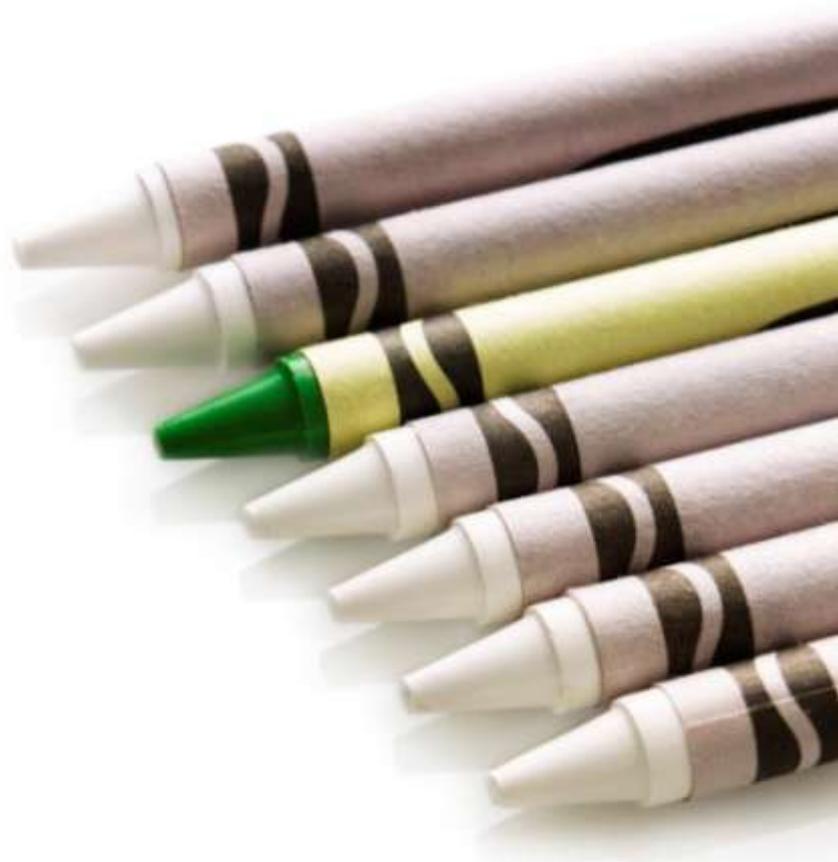


Innovation contribution reduced for R&D costs settled under cost sharing agreement

Tax Alert



The aim of this newsletter is to inform our clients of a recent court decision relating to the deduction of R&D costs recharged under a cost sharing agreement from the innovation contribution.

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Based on a recent decision of the Supreme Court, R&D costs charged from abroad to a Hungarian company under a cost sharing agreement may reduce the Hungarian company's innovation contribution.

Based on the background, the Hungarian company, a member of a multinational group, is a party to an agreement under which the costs of centralized R&D activities carried out abroad for the group are borne jointly by the group members. The company reduced its innovation contribution by the costs charged by the foreign company that actually performed the R&D activities. The Hungarian tax authorities challenged the reduction during a tax audit.

Innovation contribution is a tax payable by the Hungarian companies above a certain company size in order to encourage/finance the innovation activities in Hungary. Under the Innovation Contribution Act, the gross amount of the innovation contribution may be reduced (among others) by the direct costs of R&D activities conducted by a business association within its sphere of activities.

The tax authorities took the position that the centralized R&D activities cannot be considered R&D activities conducted within the company's sphere of activities, which is the key criterion for a reduction of the innovation contribution. Accordingly, the authorities claimed that the Hungarian company was not entitled to reduce the innovation contribution by its contribution to the costs of the R&D activities.

The Supreme Court rejected the tax authorities' argument and concluded that R&D activities performed under a cost sharing agreement in accordance with the OECD Transfer Pricing Guidelines should qualify as own R&D activities (rather than R&D received). As a result, the innovation contribution may be reduced by the R&D costs settled under the cost sharing arrangement. Significantly, since both the corporate income tax base and the local business tax base may be reduced by the costs of R&D activities conducted within a company's sphere of activities as from 1 January 2010, the court's decision may have broader impact and also be relevant for corporate income tax and local business taxes as well.

Companies that account for R&D expenses in a similar way and do not yet apply R&D allowances should re-examine their current practices. It should be noted, however, that to qualify for a beneficial treatment, the contractual arrangement must be appropriate and the company must meet the other relevant requirements under the law.

If you have any questions, please do not hesitate to contact one of our experts, who would be able to assist you with the assessment of agreements similar to the above contractual arrangement, as well as eligibility for potential R&D allowances.

Contact

If you have any questions or comments concerning the above, please contact one of our tax experts below:

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