



THE AUSTRALIAN ACADEMY OF THE HUMANITIES

**Submission in response to the Treasury's consultation paper**  
***The new research and development tax incentive***

The Australian Academy of the Humanities has a strong interest in the more effective utilisation of Australia's innovation and research capacity, and is pleased to contribute to the Treasury's consideration of the R&D tax arrangements.

At the outset, we would like to express our wholehearted support for the conversion from the tax concession to the tax credit system. The reasons for the reform have been well rehearsed so there is no need for us to go into any detail, but the practical utility of the new system, particularly for start-ups, is of great benefit to research-active industry. We also support the tightening of the eligibility requirements, especially for supporting activities.

The Academy has no specific expert view on most of the Principles and Questions posed in the Consultation Paper. The central issue we wish to address is the explicit exclusion of research within the humanities, arts and social sciences from eligibility as core research activity under the current R&D tax arrangements. This submission therefore constitutes an answer to Question 5 (a), "Should the current list of activities excluded from being considered core R&D be amended in any way?"

Our answer is yes: the Academy recommends in the strongest possible terms that the systematic exclusion of those forms and fields of research named in subsection 73B(2C)(f) of ITAA 1936 be removed from the new R&D tax incentive's enabling legislation, allowing industry to avail itself of all relevant legitimate research activity with the support of the tax incentive.

The new tax incentive is designed 'to be better targeted at the underlying rationale for public support' (consultation paper, p.14): to achieve this, it will need to remove this exclusion, which specifically undermines that objective in at least three key respects. In the first place, the rule excludes otherwise eligible activity from benefit from this form of public support, thereby reducing the beneficial effect of the scheme as a whole by artificially and arbitrarily reducing its scope. In the second place, it excludes precisely the kinds of research which is among those forms most likely to fulfil the declared target criteria. Finally, the statutory letter of the exclusion does not reflect the stated policy intention of the exclusions. We will take these points in turn.

## 1. Arbitrary limitation of the incentive's benefits

This exclusion systematically banishes activity that is in every way similar to eligible activity in the physical and technical sciences, in terms of the objectives and constraints of the incentive. In other words, it excludes R&D activities that would otherwise be eligible: if it did not do so, the exclusion would be superfluous within the legislation, as the activities would be ineligible on other grounds.

It has been argued by some that these disciplines are named in the legislation simply in order to provide an efficient 'shorthand' means of excluding activities that would inevitably be excluded later, on other grounds (after more resources have gone into assessment). This specious argument betrays a fairly complete ignorance of the kinds of research that takes place within the humanities, arts and social sciences, coupled with an alarming failure to recognise that ignorance. We are not aware of any evidence at all demonstrating a necessary (or even an unusually high contingent) correlation between these disciplines and a failure to satisfy the other eligibility requirements. We put it to the Treasury that the onus is upon anyone making the assertion that such a correlation exists to adduce evidence supporting it; in the meantime, we would like to canvass a couple of potential examples of research in these disciplines that do otherwise satisfy the incentive's eligibility requirements.

Australia has a pronounced and growing strength in the creative industries, both directly through the creative economy and indirectly and a component of industry case-based R&D. This entire sector of the economy, a major driver of innovation that contributes very substantially to the national prosperity, is intimately dependent upon the humanities and creative arts. Current international trends demonstrate that the potential exists for far greater returns than our current levels of investment are able to realise. The humanities and creative arts provide the all-important content and technical know-how that fuel the creative industries, as well as critical analysis of the cultural contexts in which the creative industries operate.<sup>1</sup> Despite this, the R&D tax incentive is not available for work in these fields, regardless of the economic and other merits of any given case, as they fall within the excluded humanities and creative arts. For instance, a company in the competitive and highly innovative computer gaming industry wishing to develop a new product package will gain tax incentives for work on the IT component<sup>2</sup> but not for the all-important visuals, story-boards or sound effects – despite the fact that considerations such as 'look and feel', narrative coherence and character design are absolutely crucial to competitiveness in the computer game marketplace.

Similarly, had the Apple iPod been designed here, it would have been valued in the Australian R&D regime solely for its technical advances, rather than elements such as its artistic design innovation. This is contrary to very clear market signals in this competitive industry about what matters to consumers in terms of product development. The iPod illustrates this clearly – it has preserved its domination in the MP3 market over several generations of advances, and

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<sup>1</sup> For further discussion of the role of the creative industries and the implications of policy decisions relating to investment in these fields, see Stuart Cunningham, *From Cultural to Creative Industries: Theory, Industry, and Policy Implications* (Media International Australia Incorporating Culture and Policy: Quarterly Journal of Media Research and Resources (102), 2002, pp. 54-65) and *What price a creative economy?* (Platform Papers, number 9, Redfern: Currency House, 2006).

<sup>2</sup> We recognise that eligibility considerations specific to software R&D are also under review: however, this example does satisfy the intent of the original multiple sales test, so we feel it is entirely apposite. The choice of a software example does not limit our fundamental argument: whatever the decision with respect to software R&D support, it should be applied without discrimination based on the field of work R&D.

maintains this dominance significantly on the strength of look, feel and design, even in the face of more technically advanced competitors.

Critics of this argument have been quick to point out that the iPod was not designed in Australia: we would simply observe that, with this arbitrary restriction of the R&D incentive in place, it is no wonder. Given Australia's relative fluency in the creative industries, including fields such as design and gameplay development, this impediment hampers our ability to harness the strengths available to industry. The resultant global competitive disadvantage renders Australia vulnerable to a flow of artistic talent off-shore, or to the exploitation by foreign concerns of our local talent.

A former Chief Scientist of Australia was fond of citing the example of Nokia as a technology success story. It is important to recognise that the success of the Finnish company was significantly derived from its commitment to the arts- and humanities-based research disciplines as a key element of its development programs (in concert with, but not subordinated to, technical research). It is through these innovations that Nokia has been able to develop attractively designed, ergonomic, human-oriented products that stood out in the global marketplace of clunky gizmos designed by techies who had little knowledge and no expertise in user needs and preferences. If, as that official liked to say, Australia should be positioning itself to produce the next Nokia (or the next iPod, for that matter), we should create incentives to bring all of the talent necessary into the R&D picture, and not exclude good and useful work through an arbitrary definitional exclusion.

The Academy is keen to emphasise that we are not arguing for any dilution of the eligibility rules surrounding research and development activities. We wholeheartedly support the application of strict eligibility tests to all claims for public support for private R&D activity, and indeed we support their tightening in the proposed reform. All we are arguing for is the right for otherwise legitimate claims to be admitted for such stringent testing from these domains of research activity. The removal of this arbitrary bar will provide for the more effective functioning of the incentive, as it will be able to fulfil its objectives across the full range of research and development fields.

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## 2. Excludes the kinds of activities professedly targeted

The case for reform within the consultation paper makes the point that,

fundamentally, an effective R&D tax incentive needs to result in firms conducting R&D that they would otherwise not perform because they cannot capture sufficient benefits from the activity to justify an investment. That is, although the benefits of the R&D activity 'spillover' to the rest of the community, it is not commercially sensible for any one individual company to invest (p.2).

Research and development in the humanities, arts and social sciences is actually more likely to be subject to this criterion, overall and on average, than comparable activity in the sciences and technology. This is because many of the kinds of knowledge produced from humanities, arts and social science research – with the nearly exclusive exception of copyrightable artistic production, defined broadly – is much less suitable for protection as intellectual property than more conventionally patentable products and processes from science and technology research. In excluding work within these disciplines from eligibility, then, the distributed beneficial

effect of the incentive scheme is being reduced not only in proportion to the quantum of otherwise eligible activity, but to an even larger degree due to this larger proportion of such work that would satisfy this primary – fundamental – objective of the scheme.

Before leaving the topic of the fit between the legislation and the intent of the incentive scheme, we would point out that the removal of exclusion (f) would not trouble the definition of R&D in the least. The tax incentive regime relies upon the Frascati definition to arrive at the systematic, investigative and experimental (SEI) taxonomy. Treasury will be familiar, then, with the Frascati Manual's description of research and development as 'creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of humanity, culture and society, and the use of this stock of knowledge to devise applications.'<sup>3</sup> This is good enough for the Australian Research Council, which likewise applies a rigorous test to exclude market research, product testing, quality control and the like, as well as unsystematic or non-evidential enquiry, and forms of 'knowledge' that are unsubstantiated and declamatory. The ARC quotes this Frascati definition and states that it is consistent with its own:

the creation of new knowledge and/or the use of existing knowledge in a new and creative way so as to generate new concepts, methodologies and understandings. This could include synthesis and analysis of previous research to the extent that it is new and creative.<sup>4</sup>

Both of these definitions unproblematically include the humanities, creative arts research and the social sciences within their ambits. The ARC recognises that the humanities, arts and social sciences are well-respected disciplinary formations with widely recognised and effective methodologies, practices, and means of determining confidence in the knowledge it produces. The national research funding agency echoes Frascati in having no problem in its determination of what constitutes research. The R&D tax incentive reform could adopt this stance with respect to those disciplines without doing any harm to the notion of what constitutes research activity.

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### 3. Inconsistency between description of eligibility and legislative form

The consultation paper mentions the exclusions list in subsection 73B(2C), and states that the 'primary objective of these activities is considered to be to develop markets, do pre-production planning or to get production or control systems working smoothly' (p.13). The Academy has absolutely no problem with such activities being excluded, as they clearly do not fit the design objectives of the incentive. However, if this is the rationale, item (f) clearly does not belong in this list. There is absolutely no sense in which research within the humanities, creative arts and social sciences is necessarily, habitually or even very often at all oriented towards these purposes and outcomes. On the contrary, the vast majority of the kinds of activity we have in mind that would be otherwise eligible is primary research contributing to product and process development, precisely akin to the kinds of hands-on fundamental R&D within the sciences and technology fields that is currently supported. If the humanities, arts, and social sciences have been included in this list of exclusions on this rationale, then

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<sup>3</sup> *Frascati Manual 2002: Proposed Standard Practice for Surveys on Research and Experimental Development*. Paris: OECD, 2002; p.30.

<sup>4</sup> *ERA Submission Guidelines*. Canberra: ARC, 2009; p.9.

they have been excluded from the R&D tax incentive on the basis of a basic misunderstanding of the nature of their work and the outcomes they deliver.

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In closing, we would like to advance a supplementary rationale for recommending the removal of exclusion (f), one not directly related to the operation or objectives of the R&D tax incentive itself but that goes to the role played by the scheme in the wider framework of government policy and ambition. In a nutshell, the exclusion is contrary to the Federal Government's research and innovation agenda, one stated aim of which is to consolidate and support disciplines in which Australia has a recognised strength. The Australian humanities regularly out-perform most other discipline clusters in international assessments of global research strengths. For example, ANU's widely reported strong showing in the Times Higher Education global university rankings was significantly a product of its strength in the humanities and creative arts, which outstripped all other discipline clusters for our top-ranking university. Within the next two Australian institutions, the Universities of Melbourne and Sydney, humanities and creative arts were only outperformed by medical sciences. The exclusion of humanities and arts research from legitimate support by R&D tax incentives limits industry's uptake of and engagement with these highly successful fields, constituting an impediment to the involvement of this world-class research activity in the national innovation system.

The exclusion *by definition* of the humanities, arts and social sciences is inappropriate, regressive, arbitrary and counterproductive. It is precisely anti-innovative, because it closes down creative space, incorrectly writes off the possibility of beneficial experimental and exploratory work in these areas, and it militates strongly against interdisciplinary collaboration. None of these outcomes is consistent with government intentions in designing the complex innovation system that includes the interaction between industry and research, and which the R&D tax incentive is designed to support. The removal of this exclusion will improve the alignment of the incentive with the objectives of the innovation system it is designed to serve.

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We hope that these comments are helpful to the Treasury in its deliberations. We would be keen to discuss this recommendation with officials, including further instances of high quality research in these fields that are of value to industry and that not only meet the other eligibility requirements but that are unusually well matched to the stated rationale for public support. We thank you for taking the time to consider our views and extend our best wishes for a successful reform process.

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