

need to know

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UK Games Tax Relief

This document has been prepared by Ukie Associate Member Osborne Clarke as a plain English explanation of the new tax relief and does not constitute legal advice. It is based on the latest version of the draft legislation and there may be changes made to the scheme when the final legislation is published. Please seek legal advice and clarification independently before taking any action.

1. Background

A tax relief for game development will come into effect on 1 April 2014. This note provides a simple overview of how this relief will work.

2. But wasn't this relief announced ages ago?

2.1. Yes. The Government originally published draft legislation to implement this relief back in December 2012. The Government's intention at the time was for the relief to come into effect on 1 April 2013, but this was always subject to state aid approval from the European Commission.

2.2. In the Budget on 19 March, the Government restated its commitment to the introduction of this relief and announced two changes to address some concerns expressed by the European Commission. The first was to extend the relief to expenditure provided on goods and services provided from within the European Economic Area (EEA) as opposed to just the UK. The second was to include a cap of £1m per game on sub-contracted expenditure. Following these changes, on 27 March 2014 the European Commission announced that it has concluded that the proposed relief is consistent with state aid rules.

3. What games can benefit from the relief?

3.1. The draft legislation calls the relief a 'tax relief for video game development'. The legislation does not define the term 'video game' and the intention behind this was to avoid including a definition that might not keep up with developments in the industry. In principle therefore, the relief will apply to any kind of game

for any platform, including mobile and tablet.

3.2. However, anything produced for advertising or promotional purposes or for the purpose of gambling is expressly excluded. In addition, there are some conditions to the availability of this relief which are summarised below.

4. Who can claim this relief?

4.1. The relief in respect of a game can be claimed by any company (not an individual, partnership or LLP) that is responsible for the design, production and testing of that game, is actively engaged in planning and decision making during this process and directly negotiates, contracts and pays for rights, goods and services in relation to that game.

4.2. Importantly, there can only be one company that claims the relief in respect of a game. If more than one company is involved in these activities, then it will be the company that is 'most directly engaged' in these activities that can claim the relief. For example, if a game is being co-developed by two companies, then those two companies can and should agree which company will claim the relief.

5. How is the relief calculated?

5.1. In summary, the relief allows a company to make an additional deduction in calculating the profit and loss of a game development project. The company will then either pay less corporation tax on that project or, if it has made a loss on that project, will be able to surrender that loss for a payable tax credit (i.e. a cash payment from HMRC).

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5.2. Each game development project on which relief is claimed will be treated as a 'separate trade' of the company. The company will be treated as starting that trade when it commences the design of the game or (if earlier) when it receives any income from that game.

5.3. In the first period of account of the trade, the company brings into account the development costs incurred in respect of the game in that period and the estimated income earned from that game in that period. In subsequent periods of account, the company then brings into account the additional development costs incurred and the additional estimated income earned since the previous period.

5.4. The relief is based on the following key concepts:

a) **Core expenditure:** Expenditure on the design, production and testing of the game. However, it does not include any expenditure on initial design work, debugging a completed game or maintaining a game. There is also a cap on sub-contracted expenditure of £1m per game.

b) **EEA expenditure:** Expenditure on goods that are used or consumed in the EEA. If any expenditure has to be apportioned between EEA and non-EEA expenditure, then this has to be done 'on a just and reasonable basis'.

5.5. For the first period of account, the company may deduct the lower of the two following amounts:

a) **Core expenditure** that is also **EEA expenditure**.

b) 80% of the **core expenditure**.

5.6. In subsequent periods of account, the company makes the same calculation, but subtracts the amount of the additional deductions given for previous periods.

5.7. If after making this deduction the company makes a loss in a period of account, then the company may claim a tax credit of 25% of its 'surrenderable loss' for that period. The company's surrenderable loss in a period of account will be its actual loss or, if lower, the amount of the core expenditure for that period.

5.8. The Company may surrender all or part of its surrenderable loss for a tax credit of 25% of the loss surrendered. If a company makes this claim, then HMRC will pay the company the amount of this credit in cash or it may be used to reduce the company's overall corporation tax liability. A company can forward any unused surrenderable loss to a subsequent period of account.

6. A quick worked example

A games development company is commissioned to develop a game for £1m but incurs core expenditure of £1.2m developing that game. All of this core expenditure is EEA expenditure:

Total income	£1m	
Core expenditure (all of which is EEA expenditure)	(£1.2m)	
Pre-games tax relief profit(loss)		(£200k)
Additional deduction; the lower of: (1) EEA expenditure of £1.2m and (2) 80% of core expenditure (being £960k)		(£960k)
Post-tax relief profit (loss)		(£1160k)

The surrenderable loss in this example is the lower of:

a) The available loss of £1,160k and

b) The available qualifying expenditure of £960k

So in this case the company can surrender the whole qualifying expenditure of £960k. The amount of payable tax credit due is 25% of the loss surrendered (i.e. the available qualifying expenditure of £960k) giving a payment of £240k.

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7. What are the qualifications for the relief?

7.1. The relief is only available for a game where the following three conditions are met:

- a) **Intention for supply:** The game must have been intended to have been released to the public. (This refers to the intention at the time that the production activities began, and so if the development of a game is abandoned during production, this will not disqualify the game from relief.)
- b) **British video game:** The stated aim of the legislation is to, 'promote the sustainable production of culturally significant video games in the UK'. In order to meet this condition, the game must pass a cultural test (see below).
- c) **Minimum EEA expenditure:** At least 25% of the **core expenditure** on the game must be **EEA expenditure**.

8. What is the cultural test and how will it work?

8.1. The cultural test sets out the criteria against which a game will be assessed. Each carries a number of possible points and to pass the test a game must be awarded a minimum number of points.

8.2. The final cultural test has now been published here: bfi.org.uk/film-industry/british-certification-tax-relief/cultural-test-video-games. A summary of the criteria are:

- a) The percentage of the game that is set in the UK or another country in the EEA.
- b) The number of characters in the game that are from the UK or another country in the EEA.
- c) Whether the game is based on a British story or a story relating to another country in the EEA.
- d) The percentage of the dialogue that is in English or another regional or minority language.

e) The level of contribution of the game to 'the promotion, development or enhancement of British culture'.

f) The amount of work done in the UK.

g) Whether the lead people involved in the making of the game are citizens of or ordinarily resident in the EEA.

8.3. A company will have to make an application to the Department of Culture, Media & Sport for certification that the game is a British video game. A company can apply for an interim certificate before the game is completed to enable claims for relief during the development period. This will also provide comfort that the game will ultimately obtain a final certificate.

9. What happens if a project is abandoned?

The abandonment of a project will not affect the entitlement of a company to claim the relief in respect of that game or affect any relief that has already been claimed.

10. How does this relief work with R&D relief?

10.1. There can be no overlap between this relief and R&D relief (no 'double-dipping' is allowed). The relief will not be available in respect of any expenditure that can qualify for an R&D expenditure credit or where the company has already obtained relief for expenditure on research and development. A number of UK developers have been very successful in making R&D claims and so going forward will have to think carefully about which relief to claim for which expenditure.

What should I do next?

For further information on this document or UK Games Tax Relief contact Paul Gardner at Osborne Clarke (paul.gardner@osborneclarke.com).