ruled out). And even if the investor brought and won a claim, it could well be argued by the Commission that any damages awarded were also state aid, again repayable by the investor.

## Clearance

As mentioned above, if an investor has decided to invest in a particular region and has structured its project around receiving incentives from the state, it is crucial that those incentives are cleared by the Commission, if clearance is required; if the incentives package is not cleared, the investor may need to reconsider the site of its investment or the structure and timeframe of the project, thereby incurring further costs and wasting additional time.

It is therefore crucial for any investor to take sufficient time both before approaching a state for aid and while agreeing a package of incentives to really consider whether the incentives granted to it will be cleared and how to present the project and incentives to ensure they are cleared.

First, as any aid granted by the state (even regional aid which could fall within the exemption) could distort competition, it will only be cleared if it genuinely promotes the EU's policy of improving the economic balance between regions of the EU. Therefore, when the investor presents its project to the relevant state and when the state submits its application to the Commission, there must be real focus on the benefits to the region which the investment will bring. Although it is natural that any investor will be concentrating on the advantages to its business, it must be able to show that it and its project would be competitive even without the proposed incentives and that any benefits it receives will only be a necessary side-product of, and significantly outweighed by, the benefits for the region. *If the Commission believes that the main reason for the investor's relocation is that it will receive aid and that, without it, the investor could not operate and be competitive in the market, the Commission will not give clearance.*



It is essential that the investor, and not only the relevant state, focuses on this, as most (around 90%) of the information which must be notified to the Commission relates to the investor and its project. It is crucial that it is presented in the correct way and, of course, given the change in strategy of the EU (and the almost certain change in strategy of the governments in the Visegrad 4 states), it is always a good idea for a potential investor to emphasise any research and development, technological or innovative aspects of its project.

Secondly, where the investor is a big player in its field and has a dominant position in its market (especially if supply exceeds demand) it would be very difficult, if not impossible, to persuade the Commission to give clearance to incentives granted to such an investor. The Commission would take the view that any incentives granted to a dominant market player would help to strengthen its dominant position and potentially drive competitors out of the market. It would be very difficult to argue that such a distortion of competition was outweighed by the benefits to the region invested in.

Depending on the investor's circumstances and well before any detailed discussions with the relevant state agencies, it can really be worth an investor instructing specialist EU lawyers, who can analyse the relevant market and the investor's position within that market. Spending time and money investigating these issues can save a lot of wasted time and money dealing with the state agencies and arguing with the Commission if it is clear from the outset that aid will never be granted clearance.



‘... there must be real focus on the benefits to the region which the investment will bring.’



#### **Other support offered by the state**

When an investor approaches a state for incentives and agrees on a site for investment, the state may offer to carry out works which, although not specifically targeted at the investor’s project, will be of significant benefit. For example, it may offer to build roads which link the investment site to the nearest highway or improve telecommunications or utilities connections, which it does not consider to be aid because this infrastructure could be used by businesses other than the investor. Remember though, it will never be enough to prove only that third parties would be entitled to use the roads, telecommunications etc.; rather the investor must be convinced that others will use them. It must be clear that these are not being built solely for the advantage of one investor.

#### **Conclusion**

The risk of misunderstanding the rationale behind the exemptions from the prohibition on state aid (i.e. understanding why the proposed investment may be entitled to receive incentives), getting the required information wrong, not taking into account the relevant timing and deadlines, or misjudging the approach of the Commission could have consequences that would be disastrous for a company which is investing or relocating for important strategic and financial reasons.

Once again, the crucial issue is for the investor to analyse the facts and the related legal issues before agreeing to make any investment. Time spent analysing the offered improvements and their benefit to other parties is time (and money) well spent.

# Part 4

## Focus on incentives II: incentives available in CEE

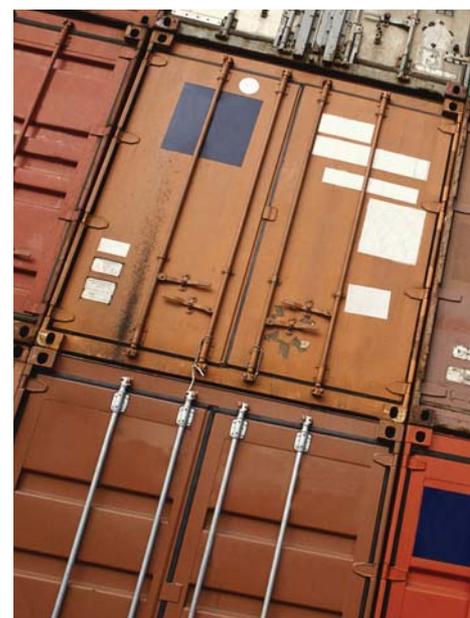
It is worth reiterating, as will become clear, that each of the four CEE countries has a very different approach to granting incentives. An investor should not fall into the trap of assuming that the incentives available or the application process in a particular state will be the same as in the other three CEE countries. Individual agencies will have official or unofficial guidelines which may or may not have the force of law.

We do not propose to give a detailed explanation of all the types of aid provided in each jurisdiction or the conditions an investor must meet to receive them – what will be available to a particular investor will depend on many different factors and detailed advice on the incentives available should always be sought. We have therefore sought instead to provide a guide to the overall approach taken to incentives by each country and to give an idea of what might be available.

However, before considering the approach taken in each of the four CEE states, there are some general points which an investor in any of the four states should consider:

### Presenting your project

Whichever country the investor is considering investing in, it will need to prepare a detailed plan of its project, setting out, amongst other things, the nature of the project, the investment it intends to make (how much and into what), the jobs it intends to create (how many, what types, when and for how long), the technological benefits of the project and the research and development aspects of the project. It is crucial that the investor does this very early in the process as the description of the project will affect what incentives the investor can receive, it will be the benchmark against which receipt of incentives is measured and it will help the relevant state agency to explain the proposed incentives package to the Commission and local governmental bodies and committees.



‘... dealing with the state ... is different to dealing with any other commercial party.’

## Dealing with the state

It will come as no surprise to learn that dealing with the state in one of these four CEE states is different from dealing with any other commercial party. First, the scope of the state's room for negotiation will be limited by many factors, including national and EU legislation, national and in-state regional policies, the budget, the requirement to have any decisions approved by various governmental bodies and committees and the need to "sell" any decisions to the public. There may be political tensions involved.

Secondly, any process which involves state agencies and the European Commission will be inherently bureaucratic and may become long and drawn out. Any investor must be prepared to take the inevitable delays in its stride and potentially factor these into the timeframe for its project. On the other hand, taking early advice and being scrupulously organised can significantly help to reduce delays and to help keep projects on track.

Finally, there is a more general point. As most investors are aware, dealing with parties in different jurisdictions requires an understanding of the differences in culture, styles of negotiation and approaches to decision-making. It is worth taking time to talk to other local contacts, such as commercial sections in embassies, chambers of commerce and, of course, local lawyers, financial and tax advisers and accountants, to get a feel for any important factors which should be considered.



'Any investor must be prepared to take the inevitable delays in its stride ...'

## Financing your project

As a major undertaking, usually operating in numerous jurisdictions, it is likely that any FDI investor will have already considered, if not decided on, the structure of the financing of the project even before it discusses incentives with the relevant state agency.

For tax, corporate or structural reasons the investors may have decided, for example, to:

- manage the project through a local vehicle or a foreign operating company;
- fund the project through intra-group loans, bank debt or equity investment in a local vehicle; and/or
- have the buildings and assets used in the project owned by a local company or by a foreign parent and then leased to the local vehicle.

It could therefore come as a very nasty surprise for an investor to discover that, while a state is willing to offer incentives, it will only do so if the project is funded a certain way and if assets are owned within the jurisdiction. If this is likely to be an issue for an investor it should be raised with the relevant state as early as possible. Many of the countries have a requirement that the project company must be a company incorporated in the relevant jurisdiction – it is questionable whether this requirement is compliant with EU law, but in practice most investors usually comply with this requirement anyway.

‘... it will always be worth an investor investigating the availability of such funding ...’

### EU structural funding

Whatever the rules in a particular country regarding the grant of incentives out of national government funds, an investor should also consider the availability of EU structural funds. These are central EU funds allocated to regions with lower than average GDP to help improve the standard of living. As the four CEE states have some of the poorest regions in the EU, they will each be entitled to quite significant amounts of structural funding over the next few years.

This funding can be used by the relevant state in a variety of ways, to support specific regions, programmes and businesses. As one example, in the Czech Republic in 2004 – 2006, the following programmes (among many others) have been set up:

- **programme for infrastructure for industrial research, development and innovation** – providing grants to Czech companies to assist with the establishment of science parks, centres for technology transfer and other links between research and development and industry;
- **programme for the development of business infrastructure** – providing grants to municipalities, developers and SMEs to upgrade the quality of existing and new business sites and industrial zones; and
- **start programme** – providing preferential interest-free loans for small enterprise start-ups.

We do not propose to give full details of all the programmes funded in each country as they are numerous and complex. However, it will always be worth an investor investigating the availability of such funding, either because it is able to benefit directly or because the region it is looking to invest in will do so. Advice on the availability of such funding will be available from the relevant state body and local lawyers, although one issue an investor should always bear in mind is that the allocation of EU structural funding will still be subject to the general EU rules on state aid described in Part 3.



‘... as long as investors stay within the aid schemes they can avoid the lengthy and costly procedures before the European Commission.’



## Czech Republic

In the Czech context, it is important to distinguish between state aid in the broad sense and “investment incentives”. All investment incentives represent state aid, but not the other way round. Under Czech law, “investment incentives” is a technical term used for describing certain specific forms of state aid granted under special pieces of Czech legislation<sup>6</sup>. However, it is possible that state aid could be granted to attract foreign investors on an individual basis, which goes further than the investment incentives allowed under the existing investment incentives schemes. Such aid would therefore fall outside the framework of the relevant Czech legislation, but this is rarely (if ever) used.

Investment incentives in the narrow sense represent so-called Czech “aid schemes”. These were approved by the European Commission upon the accession of the Czech Republic to the EU. Consequently, these incentive measures are considered automatically to fulfil all the requirements and conditions applicable under EU law, without clearance by the European Commission being required. The process of applying for, and being granted, these investment incentives therefore remains in the competency of the Czech Republic and it is transparent and effective. For more details on the procedure, please refer to Part 5.

Due to the qualities of the currently available investment incentives schemes in the Czech Republic (for details, see below), all major investment projects since the introduction of the incentives schemes have been granted aid on the basis of these schemes. The main reason for this is that, as long as investors stay within the aid schemes, they can avoid the lengthy and costly procedures before the European Commission. Nevertheless, should the investor require special individual treatment, it is theoretically possible to negotiate with the Czech state on a case-by-case basis. However, if the individually negotiated aid goes further than the available investment incentives schemes, the individual aid would have to be notified to, and cleared by, the European Commission and would be subject to its discretion. Furthermore, the currently available incentives schemes try to offer investors the maximum amount of aid permitted by the EU state aid framework. As a consequence, it is uncertain whether the EU would clear an attempt by an investor to benefit from a higher level of state aid unless exceptional circumstances applied. Finally, in relation to this, we have also been informed by CzechInvest, the Investment and Business Development Agency in the Czech Republic, that it does not envisage that in practice aid will ever be granted outside the aid schemes described below.

‘The grant of incentives in the Czech Republic usually follows a very structured approach ...’

<sup>6</sup> i.e. incentive measures granted e.g. under the Act on Investment Incentives or the Framework Programme for Support of Technology Centres and Centres of Business Support Services, as described.

## General structure of incentives

The grant of incentives in the Czech Republic therefore usually follows a very structured approach, with the incentives available to a particular investor depending on specific legislation (working within the framework EU rules that were described in Part 3) dealing with the specific industry sector in which the investor operates. Given this very structured approach and the lack of any real negotiation between the Czech state and the investor, it is possible for a quite detailed picture of the incentives an investor might receive to be provided by local lawyers.

In general, the Czech Republic offers incentives in two major sectors, namely the manufacturing sector and the business support services and technology centres sector. As the incentives available and the conditions which the investor must meet to receive incentives in these sectors differ, it is crucial for an investor to consider what type of project it has and whether it meets the relevant legislative conditions before trying to determine what incentives it might receive.



'... it is crucial for an investor to consider what type of project it has ...'

## The manufacturing sector

Under the Act on Investment Incentives, the basic conditions that an investor's project has to fulfil to qualify for incentives to be granted are:

- it must launch a new production, expand existing production or modernise it for the purpose of a fundamental change in a product or production process;
- there must be an investment of at least CZK 100 million/CZK 150 million/ CZK 200 million (depending on the region where the investment project is made) into the acquisition of long-term tangible or intangible assets. At least half of this amount must be an equity investment by the investor;
- a minimum of 40% of the total investment must be in the form of an investment into machinery, with the overall investment objective of installing a new production line, expanding an existing one or modernising the production process;
- the investor must keep the investment for at least five years following the fulfilment of the general conditions (the same applies for job creation grants where the investor must keep the number of newly created jobs for at least five years from the date on which the grants are first applied for); and
- the investment project must be environmentally friendly and comply with all Czech requirements on environment protection.

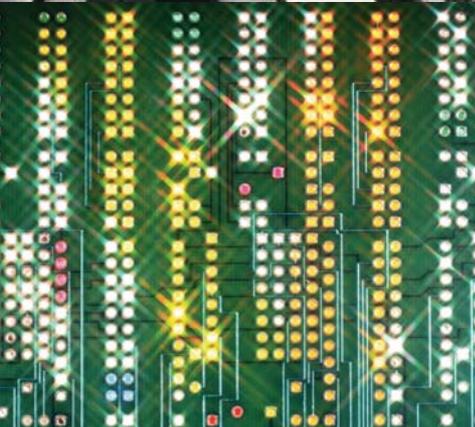
The incentives specified under the relevant legislation are: (i) tax incentives (corporate tax relief for up to 10 years); (ii) job creation grants; (iii) training and retraining grants; and (iv) site support (transferring of public land at a favourable price).



The investor can apply for corporate tax relief only after having fulfilled the general conditions for the granting of incentives and special conditions for the granting of corporate tax relief. This application can be made within three years from the date on which the incentives were granted. Therefore, for example, an investor who fulfils the general conditions in the first or second year from the date incentives were granted could nevertheless wait until the third year and begin applying the tax relief in this tax period. This may provide the investor with the flexibility to apply the tax relief in the period where it will be most efficient to do so. Once three years have passed, the 10-year tax relief period will begin to elapse automatically, regardless of whether the investor has made a profit or loss. This tax relief is available, in slightly different forms, both to new legal entities established to carry out the investment and for the expansion or modernisation of existing companies.

The level of job creation grants depends on the unemployment rate in the area where the investment project is made. The grants available range from zero (in areas where the unemployment rate is below the national average) through to CZK 100,000 per employee (in areas where the unemployment rate is more than 25% higher than the national average) to a maximum of CZK 200,000 per employee (in areas where the unemployment rate is more than 50% higher than the national average).

The level of training grants is calculated in a similar way to job creation grants. However training grants are not awarded at a set amount per employee, but as a percentage of the costs of the relevant training, according to a pre-determined matrix. So, for example, where the unemployment rate exceeds the national average by 25%, the investor will be awarded 35% of the expenses it spent on the qualifying training.



### Technology centres and business support services

Incentives in this sector are governed by the Government Decree on the Framework Programme for Support of Technology Centres and Centres of Business Support Services and are available to:

- **Technology Centres** (software development centres, expert solution centres and headquarters); and
- **Business Support Services** (call centres, high-tech repair centres, shared services centres, etc.).



As Business Support Services constitute services with very high added value supporting the employment of highly educated professionals, and as Technology Centres represent centres for innovation activity, a different set of requirements applies to them from those that apply to the manufacturing sector. These aim to strengthen the Czech Republic's position in the global information and technology arena.

To qualify for incentives in these sectors, investors must make a minimum investment and create a minimum number of jobs. The minimum investment for Technology Centres is CZK 15 million, of which CZK 7.5 million must be financed from the investor's own resources. The minimum requirement for newly created jobs is 15. The minimum investment for Business Support Services is CZK 30 million, of which at least CZK 15 million must be financed from the investor's own resources. The minimum requirement for newly created jobs is 50.

If those conditions are met, the investor will be offered a subsidy for business activity which covers certain operational costs related to the project and/or a subsidy for training and retraining expenses.

The subsidies for business activity are granted for a five-year investment in assets or for two years' salary for employees employed within the first three years.

In relation to the subsidy for training and retraining, there are specific rules about what may be considered retraining expenses. These can include, for example, energy consumed during the training, travel expenses of trained and retrained employees, depreciation of tangible and intangible fixed assets used for training and retraining, and certain labour costs associated with the training. There is also a structure for calculating the maximum amount that can be counted as retraining expenses. The level of subsidy of these expenses then depends on whether the training will constitute "specific training" (subsidised at 35%) or general training (subsidised at 60%).

If the investor creates 100 or fewer new positions, the subsidy covers the training costs for three years with a maximum of CZK 100,000 per new position. If the investor creates more than 100 new positions, the subsidy covers the training costs for five years with a maximum of CZK 150,000 per new position.

'... the Czech Republic also runs a programme for job creation in the regions worst affected by unemployment.'

## Job creation support programme

As well as the incentives detailed above, the Czech Republic also runs a programme for job creation in the regions worst affected by unemployment.

The conditions that the investor must fulfil to qualify under this job creation support programme are:

- the investment must introduce new production or the provision of specific services (customer support centres or shared service centres) or the expansion of existing production or the provision of existing specific services;
- the investment project must be situated in a region where the average unemployment rate exceeds 14%;
- there must be a minimum investment in tangible and intangible fixed assets of CZK 10 million, from which CZK 5 million must be covered by the investor's own capital; and
- a minimum of 10 new jobs must be created.

An investor may be offered financial support for the creation of new jobs or for the training or retraining of employees. Financial support for the creation of new jobs may be provided at a rate of CZK 200,000 per newly created job. Financial support for the training and retraining of employees may be provided at a rate of 35% of the training expenses, up to a maximum of CZK 30,000 per newly created job. The grants are provided by the government on one of two dates each year, following satisfactory provision by the investor of proof and details of the relevant expenditure.

### Industrial parks/economic zones

Whilst the national government does have a programme to encourage similar types of business to locate their activities in certain areas of the Czech Republic, this does not take the form of "economic zones" as such, in that there are no special zones which benefit from a special legal status (and associated special laws).

Instead, the national government may work with municipalities to try to encourage development in certain areas through maximising the synergies available to businesses that choose to locate in that area by, for example, infrastructure projects, or land clearances which make areas more suitable for a particular type of industry. As noted in Part 6, municipalities may also seek to sell land to investors at preferential rates to encourage investment in particular areas. On a strategic level this may tie in with national projects to increase further the attractiveness of certain areas.

# Hungary

## General structure of incentives

While there is no legislation which applies comprehensively to the whole system of incentives in Hungary, the types of incentive which are available are set out in a series of legislative instruments. The system of incentives is therefore really quite structured and any potential investor in Hungary should always make sure that it is aware of the two levels of rule which will apply to any grant of incentives, being:

- over-arching *general rules* on aid (applicable EU legislation and the State Aid Decree, which determine the legality of any individual instance of aid being granted and which provide a framework for the available forms of incentive); and
- *particular rules* on incentives that may be obtained in Hungary (which implement the general framework and govern the details regarding the conditions and the process for providing individual forms of incentive).

The legislative provisions which relate to each type of incentive can be very complex (for example in relation to the conditions the investor must fulfil to be eligible) and it is crucial that an investor gets detailed legal advice on these matters, especially as failure to do so can result in an application being rejected without its merits being considered.

The two most important pieces of legislation under which incentives are available to FDI investors in Hungary are:

- the Investment Incentives Decree, under which investment incentives may be granted; and
- the Investment Tax Incentives Decree, under which investment/development tax incentives may be granted.



## Investment incentives

Investors should note that there is an estimate in the budget each year of the amount available to be granted as incentives under this regime.

### Available incentives

Under the Investment Incentives Decree, various types of incentive may be granted, namely:

- non-repayable contributions or grants;
- non-repayable interest coverage;
- subsidised guarantee fees;
- real property or the right to use real property (or direct subsidies for the acquisition of real property or the right to use real property);
- subsidised factoring fees; and
- subsidised leasing fees.



‘The Hungarian Government views its first priorities as research and development and innovation ...’

The relevant state bodies are entitled to grant incentives under this legislation to achieve a number of purposes and, so, those incentives will be granted to projects which bring the relevant benefits to Hungary. Examples of some of the purposes for which the incentives may be granted include the promotion of the investment of working capital, the development of logistics centres and their services, technological development and modernisation, subsidising training, subsidising investments and subsidising research and development.

#### **Sectors favoured by the Hungarian Government**

The Hungarian Government views its first priorities as research and development and innovation (reflecting the EU Lisbon Strategy mentioned in Part 3) and is keen to support the information society and the development of e-economy and e-commerce, the improvement of the information (digital content) sector, and the expansion of the broadband telecommunications infrastructure. It is therefore worth any potential investor emphasising any such elements of its project when applying for incentives in Hungary.

#### **Applicable conditions**

Incentives granted under the Investment Incentives Decree will usually be granted under an aid scheme programme (therefore not requiring individual clearance by the European Commission) involving a tender process (for details, see Part 5), where the guidelines produced in relation to the specific tender will include details of the conditions which any potential investor will have to meet in order to be considered. There are, however, some projects which the government will consider outside the tender system, where the applicable conditions will be the subject of some negotiation between the investor and the government (and which will require individual clearance from the Commission). Two examples of projects which may receive support outside the tender system are: (i) major investment projects of great national economic significance that create a manufacturing industry capacity with eligible investment costs exceeding the HUF equivalent of EUR 10 million; and (ii) regional service centres where the staff costs associated with the new jobs created by the investment project reach the HUF equivalent of EUR 10 million.

#### **Timing of incentives for major investment projects**

While an investor in a large project may want to receive all incentives at the start of its project, it is very likely that the state will want to stagger payments over a period of time, perhaps linking them to the timing of investment by the investor and making them payable over the entire length of the project (to encourage the investor not to pull out of the investment site before the region has reaped all the envisaged benefits).

### Who can apply?

One key fact that any FDI investor should appreciate is that only corporate entities (with or without legal personality) which have their registered seat in Hungary or private entrepreneurs may apply for incentives. It may therefore be necessary for an investor to set up a new company in Hungary to manage the application and project, and detailed advice on how to do this can be obtained from our Budapest office.

### Source of funding

As discussed earlier, sometimes the various CEE countries require an investor to invest certain types of funding in the project. It is a general feature of the grant programmes in Hungary that any investor must have a certain percentage of its own funds (own capital or loans) invested in the project.

‘... investments in industrial parks can usually be implemented in a few months.’

### Tax allowances

If a project meets all the requirements set out in the Corporate Tax Act and the Investment Tax Incentives Decree (which are numerous and complex and which will require detailed advice to be sought by an investor), it will be granted tax allowances for the initial year of the project and the following five years, subject always, of course, to the limitations on the maximum amounts and intensities of aid which may be granted to any investor and in any region.

In general, the types of project which may be granted such allowances include, for example:

- projects valued at HUF 3 billion (approx. EUR 12 million) or more at current prices;
- projects launched and operated within the administrative jurisdiction of a preferential local municipality that satisfy the criteria specified in the relevant government decree and are valued at HUF 1 billion (approx. EUR 4 million) or more at current prices; and
- projects which create new jobs.



## Industrial parks

Hungary offers the widest selection of industrial parks in the CEE region: investors can choose from more than 160 operating industrial parks on the basis of their business, professional, or cultural needs. Establishing a business in such an industrial park is facilitated by highly favourable conditions, including management that is familiar with local circumstances, support from municipalities, and various tax benefits. Another very important point is that investments in industrial parks can usually be implemented in a few months.

The typical services specifically provided by industrial parks in Hungary are:

- the provision of the basic infrastructure needed for production (for example, energy, water and waste-water treatment facilities);
- assistance with the development of professional co-operation in order to cut production costs;
- a wide range of other quality services (for example, banking services, customs administration, consultancy, security guards and office services); and
- the promotion of the development of a supplier base in the park.

## Poland

### Availability of local advice

When considering the availability of incentives in Poland it is important to note at the outset that the President of the Office of Competition and Consumer Protection, the body which administers the grant of incentives in Poland, should provide a potential investor with required information. However, guidance may also be sought on the amount of incentives potentially available to an investor or the form which any available incentives might take from PAIIZ (the Polish Agency for Information and Foreign Investment), PARP (the Polish Agency for Enterprise Development) and local authorities. All these institutions should provide comprehensive and consolidated information to allow an investor to tailor its position to ensure that it receives the maximum possible amount of incentives available to it.

However, the primary source of information on the potential grant of incentives in Poland is the general rules on state aid set out in the EU regulations. The conditions used to define the concept of state aid are identical to those described above in Part 3. As a brief reminder, these are whether the proposed aid:

- is granted by the state or through state resources;
- confers an economic benefit selectively on the recipient (whether a specific undertaking or a whole sector);
- distorts or threatens to distort competition; and
- affects trade between EU Member States.

‘... the primary source of information on the potential grant of incentives in Poland is the general rules on state aid set out in the EU regulations.’



### Who can apply for incentives?

One area in which the Polish regulations are particularly generous is the question of who may receive incentives. In Poland, any entity that conducts business operations may be the recipient of incentives, irrespective of its organisational and legal form or the way in which it is financed, as an investor may be a person or a legal entity. This is obviously attractive to FDI investors, as the choice of vehicle is left open to them and may be chosen to maximise other potential advantages, for example minimising the tax or liability exposure of the investment project.



## The value of incentives

It is worth noting that the total amount of subsidies to be granted to investors in Poland in a financial year is set in the budget, for example, the maximum total amount of subsidies available for 2006 was set at PLN 150 million (around EUR 38 million). However, it should also be noted that the amount available may be increased as, for example, the PLN 150 million limit had already been exceeded by the end of October 2005, and up to a further PLN 150 million will be made available for 2006.

When considering an application for incentives, the relevant body will examine the total amount of incentives granted to investors in Poland in the relevant financial year, expressed as either a monetary amount or a figure representing the intensity of the incentives. The amount of incentives granted to an individual investor is expressed as the amount of money which the recipient investor would receive if it was granted as a subsidy, expressed as a gross or net amount. This means that any tax or other advantage given to an investor is measured according to the value of that advantage in the hands of that investor. For example, in the case of a reduced level of tax being payable by an investor, the value of the incentive will be the actual amount of tax which that advantage would save the particular investor in question from paying.

## Incentives which may be available

There are several pieces of legislation which outline some of the incentives that may be available in Poland. Under such legislation, the main piece of which is the Act on Financial Investment Support described below, the government may either offer incentives through aid schemes or as individual aid.

### **Incentives under the Act on Financial Investment Support**

Under this Act, financial support for new investment projects can be granted to investors when:

- the investor satisfies one or more of the following conditions:
  - it invests a minimum of EUR 10 million;
  - it invests a minimum of EUR 500,000, where the investment involves the development or modernisation of an enterprise and provides a minimum of 100 jobs for a minimum of five years;
  - it creates at least 20 new jobs for a minimum of five years;
  - it introduces technological innovations;
  - it makes investments which improve the natural environment; or
  - it invests within an industrial or technology park;
- the investor's own share (equity investment) in the outlays connected with the investment amounts to at least 25% of the investment costs;
- economic activities connected with the investment will be conducted for at least five years from the date of the completion of the investment;
- in the event of financial support which is to be allocated for the creation of new jobs, such jobs will be maintained for at least five years from the date of completion of the relevant investment; and
- an application for financial support for a new investment is submitted before the implementation of the investment starts.

The types of incentive which would be available are: (i) subsidies for a wide range of expenses incurred in relation to the project; including for the price of land (up to 10% of the total project expenditure), fixed manufacturing assets, used fixed assets, intangible assets (up to 25% of the total project expenditure), materials and construction works; and (ii) grants to assist with creating new jobs up to the equivalent of EUR 4,000 per job.

It is always worth an investor looking to benefit from these types of incentive to note that it may also be eligible for other forms of support, such as tax exemptions in special economic zones (see below) or local tax relief, etc.; however, it must always be remembered that the total value of grants and other types of regional aid offered to the investor cannot exceed the maximum regional state aid intensity admissible for a given investment project.



‘... SEZ aid does not necessarily have to be notified to the European Commission under the regular proceedings for the notification of state aid ...’

### Special economic zones

A number of special economic zones (**SEZ**) have been set up in Poland. An SEZ is a designated area in which manufacturing or distribution activities can be conducted on preferential terms, the purpose being to support regional development, especially by means of: the development of specific fields of business activity and new technical and technological solutions; an increase in the competitiveness of products and services offered; the use of the existing industrial assets and economic infrastructure; the establishment of new workplaces; and the use of unutilised natural resources with due regard for the environment.

An SEZ is established on the basis of an ordinance by the government, which specifies the volume of public incentives designated for the entrepreneurs carrying out their business activities in the area. Currently, there are 14 SEZs established in Poland.

Before investing, an investor must gain a permit from the Minister responsible for economic affairs, which may be granted if certain conditions are fulfilled, including:

- the scope of the planned activity must be compliant with the SEZ development plan;
- the SEZ administrator must have available land, structures or premises which are indispensable for the investor to run his business activity; and
- granting the permit can be justified in view of the degree of the intended business operations' fulfilment of objectives specified in the SEZ development plan.

The permit to carry out the activity in the particular SEZ which is issued to a specific investor, will also expressly provide the minimum value of investment which needs to be financed by investors' equity. The minimum amount of investors' equity involved in the new investment or its proportion compared to the amount of public aid to be granted is set out on an individual basis.



The benefits which an investor can receive are as follows:

- income obtained from business activities conducted in the SEZ in accordance with the permit is exempt from corporate income tax;
- aid to support new investment projects; and
- aid for creating new jobs.

The exemptions from corporate income tax are governed by the general rules on income tax exemptions provided by law and investors do not need to apply for these exemptions by means of a separate procedure; they will become entitled to the concession from the date of its grant until the expiry of the concession. Therefore, the investor does not have the opportunity to maximise the effect of the exemption by utilising it during the period when it might be most efficient.

All of the benefits listed above constitute regional state aid and would require clearance from the European Commission. However, subject to certain exceptions, for example in relation to particularly large projects, SEZ aid benefits from the special arrangements agreed for "existing aid", as specified under the treaty under which Poland acceded to the EU. This means that SEZ aid does not necessarily have to be notified to the European Commission under the regular proceedings for the notification of state aid, which can of course save a lot of time and effort for the investor and the state.

# Slovakia

## General structure of incentives

Of all the four CEE states covered in this publication, Slovakia has had, until very recently, the most unstructured approach to approving aid for investors. Whilst some legislation has been enacted to determine the scope of certain types of aid, generally the type and amount of incentives received and the conditions the investor must meet to receive them have been determined by negotiation between the Slovak state and the relevant investor.

Rules have been recently promulgated in Slovakia which attempt to set out a framework for incentives in a more clear and structured manner (see “New guidelines” below). The idea is to try to bring to an end the previous era of individually negotiating incentives with the state authorities.

Under currently applicable law, the most important piece of legislation is the Slovak Act on Investment Incentives, where an investor may apply for tax allowances (the receipt of which may be delayed for up to three years from the start of operations) and cash contributions for the creation of new jobs and the training of new employees, provided it meets the following criteria:

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

‘Rules have been recently promulgated in Slovakia which attempt to set out a framework for incentives in a more clear and structured manner ...’



However, for example, we have advised clients who have received cash grants from the Slovak state to be used to help pay for the costs involved in constructing the production site and installing equipment, which, although envisaged in the general state aid legislation, have not been included in any detailed implementing legislation.

Clearly, such a system provides a great deal of flexibility, which can be attractive for an investor wanting to structure its project in a particular way. However, what it lacks is transparency and certainty – an investor approaching the Slovak state is not entitled to anything and cannot know what, if anything, it might be offered. However, this uncertainty can be, and is being, dealt with in a number of ways, as set out below.

### Local advice

Once an investor has a plan of its project, local lawyers and other advisers should be able to suggest the types of incentive the investor could look to receive. More importantly, SARIO, the governmental body responsible for managing applications for incentives in Slovakia (details in Part 5) will undertake initial discussions with an investor to determine the incentives that would be available. After SARIO has discussed the project with the Ministry of Economy, the investor can request an indicative package of the incentives which would be on offer, tailored to the project itself. This will give the investor a clear idea of what is available without committing to any investment.

### New guidelines

At the end of October 2005, the Slovak Government approved guidelines which will regulate the process of granting incentives to companies. In general, the guidelines envisage giving tax allowances, subsidies for creating new jobs and training, support for investment costs and offering state assets at preferential prices granted to an investor depending on the *region* of the investment (the higher the level of unemployment, the higher the level of support) and the *economic sector* of the activity (for example, companies in the manufacturing industry and logistic centres would be least eligible, whereas research and development projects and technological centres would be most eligible, including being the only projects for which cash grants will be made available). In order to fall within the framework of the guidelines and to have an application considered, the investor's project will have to meet the minimum level of investment required for the relevant type of project: for research and development projects the minimum investment will be SKK 30 million; for high-tech projects the minimum investment will be SKK 40 million; and for manufacturing projects at least SKK 200 million will have to be invested (and the project cannot be based in certain regions of Slovakia). However, it is expected that certain investors will be dealt with outside the framework, for example those with large strategic projects worth over SKK 10 billion (approximately EUR 260 million), which create more than 1,000 jobs.

It is difficult to say what impact these guidelines will have in practice. Whilst they do not have the force of law (suggesting that an investor who does not meet the relevant criteria could still negotiate incentives with SARIO and the Ministry of Economy), relevant officials often treat guidelines as though they did, and tend to apply them strictly. In addition to that, it may not be that easy to determine which category of economic sector the project will fall into. However, what is clear is that Slovakia has indicated its intention to support research and development and technology projects rather than straightforward manufacturing, so that any investor really should emphasise such elements of its project when seeking incentives.

It is anticipated that such guidelines may be expected to be followed by further legislation in this area. Since this area is still rather a moving target, we have not set out the guidelines in great detail and recommend that you check the status of these guidelines at the time of considering your project.

## What exactly will the investor and Slovakia negotiate?

### **The level of investment and incentives**

Depending on the application of the new guidelines mentioned above, ultimately the parties will have to determine and agree upon the amount of incentives which the state will provide. It should be noted by an investor that in relation to cash grants (which, under the new guidelines, may only be available to research and development projects), the Ministry of Economy, which is primarily responsible for any such grants, does have a specific amount of funds set aside in its budget each year to be allocated to such projects. However, even where those funds have been exhausted, the Ministry may be willing to find funding for a special project.

As already mentioned, the state will be limited by the EU rules on the amount of aid it may grant. What is certain is that the state will want to ensure that the amount of aid it agrees to give is inherently linked to the amount of investment made or other benefits brought by the investor. Therefore, for example, any cash grant made by the state will have to be matched and exceeded by the investor to a specific extent and any grant to assist with the creation of jobs will depend on the number of jobs created. The mechanism for linking the payment of incentives to the investment or other benefit brought by the investor will be dealt with in the investment agreement between the investor and the state, which will be discussed in Part 5.

‘Slovakia has indicated its intention to support research and development and technology projects ...’

‘While the investor benefits from incentives, so the state expects the investor to make commitments ...’

### **The timing of incentives**

While an investor may want to receive all incentives at the start of its project, it is very likely that the state will want to stagger payments and grant any tax allowances over a period of time, perhaps linking them to the timing of investment by the investor and making them payable over the entire length of the project (to encourage the investor not to pull out of the investment site before the region has reaped all the envisaged benefits). In such circumstances it will be crucial for the investor to consider when it intends to make investments into the project and when it will get maximum benefit from incentives.

### **Undertakings by the investor**

It cannot be stressed enough that the relationship between the state and the investor works both ways. While the investor benefits from incentives, so the state expects the investor to make commitments about its behaviour to ensure Slovakia benefits from the investor’s presence. Typical examples of commitments we have seen are:

- to operate production at the project site for a specific number of years after production has started;
- to fund a certain proportion of the investment through equity rather than debt; and
- to encourage other foreign investors (for example suppliers) to invest in Slovakia.

According to SARIO, while foreign companies may conduct business in the territory of Slovakia under equal conditions and to the same extent as Slovak persons are allowed (following incorporation in the commercial registry), most investors decide to conduct business through a local vehicle. If this is the structure that is used, the investor may have to undertake to allow such a company to own a certain proportion of the assets purchased with the investment capital. A detailed publication on setting up and owning a Slovak company is available from our Bratislava office.



## Other available support

### Industrial parks

In Slovakia a number of industrial parks have been developed by various municipalities using subsidies from the Slovak Ministry of Economy. The relevant criteria for receiving the state subsidies are:

- at least one investor must intend to carry out manufacturing business on the site;
- the applicable land planning resolutions predetermine the site to be an industrial park;
- the municipality is responsible for at least 15% of the development costs (whether by means of its own funds, debt or co-funding);
- the municipality has secured the consent of the Slovak land fund, if its properties are involved; and
- the municipality has an “agreement on future agreement” (see discussion of these in Part 5) with the relevant investors outlining their intentions concerning their business in the park.

The state may subsidise up to 85% of the costs for improving the infrastructure of the park and the costs of acquiring the necessary land, providing that the total investment by the state does not exceed 50% of the total investment cost.

This type of support by the state is distinguished from incentives granted to individual investors, as it is the municipality which applies for funding and this may take the investment outside the scrutiny of the EU rules on state aid. It is therefore worth an investor considering whether the project could be structured so as to benefit from the provisions on industrial parks. However, once again, it is crucial for a full analysis of the facts to be undertaken before this is agreed with the state. Especially where only one investor is planning to invest in the industrial park, there is a serious danger that the subsidies granted could be regarded as state aid for that particular investor. Alternatively, actions by the municipality itself, rather than by the Ministry of Economy could put the municipality into the position of being a provider of state aid, when notification, and perhaps clearance, would be required.

‘It is ... worth an investor considering whether the project could be structured so as to benefit from the provisions on industrial parks.’

# Part 5

## Focus on incentives III: process for receiving incentives in CEE

Given the different legislative structures in the various CEE countries, the application process for receiving incentives also differs significantly. This can also be a key issue for an investor, as it will want to know what it has to do to actually be able to receive and utilise incentives. Obviously there is a good chance that an investor might be considering a number of different sites in a number of different countries simultaneously, with the initial stages of the various procedures described below being undertaken at the same time. It is especially important to appreciate, therefore, at what stage in each process steps must be taken in order to qualify for incentives (it may be earlier in one country than in another), and at what point the investor becomes effectively committed to investing in the relevant country.



‘... It is especially important to appreciate at what stage in each process steps must be taken in order to qualify for incentives ...’

### Investment agreements

As will be seen, in the majority of cases of investment in the Visegrad 4 countries, most incentives are granted without the investor and the relevant state body negotiating a detailed investment agreement. Conversely in Slovakia, it has been the practice for investors to negotiate such agreements and it appears that this practice will continue under the new guidelines described in Part 4. Having said that, it may be the case (especially where proposed projects are particularly large) that an investor could find itself negotiating an investment agreement in any of the four countries, although we understand from CzechInvest that it does not envisage that, in practice, investment agreements will ever really be used in the Czech Republic. However, we have set out below the key clauses an investor might expect to see in such an agreement.

## Description of project

The investment agreement should usually include a detailed description of the project, including for example:

- the product(s) to be manufactured/the technology to be developed;
- the amount, timing and nature of the investment by the investor;
- the number and types of job to be created each year; and
- the structure of the project, for example which companies within the investor's group will be involved and what their roles will be.

It is easy for an investor to underestimate the importance of getting the description of the project right, but it really is key. The state will want to ensure that the actual payment of incentives depends on the *actual* investment made by the investor, compared with the investment it commits to make in the investment agreement. If the project description and forecasted investment by the investor prove to be wrong, the investor could face a situation where it has made a huge investment in a new site but cannot get any of the incentives it needs from the state.

## Conditions, targets and the calculation of incentives

It will not be enough for the investment agreement to set out what incentives the state will grant and when, where the grant of any incentives is to depend on the investor meeting the investment or other targets (for example for job creation) agreed. The mechanism for calculating whether any targets have been met is likely to be rather complex and will require negotiation.

One typical approach (where the state will agree to grant incentives over a period of time) involves calculations at each stage that incentives are payable. On the relevant date, the level of investment made by the investor in the period up to that date is compared to the level of investment the investor had agreed to make during that period. If the investor has made investment equal to or more than the amount it promised then the incentives become payable.

Any investor will appreciate that there may be much room for negotiation within such a structure. For example, if the investor has only invested a proportion of what it agreed, will it receive a corresponding proportion of the incentives? If the investor fails to meet its target for one particular period but invests much more than it agreed during the next period, is it entitled to receive the incentives it did not get before? How often and when exactly will the calculations take place? When dealing with all these issues, it is a good idea for an investor to seek as much flexibility as possible in how it may meet its targets, but this is unlikely to be a popular approach with the state.

One possible way to deal with these issues, especially if the investor knows it will invest heavily in the project, but perhaps not at the times agreed with the state, is to include a final adjustment mechanism. This will compare the total investments made by the investor and the state with what they each agreed to make at the start of the project and will require the state to pay additional incentives or the investor to pay back extra incentives received as necessary. An investor may be able to get the state to agree that it can have all of the offered incentives even if it meets less than 100% of its investment targets but should also beware that it could end up being liable to make a large cash payment at a time when cash is at a premium (for example when production is about to start), if the incentives it is entitled to receive are adjusted downwards.

'The state will require the investor to provide regular and detailed information about the project ...'





### **Provision of information by the investor**

The state will require the investor to provide regular and detailed information about the project, its proposed investment (based on the project description), the actual investment made and the use of the incentives.

While any investor understandably may not want the administrative burden of preparing “investment plans” and “investment reports” for the state, they should not ignore this issue. As soon as the state’s obligation to give money is dependent on the information provided by the investor, the investor should ensure it has a clear obligation defining the information it must provide. Providing the investor fulfils its obligation, this should hopefully preclude any refusal by the state to make a payment on the basis that the investor has not provided enough or the right information.

The parties will also have to agree what information the investor will provide and how often. The state may want quarterly, six-monthly or annual updates and will almost certainly want the timing of information to reflect the timing of incentives being granted. It may be a good idea for the investor to try to agree timing for the provision of information to the state which will coincide with the preparation of its own accounts, to ease the administrative burden.

It is also very sensible to determine how any objections of the state to the information provided by the investor will be dealt with. The investor should seek to limit the grounds on which the state can object (for example because the expenditure incurred (or part of it) does not relate to the project at all or the evidence submitted does not prove that the investor incurred the expenditure) and the time it has to do so, to avoid protracted arguments and delays in receiving incentives.

‘... the investor and the state are likely to be working together over a period of years.’

### **Management of ongoing relationship**

Unlike in many transactions, the investor and the state are likely to be working together over a period of years. It is therefore crucial that some thought is given to the way in which future co-operation will work and appropriate undertakings given. Typical undertakings which the investor may want from the state could include a commitment to support the project and procure any necessary assistance from other public bodies, including in relation to the grant of permits and approvals. The inclusion of such undertakings can help to focus the minds of the parties, however, the investor should be aware that such undertakings may in practice be difficult to enforce or be unenforceable.

### **Other assistance from the state**

If it is anticipated that, as part of the package offered by the state, the state will spend money on improvements to the region which will benefit the project but which do not constitute specific incentives, the investor should require that provisions on these measures are included in the investment agreement, for example in relation to the amount to be spent, the work to be carried out and the timing agreed. Without such provisions the investor may have difficulty requiring the state to fulfil the agreed commitment.

### **Timing**

For the investor, it will almost certainly be crucial that the involvement of the state does not have the effect of hindering progress with the project, especially where the state is involved in the acquisition of the land, preparation of the site, etc. We therefore would always recommend that the parties include a detailed timescale in the investment agreement, setting out the deadlines for completion of the key stages of the project. This helps to focus the minds of the parties on the structure of the project, helps to agree an achievable timetable and gives the investor a basis on which to approach the state should the project not proceed as agreed.

### **Termination**

As with any commercial agreement, the transaction may not proceed as anticipated. It is therefore sensible for the parties to determine at the outset in which circumstances either party will be entitled to terminate the agreement. The investor may want to be able to terminate in the event, for example, that EU approval is not received or if it does not receive necessary permits or approvals from governmental bodies by the deadlines agreed. It is also likely that the state will want to be able to terminate the agreement if the investor fails to make a specific proportion of the investment it committed to making.

The parties should agree what the exact mechanism for, and consequences of, termination will be. For example, will there be a remedy period for any breach? If the state terminates because the investor is in default will the investor be obliged to repay the incentives it has received? Will interest be payable on any repayable sum?



## Czech Republic

As was explained above in Part 4, if an investor negotiates terms of investment aid with the state that go further than the currently available investment incentives schemes, the investment aid will first have to be notified and cleared by the European Commission. For more information, please refer to Part 3 where general rules on the notification and clearance of state aid by the Commission are described. However, as already mentioned, CzechInvest has made clear that, in practice, the state intends to stay within the boundaries of the currently available investment incentives schemes, especially since any aid going further than that is likely to be prohibited by the Commission.

In terms of investment incentives in the narrow sense (as was explained in Part 4), there are two main sectors where incentives are granted in the Czech Republic, namely the manufacturing sector and the services and technology sector and the process for applying for incentives in each sector differs slightly. Both processes are explained below.

Even though a number of state institutions participate in the process of granting incentives, CzechInvest, the Investment and Business Development Agency, plays the central role in the application process.



CzechInvest's contact details are as follows:

Štěpánská 15  
120 00 Prague 2  
Czech Republic  
Tel +420 296 342 500  
Fax +420 296 342 502  
E-mail [incentives@czechinvest.org](mailto:incentives@czechinvest.org)  
Website [www.czechinvest.org](http://www.czechinvest.org)

'The applicant will have to complete the form set out by CzechInvest.'

### Application for incentives in the manufacturing sector

#### Application and assessment

The process of applying for the incentives begins when the investor (the **applicant**) submits a completed application for investment incentives to CzechInvest. The applicant will be the foreign parent company looking to invest in the Czech Republic. The applicant will have to complete the form set out by CzechInvest. This is currently in the form of a booklet, and the information that is required is varied. For example, investors may be required to provide constitutional and incorporation documents, audited financial statements, group structure charts, details of the planned project, etc.

CzechInvest will then prepare an assessment of the application to evaluate whether the investment will be able to meet all the requirements set by the legislation and will then present it to the Ministry of Industry and Trade within a maximum of 30 days of the receipt of the application.

The Ministry of Industry and Trade then requests approval for the individual incentives from the relevant ministries, for example the Ministry of Finance for tax relief aid, and the Ministry of Labour and Social affairs for the job creation support programme and training grants. Approval from the Ministry of Environment is also required to determine whether the investment programme complies with Czech environmental regulations and whether it will be environmentally friendly.

Upon the assessment of the application and the prior approval of other ministries, the Ministry of Industry and Trade in cooperation with the Office for the Protection of Economic Competition will then decide on the total amount of investment incentives available for the applicant's project.

#### **The offer**

Upon receiving the comments from the ministries, the Ministry of Industry and Trade, within two months, will provide the applicant, through CzechInvest, with an offer of investment incentives. The offer contains all incentives available for the project and sets out the conditions under which the incentives are granted. It should be noted by any potential investor that one of the conditions will be that the actual recipient of the incentives must be a Czech subsidiary. Again, this may require the investor to set up a new Czech company to receive the incentives, and advice on doing this is available from our Prague office.

'... one of the conditions will be that the actual recipient of the incentives must be a Czech subsidiary.'

#### **The final application**

Based on the offer, the applicant or the recipient of the incentives (if the company already exists in the Czech Republic) may submit an application for a grant of incentives to the Ministry of Industry and Trade through CzechInvest within a maximum of six months from the date on which the offer was delivered to the investor.

#### **Decision**

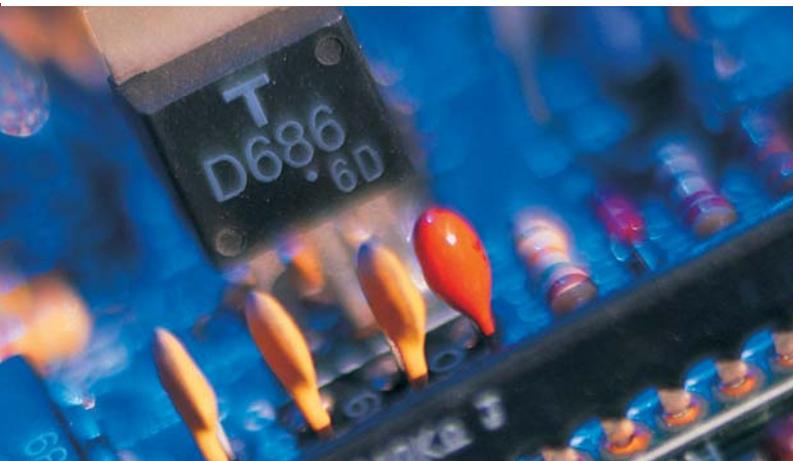
The investment incentives will be granted based on the final decision to grant the incentives which is issued by the Ministry of Industry and Trade (within two months).

## Application for incentives in the services and technology centres sector

### Application and assessment

In the same way as for the manufacturing sector, the applicant prepares the application form and submits it to CzechInvest. However, under this scheme, if the application form is duly filed and complete, CzechInvest will issue a project registration note within 14 days of receiving the application form.

Again, the assessment of the project is processed by CzechInvest, the Ministry of Industry and Trade and other relevant authorities within a period of between two and four months from the registration.



### The offer and acceptance

If the relevant authorities view the project as eligible for the incentives, the Ministry of Industry and Trade presents, via CzechInvest, a draft project aid decision to the applicant. The applicant or the recipient (if it already exists) may accept the draft project aid decision within six months from receiving the draft. Again the recipient must be a Czech subsidiary.

### The final decision

If the applicant accepts the draft project aid decision, the Ministry of Industry and Trade will issue the project aid decision immediately after receiving the applicant's acceptance.

## Ongoing relationship

Having provided the incentives, the government monitors the investor to ensure that it continues to fulfil the criteria through which it qualified for the incentives. For example, investors which benefit from tax incentives fill in a special tax return and thus specify particular information regarding their continued qualification for the incentives. As with any tax payer, the tax authorities may audit the investor to verify the information provided in the tax return. Similarly, there may be audits to confirm that other grants have been properly granted, for example an audit team may arrive at a factory to check that the jobs for which the investor received an incentive have been created as specified by the investor.

In the event that the investor fails to meet the ongoing criteria for the incentives, the authorities can not only stop incentives in the future but also, in certain circumstances, demand that the incentives be repaid. So, for example, the investor may have to pay the tax from which it was exempted, together with charges and interest.

'... the government monitors the investor to ensure that it continues to fulfil the criteria through which it qualified for the incentives.'

## Hungary

In Hungary, not only is the system for determining what incentives are available very complicated, so is the process which must be followed to actually receive those incentives. For example, where an investor seeks to benefit under one of the incentive programmes set up under the Investment Incentives Decree, it must comply with the distinct eligibility criteria and follow the particular application process set out in the relevant tender. However, where the investor has a major investment project and can be dealt with outside the tender system, the application process will be quite different. It is, rather unsurprisingly, standard practice for foreign investors to engage specialist advisers to analyse the application process for obtaining incentives for a particular project.

### Who to contact

In order to provide information to investors more efficiently and to accelerate the complex administrative procedures, a so-called “one-stop shop” has been created in Hungary. The contact institution is the Hungarian Investment and Trade Development Agency, which is also responsible for, and can be contacted to provide, information on the Hungarian investment environment. The Agency assists investors through its extensive network of contacts in both the private sector and in government offices.

The contact details of the Agency are as follows:

1061 Budapest  
Hungary  
Andrássy Street 12.  
  
Tel +36 1 472 8100  
Fax +36 1 472 8101  
  
E-mail [inf@itd.hu](mailto:inf@itd.hu),  
[investment@itd.hu](mailto:investment@itd.hu)  
Website [www.itd.hu](http://www.itd.hu)

‘The first step to be taken by the investor is to write a letter of intent addressed to the Minister of Economy and Transport ...’



‘... a so-called “one-stop shop” has been created in Hungary.’



## Application process for a major investment project

As mentioned, the procedure for large investments is different to that for applications under incentive programmes. The two key differences, which can be crucial for an investor, are firstly, that there is no tender process and secondly, that there is no application deadline.

### Application and evaluation

The first step to be taken by the investor is to write a letter of intent addressed to the Minister of Economy and Transport in which the investor describes the planned project including the overall cost of the investment, the number of newly created jobs, the length of the investment period, the location of the investment, and the industry in which the project operates.

After the Ministry receives an investor's letter, the investor will be asked to fill out a form about the details of the project. Based on the information the investor provides, the project will be evaluated, and within 30 days a written offer will be made by the Ministry.

### Negotiations and framework contract

The offer can be followed by further negotiations, and finally a framework contract will be signed between the state and the investor. It may be possible for an investor to agree with the government that it will receive all of the incentives offered by the government even if it does not quite meet the conditions set out in the framework agreement.

Before signing the framework contract the investor can, at any time, withdraw from the implementation of the project.

### Grant of incentives

Once the framework contract has been signed, the Ministry will, of course, need to seek clearance from the European Commission for the incentives to be granted. It may be necessary for the investor to assist with the preparation of the application and it will need to ensure it has provided all of the information which the government must include in the application form.

After signing the framework contract and providing clearance has been received from the Commission, the investor will receive the incentives in accordance with the terms of the framework contract through intermediate bodies, such as the Hungarian Development Bank and the Hungarian State Treasury.



## Application process under an incentive programme

The allocation of incentives under programmes set up by the government is determined through tenders. Each incentive programme has a guidebook, which provides assistance in the preparation of applications under the tender and it is always advisable to study the contents of the guidebook very carefully. Before commencing the application process it is absolutely crucial for an investor to determine, according to the information in the guidebook, whether it is actually entitled to apply for incentives under the given programme, to ensure that time and money is not wasted. It should also be remembered that no grants will be available for projects that have already been commenced.

The process which must be followed is set out below and can usually be expected to last approximately four to five months.

### The application

The relevant guidebook will set out exactly what information the investor must provide in the application. The required information will include the investor's business plan which must show that the investor intends to continuously operate and/or maintain the production capacities and new jobs created by the investment for which the incentives are granted for at least five business years.

Other information which the investor is usually expected to provide will include the total value of the investment to be required by the project, the gross value added by the investment, the jobs created and maintained as a result of the investment and the direct private investment in the business receiving the incentives.

It is very important to make sure that all the required information is included and is correct for a number of reasons. Firstly, there is always a deadline for the submission of applications, and corrections to applications may only ever be made if there is a formal deficiency in the application and within the original deadline specified in the guidebook. Secondly, if all the formal requirements listed in the guidebook are not met, the potential investor's application may be disqualified without its merits being considered, which would be disastrous especially when a lot of time, effort and money have been spent on the application. Thirdly and finally, the information provided by the investor will relate to the criteria being used by the government to select successful bidders and will be used as the benchmark against which allocated incentives are measured. It is for these reasons that we would always recommend a foreign investor to seek local legal advice as early in the application process as possible.

As soon as an application has been made, the investor may start the investment. However, it should be noted that the start of the investment will not have any effect on the evaluation of the application or represent any advantage in the evaluation process, and will not guarantee that the incentives applied for will be granted.

'... it is always advisable to study the contents of the guidebook very carefully.'



## The evaluation

Following the receipt of the application, the Participating Organisation (i.e. the Hungarian Development Bank) responsible for the application programme will verify that the application complies with the criteria as defined in the terms of the application.

If the application meets the criteria of submission, eligibility and completeness, the Participating Organisation will perform an evaluation of the submitted project according to a predefined set of evaluation criteria and the assigned scoring system. Based on the score of the application, the evaluator will then make a recommendation to the Selection Committee on granting aid. The guidebook will describe the evaluation process in detail and an application will only be deemed eligible if it receives a minimum score of 40 out of 100 in the evaluation process.

## The aid agreement

The head of the managing authority will decide whether and to whom to grant the incentives based on the recommendation of the Selection Committee; the decision will be communicated to the investor in a letter of approval or refusal.

If successful, the investor must then sign an aid agreement with the grantor of the incentives for the implementation of the approved project setting out the terms and conditions of the incentives, drawn up in accordance with the applicable legislation. In exchange for the incentives, the investor must undertake considerable long-term obligations towards the state and, if the investor fails to meet any of its key obligations or a part thereof, or a breach of contract occurs for any other reason, the investor will be required to repay the incentives together with the interest charged thereon.

## Grant of incentives

As mentioned in Part 4, incentives granted through a tender process are granted under aid schemes which have been pre-cleared by the European Commission. Therefore, once the aid agreement has been signed, there is no need to go through a lengthy process to receive individual clearance from the Commission before the incentives are granted. In practice, incentives will be granted to investors within 60 days of the execution of the aid agreement.



‘... an application will only be deemed eligible if it receives a minimum score of 40 out of 100 in the evaluation process.’

## Ongoing relationship

An investor who receives incentives in Hungary will be required to comply with the rules on monitoring of incentives, which comprise the collecting, processing and transfer of information regarding state aid granted, in particular about its types, forms and amounts.

The investor can expect that the state will monitor the implementation and operation of the project for at least five years after the framework contract or aid agreement is signed.

The investor will be obliged to submit information regarding granted incentives to the relevant authority if so requested, within the scope of and the timeframe specified in the request. The timeframe specified in the request may not be shorter than 30 days. The investor will have to submit periodical reports regarding the incentives received to the relevant authority in electronic format on a form made available on a public IT network.

It should also be noted by an investor that Hungarian law imposes an obligation to return any incentives received (principal amount plus interest) if those incentives have been granted in accordance with any legal acts inconsistent with the Constitution of the Republic of Hungary or any law or international agreements ratified by the Republic of Hungary. The investor will also be required to pay interest on those incentives, so it is crucial for an investor to seek legal advice on the validity of any incentives offered before they are accepted.





## Poland

The process which an investor will have to follow in Poland to apply for incentives will depend on the body which is granting the incentives, the type of incentives and whether the incentives are granted under an aid scheme or as individual aid. As an example, we have set out below the process which an investor will follow to receive incentives under the Act on Financial Investment Support, mentioned in Part 4.

As also mentioned in Part 4, it should be remembered by a potential investor that PAIIZ, PARP (and local authorities) may provide with guidance on the incentives which may be available for its project.

‘... all applications for grants must be submitted ... throughout January and June of each calendar year.’

PAIIZ’s contact details are as follows:

Bagatela 12  
00-585 Warsaw  
Poland  
  
Tel +48 22 33 49 800  
Fax +48 22 334 99 99  
  
E-mail [post@paiz.gov.pl](mailto:post@paiz.gov.pl)  
Website [www.paiz.gov.pl](http://www.paiz.gov.pl)

PARP’s contact details are as follows:

Panska 81/83  
00-834 Warsaw  
Poland  
  
Tel +48 22 432 8991  
+48 22 432 8992  
+48 22 432 8993  
  
E-mail [info@parp.gov.pl](mailto:info@parp.gov.pl)  
Website [www.parp.gov.pl](http://www.parp.gov.pl)

## Process under the Act on Financial Investment Support

### Application

Possibly one of the most important issues which an investor must remember when considering applying for incentives in Poland is that there may be specific times at which applications can be made, as it would be disastrous for an investor not to receive incentives because it missed the application deadline. For example, under this particular regime *all* applications for grants must be submitted by potential investors to the Minister responsible for economic affairs *throughout January and June* of each calendar year. An application itself should describe the planned investment in detail with an indication of its impact on the environment and the labour market as well as an envisaged timetable. An investor will need to make sure that it allows itself enough time before the deadline to collect the several documents which must be attached to an application, including:

- a current excerpt from the National Court Registry;
- the last annual financial statement which was filed by the potential investor company;

- a certificate confirming that the potential investor’s tax payments and social security contributions are not in arrears;
- a document confirming the legal title to the property which is intended to be the subject of the investment;
- information regarding any state aid received by the investor during the previous three years;
- a description of any new technology to be used for the investment with all information supported by the independent expert’s opinion concerning the period in which such technology has been already used in other countries; and
- an investor’s declaration on its intention to observe the work safety and hygiene legal regime.

As mentioned in Part 4, the amount of incentives and the effect on the total amount of granted funds is initially established in the budget. However, it should be noted that the order of submission of applications by potential investors does not affect the probability of receiving financial support and does not have any effect on the rights of the applicants concerned. 50% of the amount allocated for grants in a given budget year is distributed to investment projects the applications for which were submitted in the first quarter of the year and the remaining 50% is reserved for projects the applications for which were submitted in the third quarter of the year.

#### **Consideration of applications**

The Minister responsible for economic affairs will review the application for incentives, checking whether the information provided is complete and will evaluate the costs and benefits of the potential incentives. The duration of this procedure depends on the completeness of the information provided by the investor, and will include the Minister seeking the opinion of the OCCP (see below). Such an opinion will be required (and clearance from the European Commission needed) where incentives (considered as new aid) are to be granted. However, where incentives are being granted under a pre-cleared aid scheme, such an opinion (and EU clearance) will not be necessary. Consideration of applications for financial support under this Act usually takes place within the four-month period following the end of the month in which the application is submitted.

After this period, the actual decision is taken by the Minister upon consultation with the Committee for Financial Support to Investors (*Zespół d/s Udzielania Wsparcia Finansowego Przedsiębiorcom*).

#### **Signing a contract**

Once a positive decision is made, the investor is invited to sign a contract with the Minister. The agreement defines the obligations of the investor and the location



and size of the investment, contains a timetable of the investment process, the name of the applied technology and the number of employees involved. The agreement also defines the amount of the financial support as well as how it should be used and sets out any circumstances in which the investor may be obliged to return the financial support.

#### **Receiving funds**

The Minister will transfer the funds to the Investor after determining that the new investment fulfils the general criteria for granting incentives. Such criteria include: location of the investment, its value, size, the employment involved, its impact on the environment, its impact on development of the given region, etc.



‘A positive opinion of the OCCP opens up the possibility of incentives being granted ...’

## Getting the opinion of the OCCP and notification to the EU

Since EU accession the European Commission has had the sole competence for clearing any grant of incentives by Poland. However, the President of the Office of Competition and Consumer Protection (the **OCCP**), which is responsible for monitoring the grant of incentives in Poland, still issues opinions on incentives to investors before they are sent to Brussels. A positive opinion of the OCCP opens up the possibility of incentives being granted while a negative appraisal will reduce the chances of an application for incentives being successful.

The process which is generally taken is as follows:

- a draft of the proposed incentives is notified to the OCCP by the authority proposing to grant such incentives (it will provide detailed information on the investor, the types, amounts, purposes and effectiveness of incentives to be offered, including all information required by the EU);
- the President of the OCCP will issue an opinion on the compliance of the incentives in question with the common market within 60 days of receiving the application together with the attached information and documents;
- the President of the OCCP will submit an opinion without undue delay to the entity which applied for the opinion and to the authority proposing to grant the incentives;
- the President of the OCCP, through the Permanent Representative of the Republic of Poland at the EU in Brussels, will notify the intent to grant the state aid to the European Commission; and
- the President will receive the decision of the European Commission and will then inform the appropriate entity immediately, also providing a copy of the decision at the same time.

### Contact Addresses at the OCCP:

Elżbieta Anders,  
Spokesperson of the OCCP  
Office of Competition and Consumer Protection  
Pl. Powstańców Warszawy 1  
00-950 Warsaw

Tel +48 22 827 28 92

E-mail eanders@uokik.gov.pl

Dariusz Lomowski  
Head of Press Office  
Pl. Powstańców Warszawy 1  
00-950 Warsaw

Tel +48 22 827 28 92, 55 60 314

Fax +48 22 826 11 86

E-mail dlomowski@uokik.gov.pl

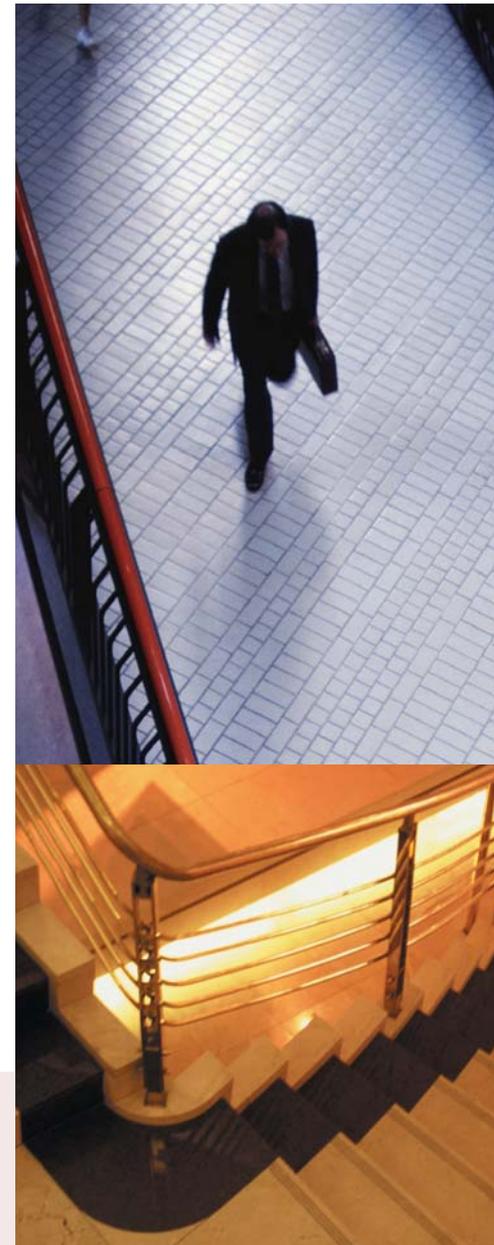
## Monitoring of granted incentives

An investor who receives incentives in Poland will be required to comply with the rules on the monitoring of incentives, which comprise the collection, processing and transfer of information regarding state aid granted, in particular about its types, forms and amounts. The authority which monitors incentives is the President of the OCCP.

The investor will be obliged to submit information regarding granted incentives to the President of the OCCP or to the authority granting the incentives if so requested, in the scope and the timeframes specified in the request. The timeframe specified in the request may not be shorter than 30 days. The investor will have to submit periodical reports regarding the incentives received to the President of the OCCP or to the authority granting the incentives in electronic format on a form made available by the President on a public IT network.

The Minister responsible for economic affairs will evaluate the scope of the investor's performance of its obligations by comparing the investor's actions with what was agreed at the start of the project. In the case of non-performance of any obligations which were conditions of the granting of incentives, the incentives granted will have to be repaid with interest assessed from the date of grant.

It should also be noted that the EU Commission may order the return of the state aid granted if it was granted contrary to the principles of the common market or if it was used contrary to the agreed purposes. The state aid must be returned together with the interest and until such return is completed, no other state aid may be granted to the given investor.



## Further agreements

An investor who enters into an investment agreement with the relevant Ministry may find it necessary to conclude further agreements related to the investment. In such a case, however, there are two issues to be taken into consideration. Firstly, the total value of state aid which is provided by different sources and separate agreements is limited. Secondly, there are only two periods in the year during which applications may be submitted, January and June, and therefore investors will apply at regular intervals for further aid.

## Slovakia

Until recently, Slovakia has had the most ad hoc procedure for allocating incentives. Whilst many of the features of the older style of allocating incentives have been superseded or removed, the process is still in a state of flux and many of the features of the old system remain. The key steps of the process are as follows:

‘Until recently Slovakia has had the most ad hoc procedure for allocating incentives.’

### Initial discussions with SARIO

As mentioned in Part 4, any investor looking for state support from Slovakia should contact the Slovak Investment and Trade Development Agency (**SARIO**).

Part of the intended role of SARIO is to work with all different types of investors in Slovakia, throughout various stages of an investment including helping with the search for the best locations, real estate and subcontractors, helping with the application for incentives and helping with the creation of new job opportunities and employee retraining programmes. It claims to offer a comprehensive database of land and property available to investors, a comprehensive database of investment opportunities and detailed regional analyses and studies. In practice, this is usually a supplement to the investigations that the investor will make on its own account with private sector advisers.



SARIO's contact details are as follows:

Martineckova 17  
821 01 Bratislava  
Slovakia

Tel +421 2 58 260 100  
Fax +421 2 58 260 109

E-mail [sario@sario.sk](mailto:sario@sario.sk)  
Website [www.sario.sk](http://www.sario.sk)

It is likely that the investor will commence discussions with SARIO. During these initial discussions, the investor will present its project and the parties will discuss the types of incentives sought and what is on offer. However, it should be noted that the new guidelines on the granting of state aid are intended to remove too much discretion on the part of SARIO in negotiating the eligibility of incentives since they set out a framework which is designed to predetermine whether an investment will qualify for incentives or not.

## Agreeing the incentives

Before the new guidelines were introduced, following the initial negotiations between SARIO and the investor, SARIO and the Ministry of Economy would put together an indicative package of the incentives which Slovakia would undertake to provide. The Ministry of Economy and the investor would then enter into a memorandum of understanding (**MoU**), a non-binding agreement which recorded the main terms agreed in principle before the more detailed investment agreement was prepared and negotiated. The benefits of signing such an MoU were that it focused the attention of the state on the structure and amount of incentives required, identified issues and clarified potential misunderstandings and required the parties to check the compliance of the incentives with EU rules at an early stage. It was always important for an investor to take extreme care to ensure the agreement was non-binding and not an agreement to enter into a future agreement, which, under Slovak law, is an agreement under which the basic terms of an agreement which is later to be signed “in full” are set out and which enables a party to insist on entering into a proper agreement.

The new guidelines envisage a different procedure for agreeing the incentives which are on offer from the government. It is anticipated that, following any initial discussions, the investor will submit an indicative application for incentives to SARIO which will rule within a specified time frame (10 days) whether the application for aid is complete and correct. If it is, the relevant ministries will have a further 10 days to make comments on and approve the application. The guidelines do not refer to the use of an MoU and envisage that the parties will proceed straight to negotiating an investment agreement. However, the guidelines do not rule out the use of MoUs and, if the parties did decide to use one for the reasons set out above, any investor should seek local advice to ensure the agreement is non-binding.

‘... the investor will submit an indicative application for incentives to SARIO which will rule within a specified time frame ...’

## Investment agreement

The most important stage of the procedure is the investment agreement entered into between the Ministry of Economy, the investor and the municipality where the investment will be made (to ensure the support of the municipality throughout the project). The new guidelines anticipate that the negotiation of the investment agreement should take 90 days. It is crucial to get this document right as it will form the framework within which the investor must operate and under which incentives will be granted. The exact contents will be negotiated with SARIO on behalf of the state and the key clauses we would expect to see are discussed at the beginning of this Part 5.

‘... any investor must be aware that agreeing such contracts can take a lot of time.’

### Formal application for incentives by the investor

In the past, the investor and the Ministry of Economy would execute the investment agreement before the investor officially applied to the Slovak government for incentives. Under the new guidelines, however, the investor will submit to the Ministry of Economy the final draft of the investment agreement it has negotiated with SARIO together with the formal application for the incentives required by Slovak law.

Unfortunately, the new guidelines do not make explicit exactly what information the investor will have to provide in the application and it is therefore very useful for the investor to seek assistance from SARIO and local lawyers before completing and submitting the application. Once it has received the application and draft investment agreement, the government will then approve the agreement and execute it, before proceeding to the next stage.

### Government applies for EU clearance

The government will apply for clearance from the European Commission after executing the investment agreement unless EU rules do not require clearance to be sought, for example, because the aid is *de minimis*, as discussed in Part 3. An investor and its lawyers can expect to get quite involved in helping to prepare any application.

### Further agreements signed

Of course, as the investment agreement only provides a framework for the incentives, it may well be necessary for the investor to enter into some further agreements with other state bodies. For example, if the investor is to receive training aid, it will need to agree an implementation agreement with the Slovak Labour Office, setting out the exact mechanism for the grant of that aid. However, the key terms of any such agreement should have been set out previously in the investment agreement (for example, how much training aid will be allocated and the investment targets the investor must meet to receive it), so very detailed negotiation should not be necessary. Having said that, any investor must be aware that agreeing such contracts can take a lot of time.

### Provision of information and receipt of incentives

Going forward, the investor will, of course, have to regularly provide the information required by the investment agreement to the Ministry of Economy on or before the dates which have been agreed. Any disputes between the Ministry and the investor about the information which the investor provides will have to be dealt with according to the mechanism adopted in the investment agreement.

The Ministry will evaluate the investor's performance of its obligations by comparing the investor's actions with what was set out in the investment agreement. Depending on the exact terms of the investment agreement, if the investor fails to perform any of its obligations which were conditions to the granting of incentives, either the incentives will not be granted or any incentives already granted may have to be repaid with interest.

# Part 6

## Focus on real estate issues

A further key issue for any FDI investor will be how it actually gets ownership of the investment site. Although the purpose of this brochure is not to go into detailed explanation of all general real estate issues (separate publications are available on these topics from the various Allen & Overy offices – please contact us for copies), we will look at some specific issues which may arise for large scale investors in each jurisdiction.

However, there are a few general issues which an investor in any country should consider:

### Legal due diligence

When considering potential investment sites, based on the key factors for the particular type of project discussed in Part 2, we would always recommend that the investor, as a potential purchaser of real estate with a considerable value, carries out quite extensive due diligence on the proposed site. This may include (depending on the type of land and the jurisdiction) an examination of:

- an extract from the relevant land register showing ownership of the land;
- any possible leases which are not registered in the land register;
- claims of former owners, litigation and administrative proceedings concerning the property;
- claims for easements (perhaps created by prescription) and unregistered mortgages;
- preliminary injunctions and pending execution;
- bankruptcy proceedings;
- appropriate zoning and building permits or occupancy certificates;
- the designation of the land for a specific purpose (for example agriculture) as this may need to be changed (which can take time); and
- property, liability and other relevant insurance policies.

Of course, legal due diligence is not the only type of investigation that may be necessary in relation to the land; for example, an investor may want to consider having an environmental audit of the site, especially where there could be ongoing liability for environmental damage caused by previous owners.

‘... we would always recommend that the investor ... carries out quite extensive due diligence on the proposed site ...’

### Consider who owns the land

Imagine an investor which finds the perfect investment site and begins to purchase the land. After quite some time, it discovers that a piece of land right in the centre of the project site belongs to a private owner who is unwilling to sell, making it impossible to start construction of the necessary buildings according to its schedule. It is because of this type of scenario that an investor should consider the fact that, while for every other reason a site may be perfect, it could become a nightmare if owned by 200 (or 10,000) different private owners, each of whom has to be approached and negotiated with.



### Certificates, approvals and permits

Whenever construction and use of land is intended, there will be a number of certificates, permits and approvals which the investor will need to obtain. Failure to do so can lead to very large fines or worse, for example, the refusal of permission to occupy or use a building which has been constructed and appropriate local legal advice should always be sought. Some examples of the types of permits which might be necessary are as follows:

**Zoning permit** – this states that the type of building envisaged, with generally defined parameters, may be built on the site.

**Building/construction permit** – this allows the investor to construct the specific building, road, conduit, etc. as set out in the detailed plans submitted to the relevant authority. There may be conditions, for example, planting trees to replace any cut down for the construction. An investor must beware of any changes to the design of the construction after the permit has been issued as an amended permit may be necessary.

**Occupancy/use certificate** – this sets out the purposes for which the building may be used and a building may not be used without it or for any purpose not included in it. It is therefore key to ensure that the permit applied for covers all the potential uses to which the buildings may be put.

**Approval of environmental agency** – this may be needed, for example, if the construction site is near a water source and the construction would have to comply with any rules set down by the environmental agency.

‘... while for every other reason a site may be perfect, it could become a nightmare if owned by 200 (or 10,000) different private owners ...’

## Czech Republic

Generally in the Czech Republic, the real estate issues which an investor must consider are the same as those for other purchasers of land. However, one aspect of the purchase of land which may differ for an investor is the potential to acquire land at a discount.

### Acquisition of land at a discount

As well as the centralised, legislation-based system of incentives described in Part 4, an investor may also be able to take advantage of local benefits which may be provided by municipalities seeking, for example, to increase employment in their region. This will often take the form of the sale of land to an investor for less than market value. The municipality will typically require a number of criteria to be satisfied by the investor to ensure, for example, that the investor does not acquire the land for speculative purposes, does in fact build the planned factory, continues to use the land for the planned purpose for a fixed number of years and invests in certain infrastructures on the land etc. It is useful for a potential investor to note that the purchase agreement entered into between the investor and the relevant municipality may well have many of the features of an investment agreement described in Part 5.

These requirements will typically be tested at various intervals after the sale (for example after two and four years), with the municipality having the authority to reclaim the land from the investor if it is not meeting the criteria.

These discount sales, as they are not centrally regulated, can apply differently in different areas, and there is no single framework of requirements that investors should fulfil, nor fixed level of discount nor fixed conditions on sales.

However, it is important to note that, while these sales fall outside the “incentives” system from a legislative point of view, the benefit to the investor must be taken into account when considering the total incentives which that particular investor has received for the purpose of the EU restrictions on state aid. Typically the value ascribed to a sale will be the difference between the market value of the land involved and the actual purchase price paid by the investor.

### Help acquiring land

In order to sell large areas of land to investors, municipalities may need to purchase the land from private individuals. The municipalities do not do this under any special statutory powers. The government does have the power to order the compulsory purchase of land from individuals, however this power does not come from any legislation related to incentives but is a power of general public interest. To date the government’s policy has been that these powers are not appropriate for use to acquire land for the purpose of incentives.

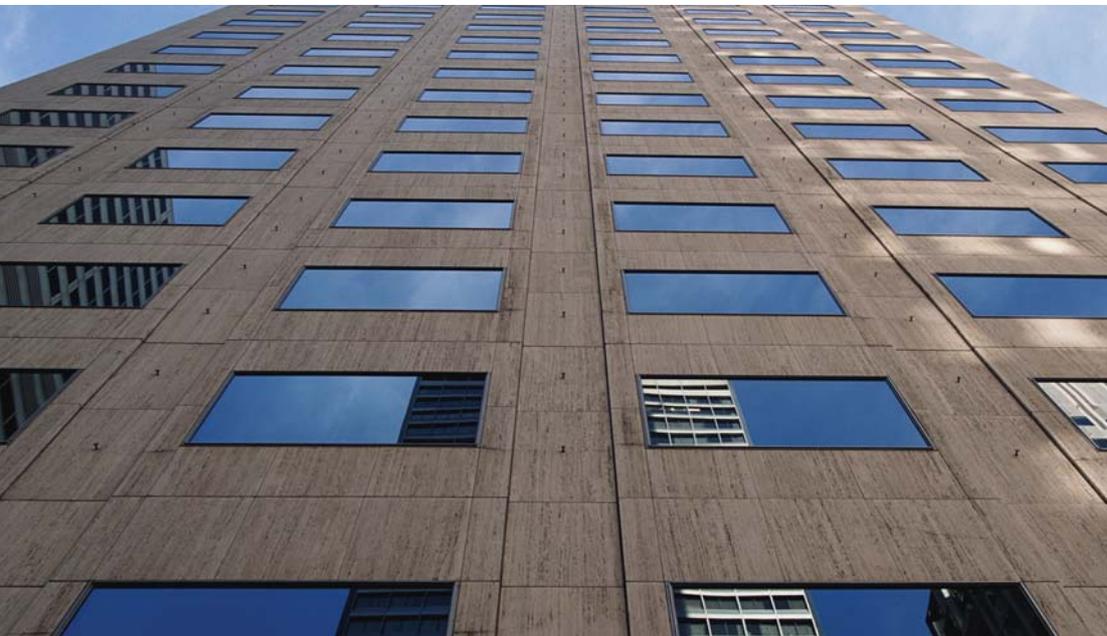
However, municipalities have in the past negotiated with private individuals to buy land in situations where the potential sale to an investor as part of an “incentives” scheme is already in place. In this situation, the municipality is effectively acting to buy the land on behalf of the investor, although legally this may not be the case.

‘... the municipality has the authority to reclaim the land from the investor if it is not meeting the criteria.’

## Hungary

As for the Czech Republic, the main issues facing an FDI investor when seeking to acquire real estate in Hungary are the same as those for any other purchaser of land. However, any potential investor should be aware that there are some general restrictions on foreign entities purchasing land which may affect the choice of site or require the setting up of a Hungarian company.

As a general rule, foreign individuals or legal entities may not acquire the proprietary rights to any agricultural land or protected natural areas. Except for cases when they are acquired by inheritance, which is, of course, very unlikely for an FDI investor, the property rights of properties that do not qualify as agricultural land may be acquired by foreign individuals or legal entities, if such acquisitions are authorised by the head of the Budapest or county administrative office with jurisdiction over the locality of the properties. The acquisition of property by foreign natural persons establishing themselves as independent entrepreneurs in Hungary must also be authorised, if such properties are directly required for the performance of the economic activities they are establishing.



‘...there are some general restrictions on foreign entities purchasing land which may affect the choice of site or require the setting up of a Hungarian company.’

### Acquisition of land at a discount

Again, as for the Czech Republic, it may be possible for an investor to negotiate a preferential price for land owned by the Hungarian Government or by a local municipality, and any reduction in the price of the land below market value could well constitute state aid and so must be taken into account when considering the total incentives that the investor has received for the purpose of the EU restrictions on the intensity of aid discussed in Part 3.

### Help acquiring land

Where an investor is investing in Hungary, it can expect that the government will assist it to try to simplify the acquisition process for the investment site. However, it should also be noted that, while the government does have the power to order the compulsory purchase of land from individuals, this power is only used in very limited circumstances.

## Poland

### Title to real estate

Under Polish law there is generally little difference between public and private ownership of real estate. However, where the acquisition of state-owned land is being considered, there are special regimes regarding transfer of the title to the land set out in the Polish Law on Real Estate Management. In such cases a tender procedure is usually undertaken, and it is only in exceptional cases that state-owned land will be sold on the open market. This is obviously a key distinction for an FDI investor, as a tender offer process may provide the potential investor with an opportunity to present terms to the seller which reflect the value of its overall investment, rather than merely negotiating on price alone.

Real estate located in an SEZ is generally state-owned, with the exception of cases where the land is owned by a managing entity, which is a special company set up for the purpose of managing the SEZ (in which the state owns a majority of the votes at shareholder meetings and is entitled to appoint and dismiss a majority of the members of the board). However, a private owner may agree to its land comprising part of an SEZ so that it is subject to the rules of the SEZ. This may be a key issue for an investor and, when considering land within an SEZ, it is important that at the earliest possible stage it is established whether the land is privately owned or state-owned, because if the land is privately owned the tender process described above will not be available.

Apart from the ownership title the real estate may be subject to a perpetual usufruct, which is a legal concept similar to a leasehold agreement and is specific to Polish law. A perpetual usufruct refers only to property which is owned by the state or local authorities (municipalities).

### Benefit of acquiring land from the state

The investor will need to negotiate a land purchase agreement or a preliminary land purchase agreement with the owner of the real estate in question, whether it is the state or a private individual. However, one benefit of buying state-owned land is the reduction of the risk of re-characterisation or termination of the land purchase agreement by a fickle private seller. Another benefit is that in most cases the price of state-owned real estate sold for investment purposes will be preferential when compared with equivalent market prices. This applies to both land located within, as well as outside, an SEZ. However, it should always be noted that the general rule is that the price of the land is established by the owner, and this determination is not dependent on the status of the land as being either publicly or privately owned.

### Help acquiring land

If the project includes a significant investment, in our opinion it may be possible to expropriate the land from its owner under additional proceedings which override the owner's refusal. The local government authority (*Starosta*) may be entitled to expropriate the land from the owner if the expropriation is in the public interest and provides adequate compensation in relation to the market price of the real estate.



‘... where the acquisition of state-owned land is being considered, ... it is only in exceptional cases that state-owned land will be sold on the open market.’

## Slovakia



### Help acquiring land

The Slovak Government has recognised that, especially where the investment site is not owned by the state or the relevant municipality, actually acquiring land can be logistically difficult and very time-consuming for the investor. The municipality where the site is located may, therefore, agree to set up a special purpose vehicle (**SPV**), funded by the state, which will acquire the ownership of all the land. The SPV will then be sold to the investor for the price of the land. This can save the investor from negotiating many land purchase agreements and, therefore, from expending a huge amount of time and legal costs. Remember, though, that if the municipality does agree to purchase the land, the investor and the municipality should include provisions about this and agree a strict time frame for this to be completed in the investment agreement; otherwise the project may be seriously delayed, with construction unable to start and without the investor really having any legal basis to speed up the process.

‘If the project proposed by the investor is granted the status of a “large investment” ... there will be further benefits ..’

### Further benefits for large investment projects

If the project proposed by the investor is granted the status of a “large investment” by the Ministry of Economy, there will be three further benefits it can take advantage of when acquiring the land on the investment site, all discussed below. Large investment status may be granted (following an application by the investor) where:

- the construction costs needed for the production project are not less than SKK 1 billion (approximately EUR 25 million), or not less than SKK 500 million (approximately EUR 12.5 million) if the investment is to be made in a region where the unemployment rate exceeds 15%;
- the contemplated production volumes and the impact on employment are regarded as material to the national economy;
- the beneficiary of the grant is a legal person incorporated in Slovakia; and
- the Slovak Government has decided that the investment is in the public interest.

The three benefits are as follows:

#### **Simplified acquisition procedure of state-owned land**

When working on a project with large investment status, the municipality is entitled to follow a simplified acquisition procedure if the state or the Slovak Land Fund is the owner of the site. Obviously, this assists in transferring the investment site to the investor more quickly.

## Expropriation

As mentioned in the introduction to this Part, the worst possible scenario for an investor would be to own virtually the entire investment site only to find that one or more private owners refuse to sell. How can this be dealt with? Well, if the project has large investment status, the municipality may be entitled to expropriate the land from that owner under proceedings before the Building Office.

However, given that expropriation represents such a significant restriction on a private individual's constitutional right to own property, the Building Office will only allow the municipality to expropriate:

- if all other possible means to achieve the transfer of the real estate have failed;
- if it is strictly necessary to expropriate the land;
- if the expropriation is in the public interest; and
- if adequate compensation in relation to the market price of the real estate is available.

Beware also, that any of the decisions of the Building Office may be appealed and/or judicially reviewed, potentially creating huge delays and legal costs. Also, the Building Office may fully or partially revoke its expropriation decision if the expropriated land is not used for the purpose for which it was expropriated within the time limit provided in the expropriation decision (this time limit may be up to two years).

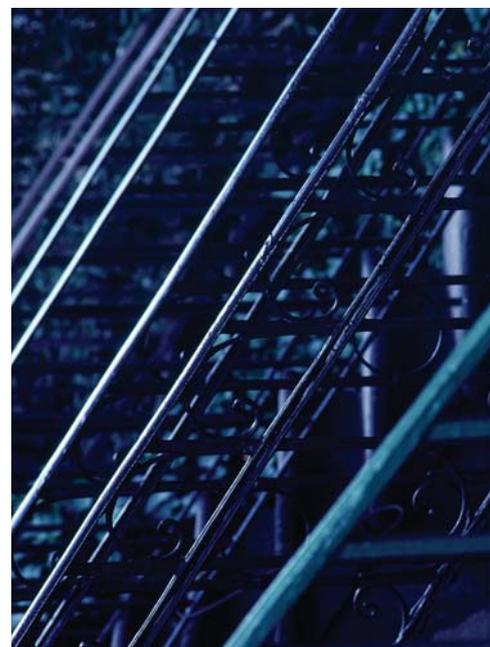
## Restriction of other rights

As in many jurisdictions, there is a possibility in Slovakia that a third party of whom the purchaser was not even aware may claim that he owns the title to land purchased from the apparent owner. If this occurs, there can be a number of adverse consequences for the purchaser, including a successful claim by the third party that ownership of the land never validly transferred to the purchaser.

The advantage of having large investment status is that no third party can be authorised to claim title to the land forming part of the site of the large investment. However, it must be recognised that a third party's right to receive damages is not affected and, in such circumstances, the investor should contract with the transferor of the land for specific indemnities or other suitable risk allocation provisions to avoid or reduce the investor's exposure to liability.

## Other issues

There are many issues that a purchaser of real estate in Slovakia must always consider, for example ensuring that the description of the land in the purchase agreement complies with the law, translating the agreement into Slovak and arranging for the legalisation of the signature of the seller, and these are dealt with in a separate publication entitled "Real Issues in Real Estate", which is available from our Bratislava office. However, one issue to note is that where any parts of the land required by the investor are state- or municipality-owned, it may be possible for an investor to agree to purchase that land for a reduced price. Again, it must be remembered that this could constitute state aid.



## Conclusion

In conclusion, it can be seen that the CEE countries covered by this publication have spent a great deal of time and effort developing legislation, rules, agencies and procedures designed to attract foreign investment – and that these efforts have been highly successful and rewarded by a huge influx of inward investment.

The governments of each of these countries, not only in their efforts to close the “chapters” allowing them to progress to EU accession but also above and beyond that, have taken great strides in trying to create an environment which can stimulate investment and sustain it in the long term. These have included not only macroeconomic policies such as combating inflation, aiming to join the eurozone, and setting competitive but sustainable tax rates, but also getting down to the fundamentals of creating a better and more efficient legal system for setting up companies, acquiring real estate, applying for permits and liberalising the labour market – all this at the same time as privatising the entire financial, utilities and telecommunications sectors, and building roads and airports. The effort required has been staggering.

On the other hand, in devising the relevant rules and procedures, each of the governments has had to take into account policies for trying to attract investment to the places and people that most need it, and ensuring that the investment projects which receive the aid are the most deserving. The rules and procedures must be transparent and detailed, and must be compliant with EU law. Naturally, devising a set of rules to accommodate all these concerns is complicated, as it needs to take into account differing circumstances and, of course, changes in policy, and will need to be revised frequently.

Each of the countries therefore, in the process of making itself attractive to investors, and finding distinguishing ways to do so, has inevitably developed widely differing laws and procedures. Common threads are nonetheless evident, and the overarching framework of EU legislation allows some examination of the relevant issues to take place under a common system. However, the procedures involved in physically deciding upon an investment location and agreeing all the necessary elements to make your project a reality are complex, and different, in each of the countries. Planning and seeking advice is essential.

As we said at the beginning, this publication was never going to be an encyclopaedia of all that you need to know about FDI and the related rules. That would be impossible. However, we hope that it has served as a useful introduction to the issues to consider when contemplating your investment. We wish you the best of luck on your project.

‘Planning and seeking advice is essential.’



# Allen & Overy

## Our corporate practice

Allen & Overy has an acknowledged top-tier corporate practice with particular expertise in complex, high-value, cross-border work. Our global, cross-practice group is corporate adviser to more than 62 of the Fortune 500 companies, 57 of the Eurotop 100 and a quarter of the FTSE 100. We were ranked as the number one advisers for M&A in Europe in 2003, advising on 161 deals with a total value of USD128 billion (*Source: Dealogic*).

Our market leadership is underpinned by an integrated, high-quality network of 25 affiliated undertakings, including a staff of some 235 US-qualified lawyers. This broad base makes us the leading service provider for inward investment into Europe, and a major force for European and Asian inward investment to the US.

Our corporate group has extensive experience of joint ventures and strategic alliances, with particular expertise in fast-developing sectors. We cover licensing, IP, IT, R&D agreements and outsourcing, and we also help smaller ventures in the start-up phase.



## Our Central and Eastern European network

Allen & Overy has a very strong reputation as a provider of high-quality legal services in the CEE region. Highlighting our strengths in the region, the CEE team was awarded “Central and Eastern European Law Firm of the Year” at the PLC/Global Counsel 2003 Awards.

With affiliated undertakings in Bratislava, Budapest, Prague, Moscow and Warsaw, Allen & Overy has one of the largest practices in the CEE region, enabling us to deal with the most complex and high-profile transactions. Our CEE lawyers have established close working ties between their respective practices, allowing us to evolve into a more consistent and coherent practice and enabling us to provide a seamless service to our clients.

We are able to provide a fully integrated service for domestic and cross-border transactions across all practice areas within the CEE region, combining our international experience with local expertise and knowledge of local market conditions. Our main practice areas are banking and finance, international capital markets and corporate law, with specialisation in sectors such as energy, communications, competition, foreign direct investment (e.g. greenfield projects), real estate, PPP/PFI and projects.

The CEE practices, supported by a significant emerging markets practice and a range of specialist sector practices in London, New York, Frankfurt, Paris, Brussels and other cities, have developed recognised expertise across a range of finance and corporate fields.

Our lawyers have an intimate knowledge of the issues and techniques involved in advising on transactions in the region, and are able to offer advice on local as well as English, EU and US law. In addition to English and the native languages of the CEE offices, we are able to communicate in German, French, Mandarin, Italian and Japanese.



“Central and Eastern  
European Law Firm  
of the Year”

PLC/Global Counsel 2003 Awards

## Bratislava

*“Allen & Overy Bratislava, s.r.o. was voted by interviewees as the practice of choice due to its sophisticated international expertise and superior level of service across the board, but particularly in M&A and finance.”*

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*The World's Leading Lawyers 2003-2004 edition*

In July 1999 Allen & Overy became the first UK-based international legal practice with a presence in Bratislava. The office is led by Igor Pálka, managing partner, who *“is renowned for his encyclopaedic knowledge of Slovak law”* (Chambers Global, *The World's Leading Lawyers 2003-2004 edition*) and by Hugh Owen, a partner described as *“a wise negotiator and creative project manager”* (Chambers Global, *The World's Leading Lawyers 2003-2004 edition*). They are *“both brilliant advisers”* according to interviewees (Chambers Global, 2004 rankings).

Partners 2, Legal staff 17, Support staff 12

## Budapest

*“Competitors acknowledge this solid team for its visibility on high-profile transactions and for its ‘extensive Hungarian expertise’ under the aegis of the respected Éva Hegedűs.”*

### Chambers Global

*The World's Leading Lawyers 2002-2003 edition*

Since establishing an office in Budapest in 1993, Allen & Overy has built up a reputation as being one of the leading business law firms in Hungary. The office *“remains an effective player in the corporate and commercial arena”* (European Legal 500, 2003 edition) and is led by Éva Hegedűs *“who attracts recommendation for her project finance work”* (Chambers Global, *The World's Leading Lawyers 2001-2002 edition*); Zoltán Lengyel, who is listed as *“a capital markets expert par excellence”* (Chambers Global, *The World's Leading Lawyers 2003 edition*); and Marcell Németh, who is acknowledged as *“a true professional already making an impact on the market”* (Chambers Global, *The World's Leading Lawyers 2002-2003 edition*) for banking work.

Partners 3, Legal staff 16, Support staff 14

## Prague

*“Clients particularly turn to it for complex international deals, where it has the prestige and the prominence to tackle the biggest transactions.”*

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*The World's Leading Lawyers 2002-2003 edition*

### International Financial Law Review, IFLR Awards 2005

*Czech law firm of the year*

*“According to clients, the partners at this firm offer a vast array of experience. In addition to corporate/M&A and joint ventures, the team has been involved in privatisations, restructuring and insolvency. The firm can also boast some unique mandates”*

### Chambers Global

*The World's Leading Lawyers 2004-2005*

With over 12 years of experience, Allen & Overy, Praha Advokátní kancelář has developed into one of the leading practices in the Czech Republic. *“Allen & Overy has established itself as the dominant banking practice. Mikuláš Touška heads an impressive team known for its creative approach. He is described by competitors as a definite front runner in this market: he would bring great kudos to any practice. Also well respected for his financing work, particularly in the telecoms sector, is Václav Valvoda, who is acclaimed as a strong worker with excellent market knowledge”* (Chambers Global, *The World's Leading Lawyers 2003 edition*). *“Allen & Overy's excellent (corporate) practice is jointly headed by managing partner Jane Townsend and newly appointed partner Jan Myška”* (The European Legal 500, 2003 edition).

Partners 4, Legal staff 28, Support staff 20

## Warsaw

*“Judged by clients to be the Business Law Firm of the Year in Poland.”*

### Chambers Global

*The World's Leading Lawyers 2002-2003 edition*

*“From the business perspective, it's the best”* (a client talking about our M&A practice).

### Chambers Global

*The World's Leading Lawyers 2004-2005 edition*

Since its establishment in 1991 in Warsaw, Allen & Overy, A. Pędzich Sp.k. has continued to provide excellent service to its banking, corporate and ICM clients. The finance team is led by Arkadiusz Pędzich who was *“Judged by clients to be the Business Lawyer of the Year in Poland”* (Chambers Global, *The World's Leading Lawyers 2002-2003 edition*). *“In addition to mainstream corporate M&A it handles a range of work that includes major infrastructure projects and strategic telecoms advice”* (Chambers Global, *The World's Leading Lawyers 2004-2005*).

Partners 3, Legal staff 30, Support staff 25

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