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Cutler review sidestepped: R&D Tax Credit

Among my heroes, the late John Button is right up there. His political memoir, As It Happened, is a consensus pick for one of the best ever written by an Australian politician. His achievements as Industry Minister are legendary. For almost 25 years, I have proudly assisted companies in accessing his flagship program, the R&D Tax Concession (the Concession). But I wonder what he would make of the Rudd Government's attempts to end that program and effectively start again with the new R&D Tax Credit (the Credit)?

It seems the Government, through its proposed Credit, wishes to re-engineer its support for Business R&D Expenditure (BERD), with scientific work clearly remaining eligible, while commercially-focussed experimental development is left to largely fend for itself. This is radically different to the Button vision, which had bipartisan support for the past 25 years, and is a huge shift in the R&D cultural landscape.

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Responding to stakeholder concerns to its first Exposure Draft and Explanatory Materials in December last year, the Government has just released a revised draft legislation (the 'Easter package'). Yet, the new proposal contains again a series of major changes that would limit support of a range of work currently supported under the Concession scheme, and little time for public submission is provided.

Characterising the Credit as a new program, the Government has indicated there will be little carryover of the concepts and principles of the Concession. Essentially, companies are being asked to start afresh from 1 July and play in a whole new ballgame.

I agree, this is a new program as it seeks to legislate a fundamentally different definition of eligible R&D activities. For the first time, activities are divided into two distinct categories – core and supporting. Core R&D activities are restricted to those that are experimental and are seeking new knowledge. Concepts such as systematic and investigative activities, innovation and technical risk have been abandoned. Current technical objectives involving the creation of new or improved products and processes have been removed, leaving the only valid objective as seeking new knowledge. Supporting activities in a production context need to meet a new dominant purpose test which will be impossible to demonstrate with respect to most commercially-oriented R&D.

The restrictive flavor is reinforced by a narrower Object clause requiring additionality and spillover, possible extension to limits on feedstock claims and a stricter compliance regime involving greatly enhanced powers for AusIndustry and the Innovation Australia Board.

All this, coupled with the indication that the new program will be administered around sectoral guidelines, gives the strong impression that the Government wants to decide who gets the support based on who they see is doing genuine R&D so that we end up with something resembling a targeted grants program.

While not necessarily acceptable, it would be understandable if this delivered on the Government's stated policy. However, I can't see this to be the case.

In the May 2009 Budget, the Credit was announced with higher base rates for small and large companies, the introduction of foreign-owned R&D and the closure of the 175% Premium Concession. Further, in order to keep the program revenue neutral over the next 4 years and to better support "genuine R&D", a review was announced to deliver a "tightening" of eligibility criteria. Positive statements about the need to provide real incentives were made in the accompanying Innovation White Paper, *Powering Ideas*.

Since then, a stream of material from the Treasury has radically changed the program rather than tightened aspects of it. These changes are such that there is no real continuity from the Concession to the Credit, and the stark reality is that the level of support offered is likely to be drastically reduced. When pushed about the modelling that supports the need for change, the Treasury says that we can't see it. When asked what constitutes genuine R&D, it is silent on the matter.

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So, we are left to draw our own conclusions and mine don't make pretty reading.

The Government's case for reform was supposedly made out in the Cutler Review of the National Innovation System (Cutler). Cutler recommended an opening up of the base Concession but noted that concerns about large and expensive R&D projects would justify a refining of the definition of R&D and/or some limits on eligible expenditure.

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relationship to innovation thinking and without a convincing framework and robust evidence base.

Legacy policies based on normative, 'two cultures', assumptions, combined with the dominant commercial leadership of the creative industries sector which has shown little interest in engaging with policies on innovation and R&D, create and maintain this gap. R&D tax concession regimes in this country and many others programmatically exclude knowledge generation processes based in the humanities, arts and social sciences from qualifying as 'systematic, investigative and experimental'.

This is despite the updating that has gone on in Frascati which has attempted to understand afresh services R&D, of which the incessant production of new or improved materials, products, devices, processes or services in the creative industries is an increasingly critical component. .

On the other hand, the well established industries that make up the highest profile components of the creative industries (broadcasting, print, music) are populated by large, often multinational, commercial firms with little interest in qualifying for such tax concessions or like support. They don't need it, by and large, and therefore they have rarely positioned themselves to explicate the role of R&D in their incessant production of new or improved materials, products, devices, processes or services. Given this lack of interest, and their usually effective lobbying efforts that are directed to other aspects of their business interests, the whole area of innovation and R&D policy has tended to bypass the creative industries.

This has consequences, particularly because this sector is predominantly composed of SMEs with a 'missing middle' – a lack of medium-to-large firms and a small number of very large, market dominant players. There is a great preponderance of micro and small businesses and sole traders to which much contemporary innovation and industry support is, and should be, directed. Yet, our study, with Dr Terry Cutler, of *Research and Innovation Systems for Digital Content and Applications*[2], showed that the panoply of innovation and industry schemes offered by government has almost completely passed the creative industries by.

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Nevertheless, the signs are promising for the beginnings of a productive convergence. At the ARC Centre of Excellence for Creative Industries and Innovation[3], we have made advances in understanding the way culture drives change and growth in advanced 'experience' economies; demonstrated how education can be shaped for a future-oriented creative workforce; and addressed legal and regulatory inhibitors to the emergence of the digital economy. As with the Australian Government, which has also established the Creative Industries Innovation Centre[4] as part of Enterprise Connect, many countries and regions are looking to the creative industries as a new source of innovation.

[1]The Frascati manual is the internationally recognised methodology for collecting and using R&D statistics;
[2]www.cultureandrecreation.gov.au/cics/Research_and_innovation_systems_in_production_of_digital_content.pdf;
[3]www.cci.edu.au/; [4]www.creativeinnovation.net.au/

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It rejected the viewpoint of the 2007 Productivity Commission (PC) Report, *Public Support for Science and Innovation: Research Report*, which recommended a narrower definition of R&D based on additionality and spillover, a scrapping of the base Concession for all but the smallest companies and the retention of a modified incremental Concession (which Cutler said should be scrapped).

In broad terms, Cutler won the battle on Budget night with the announcement of higher base rates and a closing of the 175% Premium. Yet it seems the PC may have won the war.

The 'Easter package' gives voice to much of the PC's wish list – legislation of additionality and spillover; a narrower definition of business R&D; the disqualification of most R&D performed in a production environment. Inherent in the revised exposure draft legislation is a sense that some business R&D (biotech; medical) is more 'genuine' than others (mining; engineering).

The Government may be entitled to this view. But it should be upfront with stakeholders if it intends to operate a broad entitlement program to reflect that philosophy, and not leave everyone guessing as to what this means to their R&D programs come July 1.

Sadly, there is probably a simple explanation for what is taking place: The Treasury is seeking to save a lot of money and has taken the PC Report and run with it, sidestepping Cutler in the process.

As you read this, the legislation is most likely to be undergoing a Senate review and I urge you to have your voice heard. I believe that much work remains to be done to liberate the clear benefits of the move to the Credit whilst keeping a real planning incentive in place for all Australian companies, large and small, for all the **eligible R&D** that they undertake.

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The Button legacy must not be tossed aside lightly.