

# **NON-DOMESTIC RATES RELIEFS AND STATE AID**

**A GUIDANCE NOTE FOR LOCAL AUTHORITIES IN SCOTLAND**

## Contents

1. Introduction
2. Non-Domestic Rates Relief
3. What is State aid?
4. State aid and Non-Domestic Rates Relief
5. Developments in Fiscal Aid: Regional Selectivity

**Annex A** Charities and Not-for-Profit Organisations  
Local Services  
Hardship Relief

Annex B UK Temporary Framework Scheme

Scottish Government State Aid Unit  
February 2009

## INTRODUCTION

1. State aid is a European Commission (EC) term which refers to forms of public assistance given to undertakings on a select basis, with the potential to distort competition and affect trade between Member States.
2. The EC generally prohibits State aid but considers that certain types of aid may be considered compatible with the Treaty. The State aid rules comprise various articles of the EC Treaty, regulations, frameworks and guidelines, and these set out what aid may be allowed. The rules are designed to ensure that aid granted by Member States does not distort trade or competition throughout the EC.
3. Each public body, or aid administrator, is responsible for ensuring its public expenditure is State aid compliant. This includes central government, local authorities and other public bodies administering public funds. State aid rules apply to support given to organisations involved in economic activity ('undertakings'). An undertaking does not have to be profit-making if the activity carried out is one which has commercial competitors. Public and voluntary sector organisations, such as universities and charities, could be classified as undertakings if they are involved in economic activity (see also **Annex A**).

## NON-DOMESTIC RATES RELIEF

4. Non-domestic rates are levied on the basis of a national poundage rate (set annually by Scottish Ministers) multiplied by the rateable value of the property occupied. The rateable value broadly represents the yearly rent the property could have been let for on the open market on a particular date. Scottish local authorities have discretion, under certain circumstances, to grant rate relief from all or part of the amount of non-domestic rates payable in certain circumstances.

## WHAT IS STATE AID?

5. State aid refers to public assistance given to undertakings which has the potential to distort competition and affect trade between Member States. There are five **criteria** or **questions** which need to be considered in order to establish whether a measure constitutes State aid:

1. **Is the measure granted by the State or through State resources?**

As well as central government departments, this includes local authorities and other public, or private sector, bodies designated or controlled by the State. State resources include tax exemptions, as these are equivalent to the consumption of State resources in the form of fiscal expenditure.

2. **Does it confer an advantage to an undertaking?**

A benefit to an undertaking, granted for free or on favourable (non-commercial) terms, could be State aid. This includes the direct transfer of resources, such as grants and soft loans, and also indirect assistance – for example, relief from charges that an undertaking normally has to bear, such as a tax exemption, reduction or deferment.

### 3. Is it selective, favouring certain undertakings?

Aid that targets particular businesses, locations, or types of firm (e.g. SMEs or other sectors), is considered selective. A *general* measure affecting the whole of the Member State's economy, e.g. a nationwide fiscal measure, is not considered a State aid.

### 4. Does the measure distort or have the potential to distort competition?

If aid strengthens the position of the beneficiary relative to other competitors then this criteria is likely to be met. The potential to distort competition does not have to be substantial or significant, and this criterion may apply to small amounts of aid and firms with little market share (see also **Annex A**). *Most interventions have the potential to distort competition.*

### 5. Is the activity tradable between Member States?

The EC interpretation of this is broad – it is sufficient that a product or service is subject to trade between Member States, even if the aid beneficiary itself does not export to the EU. *Consequently most activities are viewed as tradable.*

6. Where **all five** criteria are met, State aid **is** involved and the State aid rules apply. Where one or more of the criteria appears **not** to be met, then funding is unlikely to constitute State aid. We recommend that you check with the State Aid Unit where any doubt exists.

## STATE AID and NON-DOMESTIC RATES RELIEF

7. State aid rules apply to aid measures in any form and are equally applicable to tax measures such as non-domestic rates relief. To ensure consistency and equality across the EU, guidance is provided in the **Commission notice on the application of state aid rules to direct business taxation (98/C/384/03)**.<sup>1</sup>

8. Tax measures open to all economic undertakings within a Member State are, in principle, general measures and not State aid. The reason for this is that general measures are open to all on an equal basis.

9. Expanding on this, provided the measures are applied to *all* firms and to the production of *all* goods, the following do not constitute State aid:

- tax measures of a purely technical nature (for example, setting the rate of taxation, depreciation rules and rules on loss carry-overs; provisions to prevent double taxation or tax avoidance);
- tax measures pursuing general economic objectives through a reduction of the tax burden related to certain production costs (research and development, the environment, training, employment).

<sup>1</sup> [http://eur-lex.europa.eu/LexUriServ/site/en/oj/1998/c\\_384/c\\_38419981210en00030009.pdf](http://eur-lex.europa.eu/LexUriServ/site/en/oj/1998/c_384/c_38419981210en00030009.pdf)

10. Any measure intended partially or wholly to exempt firms in a particular sector from the charges arising from the normal application of the general system where there is no justification for this exemption on the basis of the nature or general scheme of this system constitutes State aid.<sup>2</sup> Therefore, where a tax measure distorts competition by favouring selected undertakings, for example, by region or by sector, then it breaches competition rules and constitutes State aid which should comply with the State aid regulations.

11. Tax relief reduces an undertaking's current expenditure. The EC takes a particularly negative view of such operating aid and generally prohibits it. Operating aids are only approved in exceptional circumstances and subject to certain conditions, for example, certain types of environmental protection aid, and certain regions where it must be temporary and degressive.

12. The EC requires Member States to notify all State aid unless it falls under an existing approval (or within *de minimis* limits). Various regulations and frameworks set out the types of aid which the Commission is likely to approve. These aim to address market failures and support EU objectives including:

- Small and Medium Sized Enterprises;
- Training and Employment;
- Environmental Protection;
- Research and Development and Innovation;
- Regional Development;
- Risk Capital; and
- Rescue and Restructuring.

13. Proposed aid must be notified to the EC for approval before it is awarded. The General Block Exemption Regulation offers a simplified procedure for certain types of aid to enable schemes to be implemented more quickly. Failure to comply with notification requirements automatically makes the aid unlawful and recoverable.

### **De Minimis Aid**

14. The EC considers that public funding to a single recipient of up to €200,000 (approximately £175,000 at current exchange rates) over a 3 year fiscal period has a negligible impact on trade and competition, and does not require notification. This is known as *de minimis* aid and it can be given for most purposes, including operating aid. Exclusions include the fisheries and coal sectors, certain agriculture and transport activities, or undertakings in difficulty.

15. The *de minimis* ceiling applies to all public assistance given to an undertaking as *de minimis* funding over the relevant period. As such, it can be difficult to administer. Prior to awarding *de minimis* aid, all previous *de minimis* aid the recipient has received over the current and previous 2 fiscal years must be determined and cumulated to ensure the proposed aid will not breach the ceiling. The onus is on the body granting aid to ensure that the limit is not exceeded. On award, the recipient should be informed that the aid is *de minimis*, and the value in

---

<sup>2</sup> Case 173/73 Italy v Commission [1974] ECR 709

euros (at the time of offer). It is also recommended that the following paragraph is included in the offer letter.

“Under EC regulation 1998/2006 (*de minimis* aid regulation), this is a *de minimis* aid. There is a ceiling of €200,000 (approximately £175,000) for all *de minimis* aid provided to any one firm over a three-year period. Any *de minimis* aid awarded to you under this offer letter will be relevant if you wish to apply, or have applied, for any other *de minimis* aid. For the purposes of the *de minimis* regulation, you must retain this letter for three years from the date on this letter and produce it on any request by the UK public authorities or the European Commission. (You may need to keep this letter for longer than three years for other purposes.)”

16. It is recommended that, given the small ceiling, *de minimis* is used only where there are no other options.

### **Temporary State aid Framework**

17. In December 2008, the European Commission adopted a Temporary Framework for State aid measures to support access to finance in the current financial and economic crises. A UK scheme approved under this framework (N 43/2009) enables limited amounts of aid (up to €500,000) to be granted to companies during the economic downturn, and until 31 December 2010. Aid awarded under this scheme must comply with conditions and reporting requirements set out in the Framework. These are set out in more detail in Annex B.

### **Why comply with State aid rules?**

18. As the EC generally considers State aid to be incompatible with the Common Market in goods and services, it takes a serious view of aid which contravenes the State aid rules. In recent years, increasing priority has been given to applying State aid rules more rigorously. Aid in excess of *de minimis* limits which has not been notified and which is not covered under an approved scheme is classed as unlawful aid.

19. Where aid is found to be unlawful or illegal, the Commission can insist that aid be halted and the recipient required to repay the aid, plus interest. Aggrieved competitors may also seek legal action for damages, and infringement procedures could be commenced against the Member State.

### **Risk Assessment**

20. The EC has sole competence in State aid issues. It is not always clear whether a measure meets the State aid tests, or how it should be treated, and in these circumstances, a risk-based assessment should be considered. This takes into account the factors involved and the risk of implementing a measure without formal EC opinion.

21. A risk assessment should consider a number of factors. These include the extent to which the measure might be considered a State aid and its conformity with

the State aid rules (would it be approvable?). It is also important to consider the likelihood of State aid challenge – from an aggrieved competitor or another Member State – as well as the impact of any challenge.

22. In respect of financial risk, recipients may have to repay illegal aid with interest, regardless of the effect on the recipient, while a complainant could seek financial compensation for damages from the aid granter. Reputation and delivery of objectives are also at high risk if a measure is later found to be incompatible and has to be repaid.

23. Where a risk assessment is undertaken and suggests a measure is ‘low risk’, i.e. unlikely to cause incompatible distortion of competition on trade, consultation with State aid advisers, lawyers and senior officials is recommended before any final judgement is made on whether to award aid.

### **DEVELOPMENTS IN FISCAL AID: REGIONAL SELECTIVITY**

24. A main criterion the EC takes into account when considering State aid and tax measures is whether it provides, in favour of certain undertakings in the Member State, an exception to the application of the tax system. The common system applicable to the Member State is first determined. It is then examined to determine whether the exception to the system or differentiations within that system are justified ‘by the nature or general scheme’ of the tax system. That is to say, whether they derive directly from the basic or guiding principles of the tax system in the Member State concerned. Where this is not the case, then State aid is involved.

25. A European Court of Justice ruling<sup>3</sup> on a tax benefit in the Azores has provided further thinking on regional selectivity and a potential framework under which there could be potential to vary rates of tax paid by business in Scotland.

26. The Azores Government, which has a degree of tax autonomy, reduced the rates of national company tax by 30% in comparison to Portuguese rate. This was notified to the EC for approval but a full investigation concluded that the measure constituted aid. Portugal appealed, arguing that it was justified by the nature of the tax system. Following further investigation, the Court of Justice concluded that the tax reduction had to be assessed in relation to the whole Member State – the context in which it was selective. The Court set out a number of criteria to distinguish between local jurisdictions being autonomous from central government and preferential local tax schemes derogating from central taxation. For the first time, the Court held that a sub-national body could levy taxes which deviate from those applied in rest of country provided it is:

- politically separate;
- has no central interference; and
- the shortfall is not made up by central government.

27. While this did not hold for the Azores in this case, the decision provides a potential framework under which it may be possible to vary certain tax rates within

---

<sup>3</sup> Portugal v European Commission C-88/03

Scotland. The same criteria have since been used by the European Court of First Instance when considering Gibraltar tax reforms but they have not yet been tested with the EC<sup>4</sup>. To meet the conditions for autonomy, the differential would need to be set nationally and apply uniformly to all businesses across Scotland.

---

<sup>4</sup> Curia Press Release 99/08. Judgement of the Court of First Instance in Cases T 211/04 & 215/04

## Charities and not-for-profit organisations

1. State aid refers to public assistance given to an undertaking on a discretionary basis which has the potential to distort competition and trade. There is no strict definition of an 'undertaking' in EU law but it is generally taken to be any entity engaged in economic activity. This could encompass both private and public bodies, and it does not matter if it has a charitable status. A 'social' aim does not exclude a body from the State aid rules, and consideration must therefore also be given to State aid when aid is going to charities and not-for-profit organisations. A key factor is the organisation's activities and whether they are likely to distort competition. Selling new or used goods is generally considered to be economic activity.
2. Whether an undertaking is a charity, a commercial business or a social enterprise – and irrespective the undertaking's income – aid to that organisation will be a State aid if it meets the five State aid tests. In some circumstances, however, local charities or not-for-profit organisations may be deemed to be serving a purely local market (see below).

## Local Services

3. One of the five State aid questions is whether the activity is tradable between Member States. To affect trade, goods or services need not actually be exported but need only be tradable between Member States. For this reason, this criterion is usually met. An exception is Local Services – examples of which may include single businesses such as a local garage or hairdresser – small-scale businesses serving the local community only.
4. There is no definitive list from the Commission of what would be considered eligible as a local service and each case must be considered on its own merits. Some small, localised, commercially insignificant activity may not be considered as likely to distort competition or trade between Member States. However, case law shows that even very small amounts of aid can affect trade. Even where there seems to be no discernible effect on competition, the Commission may take the view that aid represents a barrier to outside companies investing in an area.

## Hardship Relief

5. Local authorities have discretion to give up to 100% relief from business rates, normally in extreme cases of hardship. As hardship relief is by definition operating aid, and as the EU generally prohibits such aid, such relief can only be given under the De Minimis regulation. Therefore, in practice, the amount of hardship relief granted to any one business must not exceed the *de minimis* limit (currently €200,000 over 3 years). However apparently well deserved, such relief will nevertheless constitute State aid and be unlawful if it exceeds the *de minimis* limit.
6. A UK temporary scheme for small amounts of compatible aid offers increased flexibility to provide support of up to €500,000 during the economic downturn. More detail can be found in paragraph 17 of the main document and Annex B.

7. As with all other rates reliefs, reasonable care must be taken to ensure that the relief is State aid compliant, for example by ensuring a decision to award hardship relief does not breach the *maximum* limits. In practice, as hardship relief is always discretionary and is granted on a case-by-case basis, it should be straightforward for local authorities to set up procedures to manage the risks involved by making a proper assessment of State aid issues on each individual case.

**ANNEX B****UK Temporary Framework Scheme N 43/2009 - Small amounts of compatible aid**

The purpose of this scheme is to provide support for business during the current economic downturn, enabling public bodies to provide aid of up to €500,000. It is valid until 31 December 2010.

A number of conditions apply to any aid provided under this scheme. These are summarised below. Full details can be found in the Framework (section 4.2 in particular) and the notification both of which can be found on the [state aid website](#)

**Maximum amount of aid** - Aid granted under this scheme must not exceed the ceiling of €500,000 taking into account any other *de minimis* aid received during the current fiscal year or aid granted under this measure from any public source. The total amount received in the period 1.1.2008 to 31.12.2010 must not exceed €500,000. Prior to granting aid, a declaration must be obtained from the undertaking concerned about any *de minimis* aid received during the current fiscal year to ensure the limit is not exceeded.

**Cumulation** - When aid granted under this measure is combined with other aid measures the maximum aid intensities indicated in the relevant guidelines or regulation must be respected.

**Record Keeping & Reporting** - When aid is granted under this scheme, detailed records must be maintained. This should include all information necessary to establish that all the conditions have been observed. To meet EC reporting requirements, Scottish Government State aid Unit will require regular reports on aid provided under the scheme. It is anticipated that the EC will require a greater standard of reporting under this measures to enable evaluation of its usage. If you intend to provide aid under this scheme please contact the State Aid Unit at Meridian Court, Glasgow.

**Firms in difficulty** – The scheme only applies to firms which were not in difficulty on 1 July 2008. While it can be used to award aid to firms that have entered into difficulty as a result of the global financial and economic crises, it does not replace the guidelines on aid for rescue and restructuring of firms in difficulty which the EC believe continues to provide the best tool to ensure long term viability of such firms.

**Sectoral Restrictions** - It does not apply to export aid, aid favouring domestic over imported products, the fisheries sectors or undertakings active in the primary production of agricultural products.

For more information on the scheme contact the Scottish Government State Aid Unit (0141-242-5816), read the website [www.stateaidscotland.gov.uk](http://www.stateaidscotland.gov.uk) or email [stateaid@scotland.gsi.gov.uk](mailto:stateaid@scotland.gsi.gov.uk)