

Breaking Tax News

Practical experience related to R&D incentives

In contrast to our monthly Tax News+, in our Breaking Tax news you will be informed immediately of regulatory changes affecting your business but without commentary by our experts.

Based on 2014's tax audit directives **utilization of tax allowance or tax base reduction related to R&D direct costs is likely to be inspected during tax audit carried out by the National Tax and Customs Administration of Hungary.**

In order to facilitate the background preparation of these audits **based on our previous experience we have summarized a few key issues. These issues are worth taking into account** by taxpayers performing R&D activities and/or benefitting from R&D incentives or cash grant.

The necessity of R&D documentation

Requirements and methodology related to the documentation of R&D activities are currently not defined by legislation. However, the R&D content of the activity **should be verified** when a company utilizes R&D incentives. Therefore, **a detailed documentation is highly recommended** in order to substantiate the R&D characteristics of the activities performed. Documentation should also contain information about to what extent the related costs may be taken into account as R&D tax allowance or tax base reduction.

Necessity of separate recording

The amount of R&D incentive should be calculated based on the direct costs of R&D activities performed in the given tax year. As a result, in addition to the proper documentation of R&D activities performed, **costs which are clearly related to those activities should be collected separately from the costs of non-R&D activities in the accounting records.** The structure of the separate recording may be established according to the taxpayer's activities. However, in the absence of such records the utilization of the R&D incentives may be unlawful, which supports the fact that establishing separate **recording is mandatory. We recommend including the separately recorded costs in the R&D documentation as well. These costs should then be assigned** to the performed activities. **Consistency** of further accounting documents (e.g. policy related to overhead-calculation, accounting policy, notes to the financial statement) and the utilized R&D incentives are also of significance.

Assessment of novelty

When calculating the amount of R&D incentives, direct costs of non-R&D activities cannot be taken into account. Therefore, **separation of activities which qualify as R&D are of great significance.** One of the key aspects of the evaluation is the **novelty content** of the knowledge acquired as a result of the R&D activity. In order to qualify as R&D **the knowledge acquired must meet the criteria of novelty.** According to the literature of R&D qualification the assessment of novelty ("újszerűség" in Hungarian) is not equivalent to the assessment of novelty performed during patent procedures ("újdonosság" in Hungarian). In the context of R&D qualification novelty is defined as, knowledge which is not obvious to a competent person in a given

scientific area. The concept of novelty is often confused with the definition of novelty in the case of patent procedures. These two areas are clearly divided by the Hungarian Intellectual Property Office (HIPO) which is the authority responsible for R&D qualification (thus, there are two different words with different content for the two concepts in Hungarian).

R&D qualification of past (ongoing) projects

To be able to decide whether certain projects or project parts qualify as R&D activities, and if yes, then what type of R&D (basic research, applied research, experimental development) and whether the performed R&D activity qualifies as “own R&D activity”, in case of future projects there is a possibility of asking a ruling request from HIPO, and **the decision of the institution has binding force in front of all related authorities. However, a possibility for R&D qualification exists related to ongoing or past projects.** In this case an “**expert opinion**” may be obtained from HIPO. Although the expert opinion received is not considered as binding on other authorities, it may implicate high security during a tax audit as it supports the R&D characteristics of the activities performed.

R&D qualification of commercial activities – pilot plant and trial production

When separating projects/project sections which qualify as R&D, determination of certain activities’ **temporal extent** is a key issue. Within this context the process of a pilot plant and a trial production should be assessed. The end of the R&D process should be determined based on the assessment which requires careful consideration.

Regarding the pilot plant, as long as the development of a given product or service is not completed – meaning that as long as the primary purpose of operating a pilot plant is non-commercial –, there should be no differentiation in principle if a part or the total amount of output is sold and that the taxpayer would thus realize an income from that sales.

Unless the trial production implies further design and engineering, it should not be considered as R&D, since the primary objective is no longer to make further improvements to the products but to commence the production process.

Should you have any remarks or questions regarding the above, please contact our professionals:

Dr. Csaba Márkus

Director
R&D and Government Incentives
Tel: +36-1-428-6793
E-mail: csmarkus@deloittece.com

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

In Hungary, the services are provided by Deloitte Auditing and Consulting Limited (Deloitte Ltd.), Deloitte Advisory and Management Consulting Private Limited Company (Deloitte Co. Ltd.) and Deloitte CRS Limited (Deloitte CRS Ltd.), (jointly referred to as "Deloitte Hungary") which are affiliates of Deloitte Central Europe Holdings Limited. Deloitte Hungary is one of the leading professional services organizations in the country providing services in four professional areas - audit, tax, risk and advisory services - through more than 400 national and specialized expatriate professionals. (Legal services to clients are provided by cooperating law firm Deloitte Legal Szarvas, Erdős and Partners Law Firm.)

These materials and the information contained herein are provided by Deloitte Hungary and are intended to provide general information on a particular subject or subjects and are not an exhaustive treatment of such subject(s).

Accordingly, the information in these materials is not intended to constitute accounting, tax, legal, investment, consulting, or other professional advice or services. The information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

These materials and the information contained therein are provided as is, and Deloitte Hungary makes no express or implied representations or warranties regarding these materials or the information contained therein. Without limiting the foregoing, Deloitte Hungary does not warrant that the materials or information contained therein will be error-free or will meet any particular criteria of performance or quality. Deloitte Hungary expressly disclaims all implied warranties, including, without limitation, warranties of merchantability, title, fitness for a particular purpose, non-infringement, compatibility, security, and accuracy.

Your use of these materials and information contained therein is at your own risk, and you assume full responsibility and risk of loss resulting from the use thereof. Deloitte Hungary will not be liable for any special, indirect, incidental, consequential, or punitive damages or any other damages whatsoever, whether in an action of contract, statute, tort (including, without limitation, negligence), or otherwise, relating to the use of these materials or the information contained therein.

If any of the foregoing is not fully enforceable for any reason, the remainder shall nonetheless continue to apply.