

# **Ukie response to HM Treasury consultation on Creative Sector Tax Reliefs**

**September 2012**



THE ASSOCIATION FOR UK INTERACTIVE ENTERTAINMENT



## **Introduction**

The Association for UK Interactive Entertainment (Ukie) is the trade association that represents a wide range of businesses and organisations involved in the games and interactive entertainment industry in the UK.

Ukie exists to make the UK the best place in the world to develop and publish games and interactive entertainment. Ukie's membership includes games publishers, developers and the academic institutions that support the industry. We represent the majority of the UK video games industry; in 2011 Ukie members were responsible for 97% of the games sold as physical products in the UK. Ukie is the only trade body in the UK to represent all the major games console manufacturers (Nintendo, Microsoft and Sony).

In preparing our response to this consultation we have spoken directly to well over a hundred companies of all sizes and types, from international publishers and their in-house development teams, through growing independent studios, to micro-studios of two developers creating mobile games.

We engaged with developers through face-to-face meetings, online questionnaires, meetings of the Ukie board and the Ukie developer group, and a series of regional seminars open to anyone from the games industry who wanted to give us their input. We held these public meetings in Birmingham, Bristol, London, Dundee and Sheffield, allowing us to connect with as wide an array of games companies as possible.

Having undertaken this process, we believe that the following submission represents a consensus of opinion from across the industry.

## **Executive Summary**

The introduction of targeted tax credits to support game development in the UK can be a watershed moment for the British games industry. Combined with a renewed focus on the supply of skills to the industry, led by the Next Gen Skills campaign, this support from the government will allow us to truly compete in having the strongest domestic games industry in the world.

If these tax credits are designed robustly and fairly, they will achieve two crucial goals: fostering the already vibrant independent UK developer community into a world beater; whilst at the same time encouraging inward investment by existing multinational companies.

These are complementary aims. A thriving scene of developers, in clusters around the country, can provide a healthy talent pool and supply lines, making the country even more attractive to global publishers. Inward investment from such publishers, meanwhile, can create more demand for developers' services, and give a start in the industry to many more thousands who may go on to found their own studio.

This must all be seen in the wider context of the changing nature of the industry. As digital distribution becomes more and more prevalent, the lines between developer and publisher will continue to blur. The tax credits system must support both, and be future-proofed for a changed world we cannot predict.



In preparing this submission, Ukie have held group seminars around the country, one-to-one discussions, and online evidence gathering, in the course of which we have spoken directly with well over a hundred companies from across the industry, of all sizes and types.

It is clear from these discussions that the industry is all but unanimous in welcoming the relief. We are convinced that the model proposed by government, based on the existing Film Tax Relief (FTR), will meet the criteria set out and, crucially, will assist the full range of the industry.

Our answers to many of the questions posed in the consultation document will be based on this principle: ensuring that the relief can help as large a proportion of our industry as possible whilst meeting the other criteria set out by government.

Although we believe the proposed design will achieve these goals, our conversations across the industry have generated some ideas that may improve the impact of the relief in future.

We will set these ideas out in detail below; the key point is that we believe the relief as proposed will provide a major boost for the industry, but that its functioning should be kept under review to ensure it is providing the most effective support it can to the industry.

Finally, we recognise that the government will be setting the final rates of relief, based on their own modelling. However, it is important that this relief places the UK on a level playing field, in the face of strong global competition. The UK games industry must receive full parity, at least, with the film, television and animation sectors, in generosity of support. It must also be helped to compete in the increasingly crowded international market.

As such, as we set out in detail below, our recommendation is for a rate of relief of 30% for all games.

In conclusion, Ukie strongly welcomes the creation of games tax relief by the government. Alongside the vital strengthening in the supply of skills that is now underway, this tax relief can be the catalyst for a new era of growth in the UK games industry, placing us back on a level playing field with the rest of the world. We pledge to assist all parts of our industry in getting the most benefit from this important new measure and to seeing this vision become a reality.

NB Ukie will be responding only to sections 2, 5 and 6 of the consultation document, as these are the areas of relevance to our industry, and about which we have the requisite expertise.

## **Specific comments**

### **Section 2: Criteria for the creative sector reliefs**

Q1: Do you agree with the proposed criteria for assessing the animation, high-end television and video games tax reliefs? Please provide any comments as appropriate.

Ukie supports the proposed criteria. In particular, under the criteria of 'effectiveness', we believe that the games tax relief will only be seen to have truly delivered cultural and economic benefits if it supports games companies of all sizes. The dual, complementary aims of the relief, we believe, are

to encourage inward investment from large publishers and to help the burgeoning UK indie scene to become the strongest in the world. These must both be met for true effectiveness in the relief.

We also wish to stress the importance of the relief being simple and cost effective to administer, both for government and for games companies, and for it to prevent abuse. The legitimacy of the system in the eyes of the general public will be crucial to its long-term success. We have sought throughout our consultation process to help deliver this. We will also be scoping out practical ways to support smaller companies, in particular to help them make rigorous claims as cost-effectively as possible.

## **Section 5: Video Games**

Q26: Would adopting a similar model to the film tax relief be an effective way of meeting the Government's objective to support video games production?

Q27: Would adopting one of these models be more appropriate than the proposed model to design a video games tax relief? Please describe and explain how this would better meet the criteria in Chapter 2.

Q28: What alternative models for a video games tax relief could the Government consider? Please describe and explain how this would better meet the criteria in Chapter 2

After significant consultation with companies of all sizes, both international and domestic, and from all parts of the industry, we are certain that the FTR model will be sufficiently adaptable to provide credits that almost all games companies will be able to benefit from. It will meet all the government's criteria and will provide a significant boost to the UK games industry.

As such we fully recommend that Games Tax Relief be introduced, from April 2013, according to the system proposed by Treasury.

Possible improvements to this model were suggested by some respondents which we believe could in the long term make the scheme more efficient and cost effective for games businesses.

We therefore recommend that the administration of the new relief be reviewed once it has been in place for enough time to consider its accessibility for developers – likely one or two years. At this review, further evidence should be considered to see if there were any efficiencies to be shared with other processes, including the current process of applying for the current UK R&D system.

We would also like consideration of the use of an Above the Line (ATL) accounting option for the relief.

Several of the larger multinational publishers in the industry have informed us that, as their budgeting and investment decisions are made on a pre-tax basis, having the relief calculated above the line would better promote inward investment.

Making the credit accountable above the line would have no impact on the rate of relief given, and could indeed be made optional. Crucially, however, by reducing the actual expenditure measured for each game, it would feature in decisions over whether to develop a game in the UK, and so make us a more attractive option in comparison to other countries.

The introduction of an Above the Line system for the R&D tax credit for large companies is currently being consulted on. This has been a long and carefully-undertaken process, which is yet to reach its conclusion.

As such, we recommend that, once it is completed, the implementation of the ATL system for R&D tax credits be investigated, to consider whether a similar approach could be introduced for games tax relief.

To encourage industry investment decisions, and limit delay of those decisions, we seek agreement for on-going consultation on both these proposals, aimed at the introduction of a revised set of guidelines for 2014.

We wish to conclude our response to this question, however, by repeating our firm opinion that the proposal set out in the consultation document to adapt FTR as closely as possible to the games industry will provide valuable and effective support and should be introduced as planned from April 2013. Our further suggestions are only intended to allow this excellent proposal to be iterated upon and improved in future.

#### Intended for Commercial Release

Paragraph 5.13, on qualifying conditions, states that a game must be 'intended for commercial release' in order to receive the relief.

It is clear that this is an attempt to adapt the phrase 'intended for theatrical release', from the film model, as closely as possible. We support the rule that a game must be intended for release, but have concerns over possible unintended consequences from the use of the term 'commercial'.

Most dangerous of all is that this could feasibly disqualify games which are released on an initially free-to-play basis, then monetized either by in app purchases or advertising. These are both hugely important models in the modern games industry, and are only going to become more widespread in the next decade. Although free-to-play is currently mostly limited to mobile and social games, it is widely expected that the next generation of console games may make more use of it.

Disqualifying games which are initially free to play would render the system ineffective from the start, and would destroy any legitimacy it had in the eyes of the majority of our industry. Such games are very clearly produced and monetized on a commercial basis by the developer.

Requiring a 'commercial' release would also disqualify the wide range of games which are commissioned from developers by charities and semi-public bodies, such as the Wellcome Trust and Channel 4.

These games will not require a purchase from the consumer (although some will include in-game monetization). However, they will be very much a commercial proposition for the developer – such commissions are a vital source of early income for a large proportion of the flourishing indie developer scene.

It is also a risk that requiring a ‘commercial’ release could harm self-publishing development studios. The lack of a contract with any other party, particularly for a game which is some variety of free-to-play, could too easily be painted as not being a ‘commercial’ release.

The intention of the criterion suggested in the consultation document is not, we believe, to disadvantage these important parts of our industry, but is a rightful attempt to ensure that only games intended for open, public release are supported by the tax relief.

As such, we would suggest that this language is used in final legislation: “only games intended for public release on a commercial basis for the developer”.

Alternatively, if the original wording is retained, we suggest that a full explanation of the meaning and impact of the word ‘commercial’, in line with the points made above, is included in the legislation. This should make clear that any game on which the developer is intending to recover their costs will count as commercial, and include a bulleted list of types of project that would be excluded.

#### Definition of Video Game

Q 29: Would adopting a similar definition of a video game exclude any content that might reasonably be included?

Q 30: Is there an alternative definition of a video game that would more accurately reflect the nature of the content being produced? If so, please provide one.

The French definition is somewhat out-dated and contains a lot of unnecessary points – most of the text is concerned with the delivery mechanism of the game, rather than the definition of a game itself. However it also covers most of the necessary points. We include the proposed definition here:

Leisure software made available to the public on a physical medium or online and incorporating elements of artistic and technological creation; the latter cover not only PC and console video games but also mobile games, on-line games for one or more players, educational or edutainment software and, provided that they incorporate sufficient interactivity and creativity, cultural CD-ROMs

For comparison, the definition used in Ontario, Canada is as follows:

An eligible digital game is an interactive digital media product whose primary purpose is to educate, inform, or entertain, and that achieves its primary purpose by presenting information in at least two of: (i)text, (ii)sound and (iii) images. Intended for individuals. Excludes operating system software.

In seeking a more concise and usable wording, Ukie has asked the industry to suggest key factors that should be included in any definition of a game. This has prompted, unsurprisingly, a wide and varied number of suggestions. However, some common themes have come through.

For example, it is clear that any definition must include ‘software’ – games are defined above all by the fact that they are built on computer code.

There has also been discussion over whether 'video game' is still an appropriate term. There have been several successful smartphone games recently which have used only sound and no video – notably 'Nightjar, for example. We would argue that these are very much interactive entertainment software which have a place in our industry and should benefit from tax relief.

Many have also argued that definitions of a game must include the feature of the user being offered a challenge of some form, within a given set of rules.

Taking the above points, we would suggest an eligible game be defined as:

"Interactive entertainment software made available on physical media or online and incorporating images, text or sounds, the primary purpose of which is to offer the users a challenge or challenges, and a set of rules by which those challenges can be achieved."

We are aware that other organisations have recommended other definitions. Most notably, TIGA, our fellow trade association, have proposed:

"Interactive entertainment software made available to the public in any medium (including on disk or by digital distribution) and on any type of device, whether single player or multiplayer and whether of finite duration or not, including software whose content is also educational in nature."

These definitions have enough in common that we believe consensus can be found. We propose further work between ourselves, Treasury and TIGA as the draft legislation is finalised to come to a universally-acceptable agreement on this. For example, a simple combining of the two could be:

"Interactive entertainment software made available to the public in any medium and on any type of device, incorporating images, text and/or sounds, the primary purpose of which is to offer the users a challenge or challenges, and a set of rules by which those challenges can be achieved, including software which is educational in nature."

### Gambling and Advertising

Paragraph 5.17 states that the "Government does not intend to offer relief for video games whose primary purpose is gambling or advertising products".

The policy aim is once again clear, but care must be taken not to unintentionally exclude parts of the games industry from support through vague definitions.

Defining games whose primary purpose is gambling should, and we assume will, be done under the definitions in the Gambling Act 2005. We believe this should be sufficiently straightforward and rigorous.

However, defining games whose primary purpose is the advertising of products may be more difficult. A key point will be whose role it is to make this determination.

Advertising is an increasingly important funding source for the games industry, particularly with the move to a free-to-play model for many games. This advertising tends to take four different forms: in-game advertising; branded virtual goods; sponsorship; and brand commissioning. If the Treasury

goes ahead with this criterion in the final legislation, it should be as clear as possible about what types of game it is seeking to exclude.

The first, in-game advertising, involves adverts being shown at some point during the game experience – often in-between ‘levels’ or at other appropriate breaks, known as interstitial adverts, or sometimes in part of the screen whilst the game continues in the majority of the screen. There are several other varieties of in-game advertising, and new approaches are constantly being experimented with.

As should be clear, these advertisements are in no way the primary purpose of the game, but merely a funding mechanism. Games featuring such adverts must be eligible for tax relief.

Branded virtual goods are items which feature within a game which can be branded. These can be a persistent, non-alterable part of the world, such as advertising billboards, or can also be items purchased for in-game use by the player, often changing the appearance or functionality of the player’s avatar or other aspects of the game. These will often be branded, and the developer will receive payment from the brand for this positioning. For example, a player’s character may be able to wear a specially-purchased Nike baseball cap during the game. Or a car being raced against, which the player cannot use, may feature Nike branding as it would in the real world. This category is essentially the game industry’s version of product placement.

Research by eMarketer estimated that branded virtual goods will provide revenues of \$88 million worldwide in 2012, up from \$16 million in 2010. They predicted that this would increase to \$318 million by 2015. This is clearly an absolutely vital current and future revenue source for games developers, which could be put at risk if games featuring it were automatically disqualified from release.

We believe this would be highly unreasonable – akin to disqualifying films or high-end television programs from relief if they featured product placement.

The third category, sponsorship, is where a brand pays to have itself associated with a game already in production, perhaps by having its logo at the beginning of play. This is equivalent, for example, to a brand being named as the main sponsor at the beginning of every episode of Downton Abbey and at ad breaks.

Again, we do not believe that this should see a game disqualified from relief.

The fourth category, brand commissioning, is where a brand decides to create a game to raise awareness of itself, and commissions an independent developer to supply the game. For example, a car manufacturer can pay to have its car in an existing game, but it may also commission a game in which players can only drive its own cars.

Games which are commissioned by a brand can still be legitimate games, and indeed are a growing part of the market, particularly in the mobile space. A recently announced example is “Red Bull Crashed Ice”, a game which will be launched through Xbox Live, the console’s online service, in winter this year. This is being jointly published by Microsoft and Red Bull, the drinks company, and is a racing game based on the real-life ‘Crashed Ice’ downhill ice-skating competition sponsored by Red Bull.



This game will clearly have significant funding put into its development, which it would be beneficial to the government's aims to have placed in the UK. We believe that such games should also be eligible for relief

All of the above categories provide valuable sources of income to games businesses and as such should not be explicitly excluded on the basis that they are funded by brands to increase awareness of their products. In order to ensure that the tax relief is as simple as possible to claim, government should make clear precisely what type of games they intend to exclude through this criterion.

As has already been shown, business models in the games industry are changing just as rapidly as technology. It is impossible to know how future games may be monetised, and advertising will inevitably be part of this mix. As such, the Treasury's definition of when a game's 'primary purpose' is advertising should be done on an exclusionary basis – specifying precisely what would not qualify, and therefore by default allowing other business models to qualify absent other evidence.

We also wish to note that games will often have a 'demo' released in advance of their full release, to allow potential customers an early taste of the game. A clear statement that such demos will not be seen as an advertisement, but that expenditure on them will be seen as part of the core expenditure on the game itself, and so qualify for tax relief, should be made.

#### Unsuitable Content and Age Ratings

Q 31: Would a workable solution be to require games to be classified in order to qualify for the tax relief and for BBFC R18 games to be specifically excluded from the scheme? If not, what other solutions would you propose to exclude pornographic products from relief?

Ukie members are in full agreement that games with extreme content which is unsuitable for public release should not enjoy tax relief. We also agree that games given a BBFC R18 rating should be specifically excluded from the scheme.

Our strong preference is for games to have been rated under a recognised age-rating or approval system for their platform in order to receive tax relief. PEGI is the legal age-rating system for physical releases in the UK because it is rigorous, effective, and has the confidence of both the industry and consumers.

However, technology continues to evolve and new platforms for games continue to arise, and it takes time for regulation to adapt to this level of change. Most crucially, there has been no attempt as yet, in either the UK or more widely, to regulate the suitability of games played online and on dominant mobile platforms. Industry codes of conduct, most notably the PEGI Online Safety Code, have been developed, but it must be recognised that these are not yet universally accepted.

The social, mobile and browser based online markets are a major growth area for our industry, in which many British developers are flourishing. Our conversations with the industry have made clear that imposing an age-rating system on this space, for which no regulation has previously been attempted, through a tax relief system would not be acceptable to the majority of games businesses.

However, some confidence has to be given to the Treasury that public money is not being given to support games with extreme content.

Our proposal is as follows:

Games applying for tax relief should secure an age rating from a recognised system for the platform in question, wherever required by the platform or law for them to do so. Our hope is that, as PEGI’s offering for the online, mobile and social games spaces continues to be adopted, this will apply more and more widely.

However, in those cases where an age rating is not secured, the games business should be required to make a declaration that there is no extreme, undesirable content in their game. Guidance can be provided on the form to content that is likely to breach this, which would include gross violence, sexual content, use of drugs, etc.

We believe that this approach offers confidence to the Treasury that games with extreme content will not benefit from public support, whilst recognising the current state of the games market.

Qualifying Core Expenditure

Q 32: Does this proposed definition capture the appropriate integral costs of producing a video game? If not, please explain why.

Q 33: Are the core production costs in video games similar to those in film? If not, please explain how the video games industry differs.

The definition of core expenditure as ‘expenditure directly incurred in the production of the video game but excluding, for example, the costs of financing, advertising etc’ is appropriate. It should ensure that all relevant costs are included, and crucially allow for flexibility as the nature of games continues to evolve at a rapid pace.

There are many differences to the production processes of films, although these should not present any difficulty to the definition above. Where films have pre-production, principal photography and post-production stages, games cannot be so clearly split into separate stages.

Most games will have an early ‘design’ stage, followed by full ‘development’, then ‘continuing development’ after public release. ‘Quality assurance’ or QA is an integral cost, but it generally continues throughout development and is difficult to separate into its own stage of the process. The post-release stage is known by some in the industry as ‘live operations’. A very simplified example of such a model is given here:

Design	Development		Live Operations
Design and Prototyping	Alpha	Closed Beta	Continued development: Open Beta and Master
20%	15%	15%	50%

However, the huge variety of genres, styles, platforms and business models across the industry mean that any such labels being applied are far less universal than is the case in the film industry.

As such it is potentially risky to become too prescriptive about production costs, meaning a broad definition such as that given above is preferable. That definition should include all aspects of game development (design, art, engineering), both pre and post release quality assurance, licensing costs paid before and after release of a game, and allocable overhead costs related to supporting studio operations.

The technology used to create and to play computer games continues to develop at great pace, and many different forms of expenditure will continue to result. The relief must not be designed in a way that would preclude such costs from being claimed, which is a possible result if types of accepted expenditure are listed.

### Grants and Public Subsidies

The consultation document states that ‘grants and other public subsidies’ will be netted off against core expenditure.

It is a reasonable principle that tax relief cannot be enjoyed on money that the public has provided to the developer. However, much as with the definition of ‘commercial’ release, clarity is needed on precisely what will and will not be included in the category of a public subsidy.

Again, we suggest that this part of the final legislation should state clearly what is being excluded. Many parts of the industry, particularly young businesses, often take support from schemes such as SMART grants, the Abertay prototype fund, and schemes based on the Regional Growth Fund, amongst many others. It will be important for games companies to know in advance how using such schemes may dilute the impact of the tax relief for them.

Also, such funding is often granted to the wider company, whereas the tax relief will be granted per project. How this disparity is measured out will also be important.

A clear distinction should also be made between repayable grants, such as the Abertay Prototype Fund, and none-repayable grants. A repayable grant is essentially investment to be repaid, and should be treated the same as private investment – we believe the developer should not lose out on tax relief because of it, as this relief will increase the likelihood of the public being repaid.

### ‘Speculative Expenditure’

Q 34: Are one or both of the proposed rules for separating speculative expenditure from early stage expenditure on a project with an identifiable end product workable?

Q 35: Is there an alternative rule that would be simpler or more effective to ensure that speculative expenditure does not qualify for relief?

Everyone in the industry Ukie has spoken to is happy with the principle that speculative expenditure not attached to a project intended for release should not receive tax relief – the support has to go towards the creation of actual games.

However, we are not convinced that the proposed rules would be effective in enforcing this principle.

The first rule, that a game could only receive relief once formally commissioned by a publisher, will work perfectly well for games which are commissioned, but of course would be of no use for games which a developer funds and publishes themselves.

The second rule, that costs would have to be incurred 'in producing a video game with the potential to be approved for commercial release' is highly subjective and potentially open to abuse.

Projects which are intended for commercial release but abandoned prior to release for business, technical or other reasons, should come within the scope of qualifying production expenditure. A more objective and easily enforced rule would be that games could only qualify for relief once they had begun coding to create a playable game – essentially once they had moved to a 'prototyping' stage of development. This would be easily proved, and would show that they had moved beyond initial design and storyboarding to begin spending resource on the actual creation of the game.

It is important to note, of course, that this early design and concept work will be eligible for relief once the game has moved into early production.

The first rule, that having been commissioned by a publisher would also qualify the game, could remain in parallel with this rule.

It is also worth noting that, if a threshold were put in place as suggested in the consultation document, this would remove much of the concern in this area. Very few independent developers who did not have external funding would spend more than £50,000 on early design work.

### Debugging and Maintenance

Q 36: Does the proposed approach to debugging and maintenance costs ensure that the costs integral to the production of a video game can qualify for relief? Please explain your view.

We have several concerns about this proposal. The thinking behind it – that the creation of new content should be supported, but that the fixing of broken content should not – seems reasonable at face value, but we are not convinced that it will be workable as proposed.

The line between what is debugging and what is the creation of new content is indistinct at best. Although most developers we have spoken to have said that they would probably be able to record debugging as separate work, it would be almost impossible for any outside party to determine whether these were accurate records. Any auditor or tax official considering the claim would simply not be able to determine with any certainty whether the split between debugging and new content creation was being accurately reported.

More generally, the term 'debugging' does not properly capture the idea of 'fixing something that is broken' that it is intended to capture. The cleaning-up of code is an integral part of feature and new content development, akin in many ways to editing in a film, and attempting to separate it out simply does not reflect the reality of how games are made – it is an integral production cost.

We are also not convinced that this distinction is in fact a useful one. Many developers have asked why debugging would be supported pre-release as part of QA but not post-release, and this reveals a core problem with the proposal: quality assurance is an integral cost to producing a video game. It is

absolutely part of core expenditure, which is why it should be supported pre-release, and is also why it should be supported post-release.

There are clearly some post-release costs which are not integral to the production of the game, such as the maintaining of servers, community management around the social aspects of games, and other such service maintenance work. It is reasonable that this work would not be supported under the tax relief.

Our recommendation therefore is that the language used in this section should be changed, to better capture the reality of the integral post-release production costs for a game. We would suggest that the distinction should be drawn between **product development** costs, which should qualify for relief, and **service maintenance** costs, which should not.

At its most simple, this means that any work on the content of the game itself, whether that be making new content or ensuring that existing content retains its functionality as technology, new features and platforms change, should be supported.

Q 37: Does the flexibility offered by the FTR model, that allows further relief for qualifying costs after the product has been completed, provide sufficient scope to accommodate costs that arise in both the video games' business models?

We believe that the FTR model will provide sufficient flexibility to work with all the business models that currently exist in the games industry.

Post-release development, be it DLC for a high-budget console or PC boxed-release game, continuing development of a persistent-world MMO game, or iteration of a successful mobile game, is an absolutely central part of the work of the modern games developer. This is a trend that will only continue to accelerate.

It is absolutely vital therefore that the tax relief supports this work; to fail to do so would risk seeing some studios place their 'live operations' teams off-shore to save costs, just as such work is growing as a percentage of spend.

We are pleased that Treasury have already recognised these points and are convinced that the FTR model, under which games can continue to be reported as the same 'separate trade' after they have been publicly released, will allow for all the different types of post-release development to enjoy tax relief.

Q 38: Does the requirement that each video game operates as a separate trade within the production company – with a separate, identifiable production budget – create any issues?

As outlined above, the keeping of separate budgets for individual projects is not universal in our industry, as it is in the film industry. However, the consensus is that those developers who do not already use this method will be able to do so without too great a problem.

The only aspect that would create real difficulty is the use of special purpose vehicles. This is a far more logical approach for films, which typically have many different sources of funding for each

project, than for games. Our conversations across the industry lead us to doubt that much use will be made of SPVs under Games Tax Relief, certainly amongst the smaller part of the market.

It is vital that the final design of the system does nothing to require the use of special purpose vehicles, or even to prejudice developers towards their use. This simply would not be a good fit for our industry, and would do great damage to the take-up of the new relief.

As stated earlier in this document, we believe that a system more closely aligned with the existing claims process for R&D tax credits would have the potential to be easier to use for developers, and should be further considered in the long-term, for a future revision of this relief.

Any issues created by the separate trade requirements, however, will be surmountable, and so due to the ease of implementation for government the system should be put in place as suggested, on the timeline suggested. We would simply repeat that Special Purpose Vehicles are not a natural fit for much of our industry, and so must not be a requirement of the system but merely an option for meeting the requirements.

It is entirely possible that Special Purpose Vehicles will become more common across the industry, particularly as crowdfunding leads to many projects having much more dispersed funding sources. However, requiring them now would not reflect the current state of the industry.

### Threshold to Entry

#### Q 39: Should there be a minimum spend threshold and if so at what level?

A majority of the people we have spoken to in the industry oppose the idea of a minimum spend threshold for games tax relief.

There are varied opinions on the minimum budget required to make a successful mobile game. Some businesses produce an iOS game for less than £10,000 that can still generate significant income, whilst others have said that at least £30,000 is required in order to compete. Production values continue to rise in the mobile space, as does the need to update games with new content, placing continuous upwards pressure on budgets.

We also note evidence from Abertay University, who have received applications for their Prototype Fund from 250 UK-based start-up games companies. Abertay make clear that budgets for these projects go as low as £25,000, and argue that ruling them out of the relief would reduce the potential for the release of the trapped value they represent into the UK economy.

It is likely that an implicit threshold will be set by the market, through the costs involved in accounting for and auditing any claim. For example, a game with a core expenditure of £20,000 will likely receive between £3,000 and £4,800 of benefit, depending on where rates are set. The majority of this would most likely be taken up by accountants' fees and management time in preparing the claim.

Some members did however raise concerns over not having a threshold. The creation of a threshold would have one particular benefit: it would reduce concerns around other parts of the system. For example, claims for speculative expenditure would be far less of an issue, as the majority of projects

would be unlikely to spend tens of thousands of pounds on this. Many games that have the primary purpose of advertising will have relatively small budgets, as they will often be browser-based.

A threshold would also, of course, reduce the likelihood of HMRC being inundated with a large number of claims. However, many developers we have spoken to are sceptical that this would occur in any case as the other criteria, particularly the cultural test, will limit applications.

The majority view of those we consulted is that successful and culturally-valuable games are made regularly for less than £50,000, the level suggested in the consultation. Most of the companies we consulted could not see any compelling reason why these games, which match the aims of the relief, should be denied support while those of a slightly higher budget are not.

The number of relief claims will be self-regulating in several other ways, not least the cultural test and the cost of preparing and making a claim.

There is a majority opinion in our industry that there should be no threshold. If the government concludes, however, that it would prefer a threshold to be in place, we suggest that it be set at the same level as the implicit, market-set threshold mentioned above. The Treasury should model the likely average cost of making a claim for tax relief, and set the threshold at whatever size of budget would provide this same amount of benefit.

Should this approach be taken, we recommend that future reviews of the system undertake modelling to examine the likely impact of lowering the threshold, with a presumption that it will be lowered to include as much of the industry as possible, as the system proves itself to be robust and sustainable.

#### Q 40: Are there any other specific design points which need to be addressed?

##### Rates of Relief

As government has recognised, this tax relief has to be set at an internationally competitive rate if it is to achieve its goals in light of the significant reliefs available in other countries, most notably Canada, and the effect this has had on the UK industry.

It must also be kept in mind that, if the film relief is followed closely, claims will be made on 80% of core expenditure only, in the case of wholly UK-based productions.

Considering these factors, we recommend that a 30% rate of relief be offered on all games that pass the cultural test. As the 80% rate of additional deduction means this will in fact be a rate of 24% on the total production budget, we believe this is a minimum necessary to truly place the UK on a level playing field.

During discussions around the consultation, some games companies have expressed interest in having banded levels of support, with games being made for budgets below a certain level being offered a higher rate of relief, as happens in the film relief. Our preference is for a flat rate of relief at 30%.

However, if differing tiers of support are put in place, we suggest that the rates of relief be kept relatively close: no less than 30% for games under the threshold and no less than 25% for games above. This threshold should be set by Treasury following modelling of the cost and impact of the relief.

### State Aid and Cultural Test

Whilst recognising that the design of the cultural test will be consulted on separately, we wish to cover it briefly here.

It is important that the final system has a carefully balanced mixture of several aspects: the content of the game; any cultural or technical innovation it embodies; the people making the game; and the place the game is made. It is also important that the test reflect how the 'tone' of a game – its scripting, humour and characters – can reflect British sensibilities, and so be British culture, without necessarily being set in Britain (or even the real world) or based on older British stories.

We look forward to engaging fully with DCMS and the Treasury to ensure that the points system accurately reflects how games are made, and are likely to be made in the foreseeable future.

We also wish to stress at this point an important related issue. The use of the cultural exemption from EU state aid rules must not lead to a change in the underlying classification of games as software.

There is a concern amongst our industry that the use of the cultural exemption, because it has also been used for films, will lead to future pressure for games to be classified as audio-visual products rather than software.

This would be patently wrong and extremely unhelpful to the industry. All games, by their definition (as stated above), are software – they cannot exist without computer code. Some of them, as this tax relief will recognise, are also products of cultural importance. Classifying them any other way will not accurately reflect the nature of our industry and so will present unnecessary complications, particularly with regard to the copyright protection games developers and publishers rightfully enjoy.

Government has recognised this point in the past, which we welcome. As the cultural exemption is put into place, however, we believe it is an important opportunity for the UK government to reiterate its belief that games and interactive entertainment should continue to be classified as software, and that their current status in copyright law should be retained.

## **Section 6: Other Issues**

### Skills

Q 44: What systems and measures could be developed or enhanced to ensure that the animation, high-end television, and video game industries have a world class skills and talent base capable of supporting the growth that the new measures will be designed to support?





The Next Gen Skills campaign, led by Ukie, has firmly placed the need for improved computer programming skills on the national agenda.

Thanks to the Livingstone-Hope report, which led to the Next Gen Skills campaign, we have a clear and detailed picture of the changes that need to be made by government, industry and the education system to turn around the talent shortage that has developed for the video games and VFX industries.

Ukie is dedicated to implementing these changes, working with all other parties, to ensure that the UK has a strong enough talent pool to support the added investment that games tax relief will unlock.

A crucial part of this solution must of course be a contribution from the industry itself. We believe therefore that some mechanism to use a small part of the funds generated by games tax relief, and redirect them to support the recommendations of the Next Gen Skills campaign, would be beneficial for our industry in the long run, as well as an important recognition of the need for the industry to take a strong role in this work.

A voluntary levy of a small percentage of the tax relief received, as exists for the film industry in the Skills Investment Fund, is one possible such mechanism, although other models should also be considered.

The important features of any system put in place must be as follows: it is carefully targeted to tackle the problems highlighted by the Next Gen Skills campaign, to ensure the real needs of the industry are met; contributions from games companies should be on a voluntary basis, as not all will be able to afford the investment; there should be clear incentives for companies to decide to take part, directly addressing their own skills needs, so that take-up is high.

We are eager to work with all sides to determine how such a system could be put in place, in time for the introduction of the relief itself in April 2013.

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