

Deloitte.

Corporate R&D Report 2011



Content

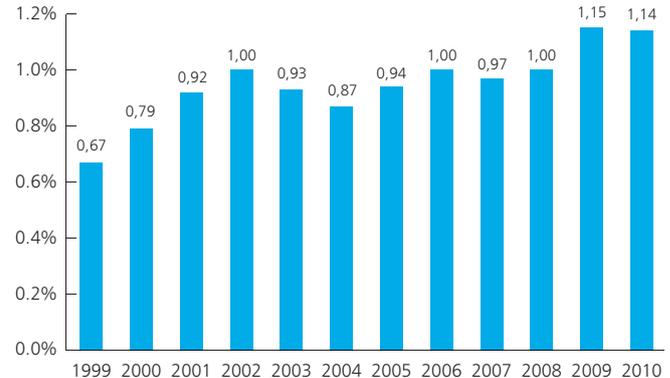
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Introduction

For a long time, research, development, and innovation (R&D&I) policies in Hungary have been lacking a uniform concept, a thoughtfully developed regulatory environment, a clear set of objectives and the appropriate instruments for implementation to align the various fields (incentives, training, etc.) affecting the question. It is not by chance, therefore, that R&D spending stagnated at around 1% of the GDP in the past decade without any clear sign of at least a slightly growing trend.

A recently developed government objective, however, sets a clear goal for R&D spending in the decade to come: *„...Hungary wishes to achieve 1.8% of GDP in R&D spending until 2020 in a way to further increase the share of corporate expenditure within total spending¹...“*.

R&D spending in Hungary between 1999-2009 in proportion (%) to the gross domestic product (GDP) - source: Hungarian Central Statistical Office (KSH)



¹ National Reform Program (NRP) creating the basis for the implementation of Strategy 2020, April 2011, page 21

Background for the Corporate R&D Report

Deloitte Hungary's R&D and Government Incentives service line conducted a survey (Corporate R&D Report 2011) for the first time with the participation of nearly five hundred Hungarian middle-sized and large enterprises on the factors (particularly tax incentives and cash grants) affecting the realisation of their R&D activities.

Experience from recent years suggests that a number of companies are unable to clearly separate R&D activities from other activities and, as a result, they claim none or only some of the available incentives. While it is quite obvious that pharmaceutical, chemical or IT services companies engage in R&D activities, it may come as a surprise that financial, agricultural, food, and even energy companies have also been R&D intensive sectors.

The purpose of the survey was to formulate proposals for the regulatory environment and funding policies. The survey to be repeated annually will, furthermore, enable a comparison of the achievements and expectations of companies from year to year.

The **Corporate R&D Report** was prepared after surveying the opinion of CFOs, tax experts, or where it was not possible, CEOs of companies featured in Figyelő's "Top 200" list for 2009, the largest dynamic growth companies, as well as the largest taxpayers in 2009. The participants were asked to complete a questionnaire comprising 9 questions on Deloitte's website in March and April 2011.

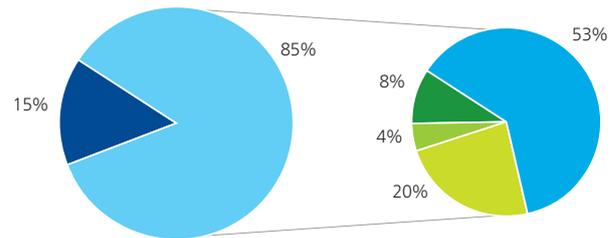
Findings

Companies commonly spend 1% of their revenues on research and development, and this figure is not expected to rise in the coming years without any change to the regulatory environment

The Corporate R&D Report 2011 found that 15% of the companies asked spent nothing at all on research and development in 2010 in Hungary while 53% spent less than 1% of their revenues. Only 12% of the participants claim to have spent over 5% of the turnover on R&D activities.

The Corporate R&D Report 2011 pointed out that about three quarters of the companies carrying out research and development will probably not increase their R&D spending in the following years if the current regulatory environment remains unchanged. Moreover, 9% of the respondents actually expect to cut R&D expenditure.

Do you spend on R&D in Hungary? If so, what percentage of your turnover was spent on R&D in 2010?



- No
- Yes, less than 1% of the turnover
- Yes, between 1-5% of the turnover
- Yes, between 5-10% of the turnover
- Yes, more than 10% of the turnover

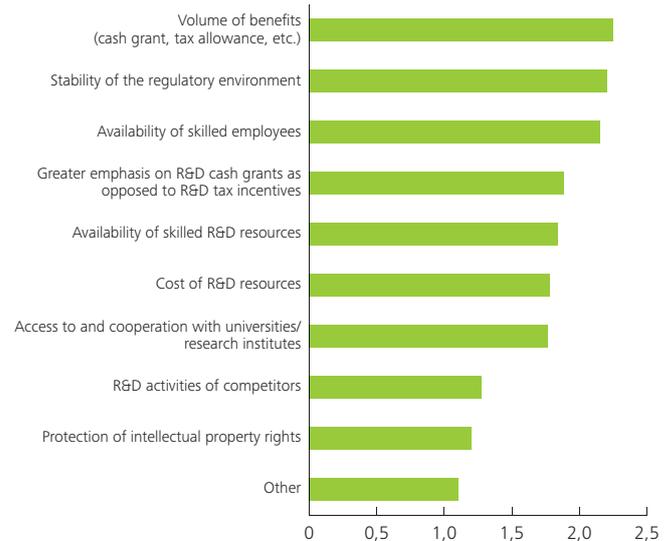
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Respondents believe that it is mainly the volume of available benefits that largely determines their R&D expenditure

In the survey we also wished to explore which external factors could best encourage Hungarian companies to increase R&D spending. Here, respondents listed the volume of benefits (tax incentives, cash grants), availability of skilled workforce, predictability of the regulatory environment, and a greater emphasis on cash grants as opposed to R&D tax incentives. The protection of intellectual property rights and the level of competitors' R&D spending are considered the least important external factors in prompting R&D spending.

To what extent would the external factors below influence the increase/decrease of your R&D spending in the coming 2-3 years?

(The importance of the various factors was rated on a scale from 0 to 3 where 0 means "a factor without any influence" and 3 means means "the most important factor")

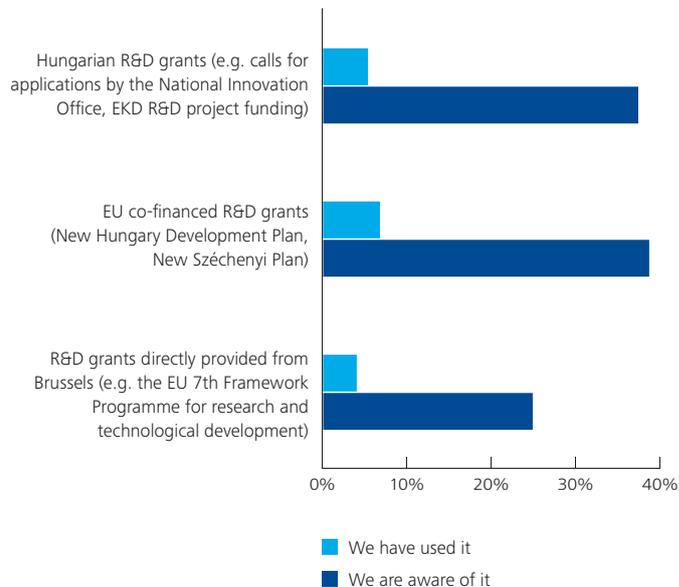


Respondents widely use and are more familiar with tax incentives than with cash grants. However, the uncertainty surrounding the tax authority's position and judgement of the R&D nature of companies' activities appear a serious difficulty in using tax incentives

Aside from the expectations and the external factors determining the level of companies' R&D spending, the Corporate R&D Report 2011 also explored how familiar companies are with the most important government benefits (cash grant schemes and R&D tax incentives) and what they see as the most serious difficulty in, or barriers to, claiming these benefits.

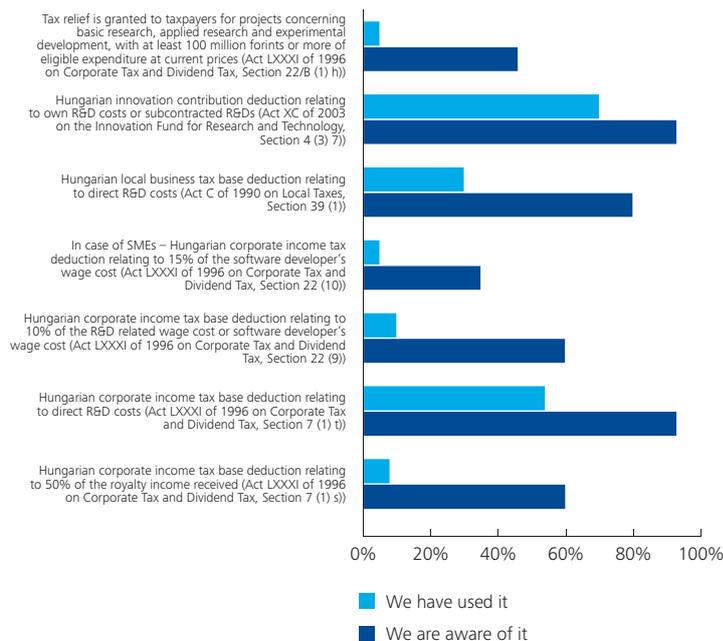
Our survey highlighted that an average of 35-40% of the companies are aware of R&D grant opportunities, primarily EU co-funded and Hungarian schemes. Hardly 10% of the respondents actually used any grant opportunities. Companies familiar with the schemes specified company policy and business philosophy as the main reasons for not applying for cash grants. In addition, the obligation of hiring new employees, as well as the difficulty in forecasting R&D project results and staff requirements for several years in advance are also commonly seen as key obstacles to applying for certain R&D grants.

Please mark which grants you are familiar with/you have ever used.
(More answers were possible.)



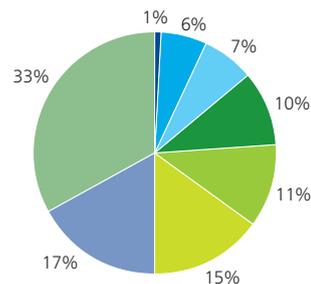
Compared to grant schemes, respondents are more familiar with tax incentives: 70% of the companies claimed to be familiar with the various tax incentives, and 35-90% of these actually know the details of the various tax incentives. The most common and widely used tax incentives include the deduction of direct R&D costs from the innovation contribution and the deduction of R&D costs from the corporate income tax base. The deduction of 15% of software developer's wage costs from the corporate income tax base of SMEs is the least known benefit (perhaps because the participants were companies with typically larger turnover). Although fairly well-known, companies still rarely use either the tax relief granted for the eligible costs of projects concerning basic research, applied research and experimental development up to HUF 100 million, or the deduction of 10% of R&D related costs or software development wage costs, or 50% of the royalty income from their corporate income tax base in Hungary.

Please, mark which tax incentives you are familiar with/you have ever used.
(More answers were possible.)



Accordingly, it is not unawareness of benefits that appears to be the main obstacle to using R&D tax incentives. It is rather the fact that before starting projects companies are left uncertain about the position of the tax authority concerning the nature of certain R&D activities which 33% of the respondents find risky. The uncertainty surrounding the categorisation and qualification of activities, as well as the internal limitations due to the unsuitability of recording, accounting, and time management systems were also listed as further difficulties in claiming R&D tax benefits.

With respect to R&D incentives, which statement do you feel relevant in your case?



- Not very familiar with R&D tax incentives
- Not very familiar with methods how risks related to the qualification of activities as R&D could be managed
- Familiar with how to prove what is R&D but my reporting/cost tracking/time sheet/etc. systems are not capable of appropriate recording/proof of related costs
- No answer
- Familiar with R&D tax incentives but uncertain about how to prove what is R&D (classification of activities as R&D activity)
- I believe that my company does not carry out any R&D activities/projects that would be eligible for R&D tax incentives
- Other
- Uncertain about the approach of the tax authority with respect to R&D costs; therefore I find the use of these tax incentives risky

N=72

Insights

According to the **Corporate R&D Report 2011** based on a survey conducted by Deloitte interviewing middle-sized and large corporations operating in Hungary, companies do not expect their expenditures related to R&D activities to rise significantly in the near future while it would be indispensable for the Government to involve the private sector in its plan to achieve the key objective of increasing R&D spending to 1.8% of Hungary's GDP until 2020. Although in the light of the above it seems sensible to further raise awareness of available cash grants and tax incentives one must not believe that this alone could help increase corporate R&D expenditure.

To boost R&D spending requires a revaluation and an appropriate revision of the regime with greater emphasis on companies' actual needs.

This seems all the more pressing since competition among countries for the 'hosting' of R&D headquarters of multinational companies is intensifying and, therefore, many European and other countries plan to introduce attractive grant and R&D incentive schemes or make their old regimes more attractive.



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