Response to HM Treasury Consultation on Audio-visual Tax Reliefs from the UK interactive entertainment association (Ukie)

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About Ukie

Ukie is the trade body for the UK's video games and interactive entertainment industry. A not-for-profit, it represents more than 600 games businesses of all sizes from start-ups to multinational developers, publishers, and service companies, working across online, mobile, console, PC, esports, virtual reality and augmented reality. Ukie aims to support, grow, and promote member businesses and the wider UK video games and interactive entertainment industry by optimising the economic, cultural, political, and social environment needed for businesses in our sector to thrive.

About the games industry

The UK video games industry is an economic powerhouse and a hotbed for the development of emerging technologies, generating £5.26 billion in gross value added to the UK economy and supporting 73,000 FTEs in 23 key locations across the UK, with the average GVA per FTE reaching £121k, nearly double that of the UK economy average. Over 55% of games development jobs are based outside of London and the South East.

Video games are also a significant part of modern popular culture with broad appeal to a diverse audience. 86% of people aged 16-69 in the UK have played games in 2020, and this is represented by an even gender split[1]. Ofcom's recent Online Nation 2022 report found that 39% of UK adults and 56% of UK children identify as playing games online[2].

The UK's established video games sector is a global leader in the future technologies which will develop and shape the industries of the future, including across the creative sector. This sees the UK leading the world in fusing creativity, art and technology, using cutting-edge techniques to develop new games and to bring new products to the market.

The games industry is also a strong exporter, and it has been estimated that 95% of all games businesses in the UK export, and that this sees an average of 45% of turnover of games firms deriving from international sales.[3] DCMS figures show digital software publishing, of which games publishing forms part, were responsible for £1.2 billion of UK exports in 2020. 78% of digital publishing exports went to destinations outside of the EU to countries like the USA, Japan and Australia[4]. These exports are also fast-growing, matching the growth of the sector, increasing by over 65% since 2015.

The video games sector has also been successful and driving investment into the UK. Recent research by Ukie has found that between January 2017 and June 2022, the UK games industry benefited from at least £7.7 billion in investment[5]. Figures show that this has been driven by a large number of acquisitions, expansions and IPOs, and with the overwhelming majority of this (£6.87 billion) arising directly from inward investment from non-UK companies.

None of this growth, investment and job creation over the last decade would have been as strong and successful if the Video Games Tax Relief (VGTR) had not been in place.

The business model for games is constantly evolving and it is also important to realise that no two games are created equal, even from the same studio. Creating a game can take anywhere between a matter of days and a

[1] https://info.savanta.com/uk-gaming-attitudes-and-behaviours
[2] https://www.ofcom.org.uk/__data/assets/pdf_file/0023/238361/online-nation-2022-report.pdf
[3] https://www.thecreativeindustries.co.uk/site-content/industries-games-games-why-the-uk
[4] https://www.gov.uk/government/statistics/dcms-sectors-economic-estimates-2020-trade/dcms-sectors-economic-estimates-2020-trade-headline-release
[5] https://ukie.org.uk/news/2022/08/uk-games-industry-received-7-7bn-of-investment-in-past-half-decade

number of years. Some of the earliest versions of popular games took days to create but can be iterated constantly over the years following the initial release. In contrast, some of the biggest AAA productions see publishers hire multiple studios to work on new entries years in advance to guarantee games are ready to publish ahead of their strict holiday deadlines. The expansive time range, coupled with wholly new operating systems which emerge on average roughly twice a decade, make video games a no size fits all operation.

Optional purchases within 'free to play' (F2P) games, a concept that has only become common over the last 10 years, are the largest source of revenue for games developers across a range of platforms and mobile is now the single most popular platform for games, offering previously unimaginable choice to players. The polarisation of spiralling costs and complexity of console games versus the unprecedently low barrier to entry and readily available tools involved in developing a mobile game presents a whole range of challenges and strategic choices to independent games developers.

The Video Games Tax Relief

The impact of the VGTR on the video games sector since its introduction in 2014 has been enormously beneficial. It is accessible to the smallest studio and is critical for them to grow, access finance options, hire people and export, while also driving significant global investment in large studios and ensuring the UK remains competitive at the top end of the market. Thanks to this flexibility to support the entire games development sector, the relief delivers an important net positive to the exchequer.

Most recently the impact of VGTR across the economy was covered in the BFI's Screen Business 2021 report. The report found that VGTR generated a return of tax investment of £1.72 for every £1 of investment[6]. It also directly supports over 15,000 FTEs, equating to over 21% of the total video games sector workforce in the UK. However, the rate of return as specified in the screen business report is based on historic data that undervalues the impact of the games industry, and Ukie is currently conducting further research to develop a better understanding of the true economic impact and rate of return of VGTR which we believe is far higher.

The relief is also accessible and inclusive for the thousands of SMEs, resulting in highly skilled and high productivity jobs in 23 key locations across the UK. The industry currently supports 73,000 FTEs across the value chain in the UK, an increase of 54% since 2016, with the average GVA per FTE reaching £121k, nearly double that of the UK economy average[7]. Additionally, it also offers a promising engine for the levelling up agenda, with over 55% of game development jobs being based outside of London and the South East and with 64% of growth in GVA in the games industry being outside of London in 2019.

The sector is inherently innovative and to an extent it is a trailblazer, developing new technologies with wider application across the economy - developments such as simulation, modelling, VR and AR, and the use of data analytics - that can help accelerate innovation in other sectors.

VGTR, which acts to draw game companies and talent to the UK, does remain broadly competitive in an increasingly competing in a tough global, offering a rate of relief of 25% and a relatively simple application process. However, there are now many other jurisdictions that are also offering similarly generous incentives to the UK. For example, the French tax credit for video games sits at 30%, Greece offers a cash rebate of 40%, Canada has several Provincial incentives including, Ontario offering a tax credit of up to 40% for video games, and a base rate of 30% in Quebec, and the Republic of Ireland has recently announced a tax credit at a rate of 32%, while Germany and Australia have also introduced new reliefs in the last three years.

[6] https://www.bfi.org.uk/industry-data-insights/reports/uk-screen-sector-economy

[7] Ibid.

Executive Summary

- **VGTR has been the most important UK policy to support the growth of our industry over the last decade.**
- **Whilst we recognise that changes in the UK's trade position following global taxation developments, particularly the OECD/G20 BEPS project and the USA 2022 Final FTC regulation, as well as the UK's departure from the EU, may necessitate changes to VGTR, the mitigations proposed by Government do not go far enough to balance out the impact of proposed changes and risk unintended consequences.**
- **The first priority should be to ensure VGTR remains at least as attractive, accessible and effective for all sizes of games company as it has been since its introduction. This is particularly true in light of growing global competition in incentives.**
- **Further policy changes, such as skills investment and co-development treaties, should also be considered to super-charge the effectiveness of the relief.**

In the wake of the consultation, Ukie launched an industry-wide survey to inform its formal response. There was an even spread of responses in terms of headcount. Micro businesses (<10 employees) made up 32% of the responses, while large businesses (>250 employees) made up 24%. The answers below have been developed based on the findings of the survey and case study interviews conducted with members and wider industry representatives throughout the process. Ukie has also extensively engaged its Tax member working group, as well as with the relevant Government departments.

The responses throughout the survey and Ukie's wider engagement paint a clear picture: since its introduction in 2014, VGTR has provided vital support to grow the Video Game Industry, being a net positive relief supporting developments from the smallest independent game development studio through to the largest AAA productions. 89% of companies surveyed agreed that the relief was important or very important to their business, with no respondents saying it was not important, with a number of large multinationals employing over 1000 personnel in the UK stating that the availability of VGTR had been a significant factor in their creation or acquisition of UK studios.

The VGTR has enabled business to access routes to finance that were previously not available, and it continues to be the one of the most important drivers of investment and economic growth of the video games industry across the UK. An HMRC commissioned report evaluating the VGTR found that "developers felt that VGTR had set the UK industry on a path to becoming globally competitive again[8]. That increased internal investment across the UK has also resulted in substantial incremental PAYE taxes being paid to HMRC (at a much higher rate than the incentive provided for by the VGTR), and companies incurring significant costs in leasing and renovating premises across the UK, which itself has brought work to many local businesses in the wider economy. Many of our respondents highlighted the case of ancillary benefits to the UK's economy being derived from increased investment in the UK as a result of the VGTR.

The VGTR also offers a promising engine for the levelling up agenda, with over 55% of game development jobs being based outside of London and the South East and with 64% of growth in GVA in the games industry being outside of London[9].

International investors cite the tax relief as a key reason for choosing the UK over other countries. and while the Government's promise to "build on the success" of the tax reliefs is welcome, extreme caution should be exercised when considering possible changes to the VGTR that could undermine further international investment.

Additionally, the global market continues to become more competitive as various Governments have introduced their own tax reliefs, including Ireland, Germany, and Australia. It is now estimated that there are around 100

[8]https://www.gov.uk/government/publications/video-game-tax-relief-evaluation
[9]https://www.bfi.org.uk/industry-data-insights/reports/uk-screen-sector-economy

examples of different tax incentives to encourage development and production across the creative sectors around the world.

Against this backdrop, the UK should, as an absolute minimum, take a "do no harm" approach to the Video Games Tax Relief, ensuring that the overall attractiveness of the scheme, including the effective rate of relief available to incentivise development activity is at least maintained. We therefore urge the Government to ensure that no changes leave domestic businesses worse off or put off international investors. The VGTR remains a key driver of investment and economic growth of the video games industry across the UK.

Additionally, following consultation with our members, Ukie believes there are opportunities to enhance the current VGTR, but there are also notable risks in making changes that could have unintended consequences. Rushed action to change the reliefs, particularly if it serves to make the UK a less attractive place to invest or locate, should be avoided.

In summary, our key points arising from this consultation are:

- **There is an overarching need to ensure any reforms to VGTR do not affect its generosity or competitiveness in comparison to international alternatives.** The UK faces competition from an increasing number of generous tax regimes in Europe and the rest of the world as well as other measures from other territories which have been designed to boost their respective games industries. We must ensure that any reforms to VGTR do not make it less generous or more difficult to claim and urge Government to consider a range of other measures to boost VGTR and the UK games industry.

- **The removal of EEA expenditure from qualifying expenditure in VGTR claims would have a negative impact on UK games companies.** 79% of respondents to Ukie's industry survey felt the removal would have a negative or very negative impact on UK games production which could result in UK based projects being reduced in scope or moved elsewhere in the world.

- **Removing the eligibility of EEA expenditure is likely to increase costs for businesses which would not be balanced out by a removal or revision of the subcontracting cap.** Whilst the removal or revision of the subcontracting cap would be welcome, this would not offset the negative effect of a removal of EEA qualifying expenditure from the VGTR given the industry's current use of and access to skilled EEA labour. Furthermore, a requirement for all expenditure to take place in the UK would push up costs and exacerbate existing shortages of specific roles for aspects of game development.

- **There is the risk of unintended consequences if these measures are carried out at pace without a corresponding look at skills education, talent pathways, as well as further measures to increase the competitiveness of VGTR internationally.** The UK remains an attractive destination to make and sell games, but the industry faces an acute challenge in finding skilled workers for a variety of roles and functions, pushing up the cost of UK productions. These changes risk exacerbating these challenges.

- **More information is needed from HMT/HMRC on 'used or consumed' definitions, as well as clear information around the timetable for implementation of expenditure credit system to allow businesses to plan for these changes.** We are concerned that definitions for 'used or consumed' for VGTR has not been available prior to the consultation and urge HMT/HMRC to clarify this urgently in order for businesses to fully understand the impact of these changes. Similarly with a move to expenditure credits – clear guidance as to the effective rate and implementation timetable are vital.

- **New US tax rules must be prepared for.** For US-headquartered companies investing in UK development, recent changes to the US Foreign Tax Credits rules will seriously reduce the attractiveness of VGTR unless changes are made.

- **Government should explore ways in which VGTR can be expanded to encourage co-development projects as is the case in Film and High-end TV.** The games industry would actively seek more opportunities for co-development and would likely see an increase in opportunities for UK studios from abroad if co-development was more easily eligible for VGTR. We encourage HMT/HMRC and other Government departments to consider ways in which eligibility for VGTR can be optimised to encourage co-development projects.

Question 7: Would the removal of European expenditure from the qualifying costs of VGTR impact your production activities? Please describe how and include any quantitative/qualitative evidence.

1. Overall, the removal of European expenditure would, according to 79% of respondents to Ukie's survey, have a negative or very negative impact on their operations and the UK's video games sector. Members described the proposition as "*damaging*", a "*significant concern*", "*unfeasible*", and "*put[ting] our longer-term investment into our UK business at risk*".

2. Our survey found that 71% of respondents carried out 80% or more of their expenditure in the UK, but only 11% of the sample had no external costs. The remaining 29% of respondents account for 42% of the total project expenditure reported in our survey and incurred between 1% and 60% of their expenditure in the EEA, a total of approx. £63m. Total EEA spend across all the respondents' most recent projects was approx. £110m.

3. A core reason for the overall negative outlook is the current inability of the UK to support all the functions required to maintain, and grow, the UK video games industry owing to shortages in its skilled labour market, with one member arguing that the "*ability to outsource to the right party supports the creation of a profitable UK industry*." This sentiment corroborates our survey findings, in which respondents detailed numerous creative functions where they are reliant on talent from the EEA and estimated that if their production were to take place wholly in the UK, it would be around 32% more expensive overall.

4. One respondent argued that "*without having a suitable situation and the talent in place to make up for the decreased incentive to work with those abroad, cutting out European expenditure at this stage is short-sighted and damaging to local businesses*."

5. 61% of respondents stated that it would be either significantly challenging or not possible at all to find UK talent that could carry out work currently undertaken by partners in the EEA. We received multiple comments on from respondents to the survey about wider issues that were affecting the industry and a great number focussed on the cost of hiring UK based staff and the lack of available talent in the UK, whilst calling for an increase in investment in education spending, greater emphasis on digital skills, better quality courses at university level and a cheaper, more tailored visa system to allow companies to attract international talent in the short term (see question 19).

6. Additionally, only 23% of respondents said they would seek to work with a UK partner to carry out work previously undertaken by a European partner, with no respondents saying that looking for a UK partner was 'very likely'. As one respondent puts it: "*Games is an incredibly high skilled industry, VGTR has been key to us being able to launch a startup studio and attract international investment. Limiting VGTR to the UK will not mean we can suddenly find talent that didn't exist before, but it will increase our cost base and potentially make start up studios less viable*."

7. Overall, 65% of respondents said they would need to reduce the scope of--or find additional financing for--projects currently being developed in the UK if EEA qualifying expenditure was lost from VGTR claims, with 29% of respondents saying that were likely or highly likely to move projects out of the UK in their entirety. 34% of respondents also said they would consider moving a future project out of the UK to a European-based studio with a tax-based incentive that allows work across multiple European territories (e.g., Ireland, France). This demonstrates how the intended result of encouraging additional investment into the UK video games industry by introducing a possible change to the expenditure that qualifies for the VGTR would instead have the opposite effect.

8. This feeling is shared between small and large businesses. An SME with less than 10 employees and £85,000 annual UK turnover said that "*it would make development of games unfeasible for us in the UK and we'd be looking to move our company to somewhere with better tax relief options such as Ireland or Canada*." A large company with over £50,000,000 annual UK turnover said there "*may be a business case to move development… [to their EU based studios] if a material number of EEA costs are considered ineligible for UK VGTR*." The most cited reason for moving UK operations to the EU is to get "*access to funding schemes and support*", of which the latter includes talent and the ability to collaborate with studios.

9. Another survey respondent said: "*This would be very detrimental to our investment in games, and in our ability to grow our UK based business, which blends internal UK specialist development teams with less specialised EU outsourced providers. In order to grow, being able to outsource to the right party supports the creation of a profitable UK industry. There isn't the capacity in the UK for these outsourced functions to support the requirements of the UK games industry, nor is there the availability of lower-cost resource to fulfil the less specialised roles. Cutting EEA expenditure from VGTR will reduce the amount of money we can invest in games, and consequently reduce the amount we spend in the UK.*"

10. This change would come at a time when the UK risks becoming less attractive to Video Games companies, amid high levels of global competition in this space. This pressure is compounded by a skills shortage, cited by respondents as a major barrier to further investment in the UK, and the internationalised nature of the industry, which relies on cooperation with parties across the globe. Respondents argued that limiting the access to required talent and support from abroad would reduce the ability of UK-based companies to operate at the current level, as well as increase the cost of production.

11. The UK Video Games sector is a growing one, with presence right across the UK. Consideration should be given to the wider economic impacts of any change which sees the benefit of the VGTR diminish. As outlined in our answer to Question 11, while removing the subcontracting cap would be welcome, this would not offset the negative impact from removing EEA expenditure.

12. It is vital that transition is carefully considered for any potential changes to the VGTR. Certainty, clarity, and providing sufficient notice are all vital. Video game production can be an iterative process over many years, and work has already begun on productions that will not reach completion until after the proposed implementation period.

13. Whilst we understand from discussions with HMT and HMRC that changes to the UK's global trade and tax position may require changes to VGTR, we also strongly encourage HMT to investigate all possible avenues to maintaining the ability for UK video games companies to continue to include EEA qualifying expenditure in their VGTR claims. If EEA qualifying expenditure is to go, HMT must consider a wider plan to examine the generosity of the relief couple with a plan to tackle skills shortages within the UK. As will be seen in our responses, a key driver for companies in seeking assistance from studios in the EEA is the access to skilled labour coupled with the ongoing challenges faced by UK companies in securing work visas for EEA residents.

Question 8: Do you anticipate any issues with the requirement of video games expenditure to be 'used or consumed' in the UK?

14. Overall, there was an even split between responses, with 53% of survey respondents said they are not anticipating any issues with a change to VGTR that requires video games expenditure to be 'used or consumed' in the UK. Some respondents argued that a shift towards defining qualifying expenditure with reference to where goods or services are 'used or consumed' as opposed to if goods or services are "*provided from within the UK or EEA*" would be a positive change. However, during meetings with the respondents, the majority were concerned by the lack of clarity over the definition of 'used or consumed', with a number noting that this may negatively impact investment and co-development decisions due to the uncertainty and fear that the detail would only be forthcoming after the consultation closes. It is essential to note that a lot will depend on how that phrase is defined and what is included in the VGTR's associated guidance. Ukie is well-placed to continue discussions around 'used or consumed' definitions with HMT/HMRC as they seek to take these reforms forward.

15. Additionally, many respondents also argued that UK companies often engage with services based in the EEA to support UK projects to access the necessary expertise. This is due to much of the talent in the sector being available outside of the UK given the UK's skills shortage, especially in areas of production and development. Unless corresponding steps are taken to enhance the skills/talent pipelines, the shortage will only be exacerbated.

16. We encourage HMT/HMRC to expedite the clarification of the definition to provide greater understanding for companies including how 'used or consumed' in the UK would be substantiated when claimed. Several larger companies raised concerns over whether licensing costs would fall outside of the definition given the significant outlay they pay to rights holders who may not be based in the UK.

Question 9: Please describe your current subcontracting activities, including the proportion of work that you tend to subcontract relative to your overall production activities, the type of work you subcontract, and the cost of the activity you subcontract.

17. Some degree of outsourcing is common in the industry, with only 9% of the sample survey respondents stating they had no outsourced expenditure on their most recent project. 82% of survey respondents outsourced up to 25% of their work.

18. In our survey we found that the total combined budget of our respondents most recent project was over £700m, of which approximately £80m was the total subcontracted expenditure on that same

project. Meanwhile, our survey found that the most commonly outsourced work was Animation, Art, Programming/Development, Quality Assurance and IT/Infrastructure. The top destinations for outsourcing outside of the UK were Poland, Italy, USA, Bulgaria.

Question 10: Would the removal of European expenditure from the qualifying costs of VGTR impact your subcontracting activities? Please describe how and include any quantitative/qualitative evidence.

19. We asked survey respondents about outsourced expenditure on their most recent project. Outsourcing expenditure in the UK and EEA combined represented 96% of all outsourced expenditure for our sample. The totals for the UK and EEA were effectively equal, so we expect that removing EEA expenditure from qualifying costs would impact almost half of all subcontracting undertaken by the UK industry.

20. The survey respondents argued that the core benefit of the current scheme is that it enables the UK to be a *"global player through effective use of capital across subcontractors in the EU which supports strong investment in the UK",* adding that studios in the EEA sometimes have the resources, in terms of skilled labour, which the UK is lacking.

21. Another consistent theme from the responses we received during our engagement with industry was that companies felt that the growth of the UK video games industry has been underpinned by having qualifying European expenditure as part of VGTR. As one respondent stated "*Without EU qualifying expenditure, we would not be able to grow as fast in the UK, and conversely would have invested more in building those skilled roles outside the UK in lower cost territories such as Spain. Removing EU expenditure will put our longer-term investment into our UK business at risk."*

22. The top 5 roles that incurred EEA expenditure were: Programming, Quality Assurance, Business Development, Art and Localisation. The top 5 destinations for EEA expenditure were Germany, Poland, Bulgaria, Netherlands and Spain.

23. It should also be noted that creating games is sometimes an inherently international process which often reflects multiple languages and diverse cultures and workstreams such as localisation are vital to this process, but also to adequately prepare games to be ready for export. We estimate that 95% of British games companies export their products.

Question 11: Would an increase to or removal of the £1 million subcontracting limit impact your production activities? Please describe how and include any quantitative/qualitative evidence.

24. While raising or removing the subcontracting cap would be welcome, over 58% of the companies we surveyed stated that they never hit the £1m limit, or only do so rarely and almost all the small and micro studios we surveyed stating that they never reach it. It is worth remembering that, according to the Federation of Small Businesses, SMEs account for 99.9% of the business population.[10]

[10] https://www.fsb.org.uk/uk-small-business-statistics.html

25. Meanwhile other larger video games companies argued that the £1m subcontracting cap always "*felt like an arbitrary cap that was only of material benefit to smaller development projects*", and that for AAA development projects, the £1m subcontracting cap would "*invariably be reached very early on in the project's development*". Once reached, the subcontracting cap effectively negated a lot of the incentive to use additional UK subcontractor support for the applicable development project. The removal of the subcontracting cap may therefore encourage larger companies to seek additional UK subcontracting that they might otherwise have outsourced to the EEA, provided that additional work is done to tackle the skills shortages we have referred to throughout this response.

26. Furthermore, as stated above, the vast majority of respondents to our survey stated that an increase to, or removal of the £1m subcontracting cap would not offset the negative effect of a removal of EEA qualifying expenditure and a corresponding requirement for all qualifying expenditure to take place in the UK owing to higher labour costs and a shortage of specific roles for aspects of game development in the UK.

27. With that in mind, while we understand that HMT is currently taking legal advice on the whether EEA expenditure can legally remain as part of VGTR claims given existing WTO rules – and would have a corresponding impact on whether companies can subcontract to studios in the EEA through the application of 'used or consumed' guidance - we would strongly encourage HMT to investigate all possible avenues in order to continue to allow video games companies to include EEA qualifying expenditure in their VGTR claims and allow subcontracting in EEA whilst broader structural issues with skills shortages remain.

Question 12: Do you claim more than one audio-visual relief? If so, which ones?

Question 13: Do you think the expenditure credit should fully replace the existing audio-visual reliefs? If not, please explain why and what changes to the expenditure credit design might change your view.

28. Although 91% of our survey respondents said they do not envisage challenges with the switch from relief to credits, a key point that has been stressed throughout the survey is that the change to expenditure credits should ensure that any new system remains as generous as the current system. To that end, our survey respondents have also asked for clarity on what the new or effective rate for VGTR would be if this is based on the RDEC model, given that these credits are subject to taxation.

29. 73% of survey respondents prefer credit under the current scheme, with 64% routinely claiming VGTR as a credit; 70% say a switch to mandatory credit would have no impact, while 91% say they don't envisage challenges with the switch. But it is important to note that a significant minority (around 15%) advocated for the system relief to stay unchanged or say the change to expenditure credit would be negative. A number of members in consultation with Ukie's tax working group were open to the change in light of the implementation of OECD Pillar 2 rules, however ultimately stressed the need for any new system to maintain the generosity and ease of the current system.

30. In addition to this, a number of small businesses have stressed the importance of cashflow to their operations and future growth. The current system allows for many small businesses to obtain finance on the basis of receiving VGTR and so any changes must have sufficient flexibility to ensure that these routes are not disrupted. The current system provides certainty for smaller companies as they can still

claim the relief even if a product is cancelled or does not make it to release. Many are able to obtain financing such as loans, VC or angel investment on this basis as VGTR gives smaller companies a lower risk profile. It is vital that these benefits are not curtailed. Some other companies cited a potential impact that small companies may end up being classified as large companies in accordance with stated thresholds in the Companies Act, thus having to recognise a HMRC debtor.

31. There is also a dependency on the interaction with any other changes to qualifying expenditure. One disadvantage would be that as the tax credit would be taxable and therefore subject to variations in the corporation tax rate there would be less certainty to the net benefit over time. Again, we ask HMT to clarify what an effective rate under the proposed new system of expenditure credits would be.

32. Additionally, all video games companies we engaged with in connection with this consultation respondents asked for transparency and clarity on the implementation and procedure of such a system, as many argued that when the VGTR first came into force in 2014 it took a while for companies to truly grasp its procedure, during which Ukie had to spend considerable resources educating the sector how to claim the relief. A worked example of the current scheme and proposed new scheme would be a useful schematic.

Question 14: Do you expect the implementation of the OECD Pillar 2 model rules in the UK and globally to impact the benefit of the UK's reliefs in their current form? And if so, how?

33. In discussions with industry members there was a degree of understanding and concern about the implementation of OECD Pillar 2 rules and the potential impact of a global minimum corporation tax on the effective benefits of VGTR, particularly where this is claimed as a reduction in corporation tax.

34. Several companies in our survey raised questions and have called for greater information on how the OECD Pillar 2 rules and any resulting changes to VGTR will impact games that are currently in development. In addition to this, through our consultation process companies called for clarification on effective dates for the implementation of the Pillar 2 rules, understood to be 1 January 2024 and the interaction with proposed changes to VGTR which may not come into effect until April 2024, as benefits from VGTR could potentially be lost in this intervening period. We ask that the HMT clarify the timeline pertaining to Pillar 2 and its impact on VGTR.

35. In addition to this, several companies have estimated that given the move to an expenditure credit model and the treatment of VGTR as a 'qualified refundable tax credit' the effective rate of VGTR will need to increase to reflect that these credits are subject to taxation. Assuming that the these are taxed at the rate of corporation tax, due to rise to 25% on 1 April 2023, respondents estimate that the effective rate would have to be increased to 33.3% to ensure that VGTR remains as generous as the current regime in terms of its headline rate. We urge HMT to clarify the expected effective rate of any reformed system of VGTR as soon as possible.

36. Whilst we understand the reforms of the AV reliefs are proposed with the intention of futureproofing the reliefs against the potential impact of these changes, it is again vital that any new system retains the existing generosity, and ease in the ability to claim for games companies.

Question 15: Assuming the same level of overall generosity, would an expenditure credit model alter the benefit of the relief(s) to you? If so, how? Please include any expected impacts of the global implementation of the OECD Pillar 2 Rules on an expenditure credit model.

37. The majority of our survey respondents (71%) thought that there would be no impact on their production if VGTR moved to an expenditure credit model. However, a number of questions about how exactly the system would work going forward have been raised.

38. Throughout our consultation process we have looked to RDEC as a potential model for a new system of VGTR, as indicated by the Government in the consultation document itself. However, several members have raised concerns over whether RDEC and the administrative steps in claiming the relief would be transplanted wholesale to a new system of VGTR. In particular, survey respondents highlighted the 7-step process to which companies must adhere in order to claim the relief.

39. For any new expenditure credit model of VGTR to remain as generous, and as simple as the current system, bringing across some aspects of the RDEC claim process would not be appropriate for video games companies – in particular any restrictions currently applied in RDEC steps 3-7[11] and that any 'Step 2' amounts should be allowed to be *'freely surrendered in any period*.' We ask Government to provide clarity as to the administration of any new system, both in terms of its effective rate, but also the ease by which it is claimed, as soon as possible.

40. Whilst for the most part, survey respondents did not envisage problems in taking up a new system – a number called for adequate transition/preparation time including clear, concise and timely information from HMRC so that they could be ready for a new system, and for more details to be provided with regards to whether, and if so how, existing development projects that have been claiming VGTR under the existing rules would be transitioned over to the new system.

41. It is worth noting that most survey respondents engaged with this topic were bigger companies with over 250 employees.

Question 16: For businesses operating internationally and advisors to businesses operating internationally, are you aware of any impact on a tax liability in another country that might follow the UK moving to an expenditure credit?

42. Those games businesses headquartered in the United States said that they were, *"very concerned"* that the recently updated US foreign tax credit regulations will significantly undermine the value of the UK VGTR if mitigations were not found. Considering the size and importance of the United States in the global games industry, the important of links between our two countries and the amount of future investment that could be put at risk – this is a critical threat to the value of VGTR to the UK.

43. In particular, a number of multinational video games said that the automatic offset of the VGTR against UK corporate income tax is likely to result in those UK taxes (offset by the VGTR) not being creditable

[11] https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird89780

in the US as they have been under the prior US foreign tax credit regulations and as such refundability should be adapted to allow for US foreign tax credits to remain competitive.

44. We strongly encourage the Government to ensure that the VGTR is not mandatorily offset against UK corporate income taxes and to structure VGTR such that payment of the relief to a UK subsidiary of a US headquartered company will not result in an opposite charge being made by the IRS. If such an opposite charge were to occur, it would *"obviously obliterate"* the value of the VGTR to such video game companies in the words of one respondent to our survey. This may have the unintended consequence of putting further continued investment in the UK at risk. As detailed in the introduction, the UK has benefited from at least £7.7 billion in investment of direct investment between January 2017 and June 2022[12].

45. To that end, we understand that the Irish Government may have encountered similar issues in connection with its R&D Tax Credit, and that it may have been able to address these concerns by making some changes to how its R&D Tax Credit was structured. We would therefore encourage HMT to review the changes made to the Irish R&D tax relief and seek specialist tax advice to ensure the VGTR continues to be a valuable relief for US headquartered video games companies. Again, a constant refrain from the larger video games companies we spoke with was that reducing the attractiveness of the VGTR to multinational video games companies at a time when other jurisdictions are actively attempting to make their comparable reliefs more attractive could result in them shifting production resources away from the UK to other more favourable jurisdictions.

<u>Question 17: For businesses and advisors, what challenges do you envisage encountering on taking up the expenditure credit? If necessary please provide details of any specific procedural changes and/or associated costs.</u>

46. Creating a game can take anywhere between a matter of days and several years, with no two development projects ever being the same. For instance, the first versions of games can be developed in days but can be iterated over years. In contrast, with some of the biggest AAA games, publishers hire multiple studios to work on new entries years in advance to guarantee games are ready to publish ahead of their strict holiday deadlines. It is vital that transition is carefully considered for any potential changes to the AV tax reliefs. Certainty, clarity, and providing sufficient notice are all vital. Video Game production can be an iterative process over many years, and work has already begun on productions that will not reach completion until after the proposed implementation period.

47. Any transition to a new regime needs to be well planned out and as seamless as possible to ensure and minimal negative impact on companies' cash flow and to the claim process. The benefits of a settled, well understood tax relief simply cannot be overstated.

[12] https://ukie.org.uk/news/2022/08/uk-games-industry-received-7-7bn-of-investment-in-past-half-decade

Question 18: What specific steps could the Government take to help businesses who currently claim the existing audio-visual reliefs manage the transition to claiming expenditure credits?

48. Due to the expansive timelines, we would recommend the new system to gradually be phased in over the coming years, allowing ongoing projects to be eligible for the current system and to allow an orderly transition. Details on whether the transition period would allow for both procedures to run would also be welcome, as would a final date by which all projects would have to have transitioned to a new system to allow businesses to adequately prepare.

49. Any change that happens needs to be gradually phased in for the vast majority of companies. Most of our survey respondents argued that any sudden implementation and changes to the current system would significantly negatively affect the sustainability of the UK industry.

50. However, in relation to our previous response in Question 14 pertaining to the effective implementation date of Pillar 2 rules, where a company may have the expertise and resource to transition to the new system at an earlier date, the system should offer some flexibility for any company to elect to transition any future or new projects to the new system at an earlier date.

51. Across all of the sectors, certainty must be provided as to the cut off points for inclusion in the new or old regime, using recognised stages in production.

Question 19: What changes not covered in this consultation would improve the administration of the audio-visual tax reliefs?

The 80% core expenditure cap

52. The Government's commitment to explore the removal of the 80% core expenditure cap on qualifying expenditure received a mixed reception, with many survey respondents admitting that they would not know what effect this would have on their operations. While some believed removing the cap could potentially bring benefits to some parts of the sector, if the 'price' for this is a lowering of the overall rate – as suggested in the consultation document – this would be negative. As one large multinational company argued, removing the 80% cap on qualifying expenditure in order to encourage more UK only productions while reducing the overall rate of relief "*would have a disproportionately negative overall impact on AAA development projects which almost invariably involve significant contributions from studios around the world.*"

53. 63% of survey respondents thought that this would be bad for their individual business, and only 26% of survey respondents thought that it may benefit the UK games industry overall.

54. We asked respondents to consider revised rates of 20-24% (on the current system of VGTR) and at what rate they would support the change. The most common response here was "not sure" (40%), followed by "there is no rate at which I would support this change" (26%), which again points to a need for further detail on this proposal. We therefore urge the Government to provide clarity and guidance of whether the rate of relief will change and, if so, what the new rate will be should it decide to remove the 80% core expenditure cap.

55. If HMT does consider a change in this area – it will be important to ensure that the system remains at least as generous it currently is and does not make it uncompetitive for companies to continue to develop games in the UK and invest in talent.

56. We recommend that HMT undertake a further impact assessment to be undertaken of the potential effects of such a change.

57. Additionally, the Government should also explore other financial schemes to support smaller developers, including funding schemes for start-ups making their first games as well as corresponding schemes for companies seeking to grow. This could also attract more talent to the UK, allow more developers to start or scale up, and existing studios will likely expand as a result.

58. As previously mentioned, and expanded on below, the Government should act to support the talent pipeline, both in education and immigration, as that is fast becoming a potential barrier to growth for the industry. The removal of the 80% cap would again likely only materially mitigate the loss of EEA qualifying expenditure if there were enough UK based outsourcing opportunities at competitive rates or if wider changes to VGTR were made, such as making it easier for co-developments to qualify for the relief (see below.)

Skills

59. The productivity, and the economic benefit that this delivers to the UK, requires a strong pipeline of talent and skills. Without continued access to the skilled workforce needed to drive this industry, the UK's extraordinary global lead risks being eroded or lost, regardless of the VGTR's attractiveness.

60. There have been recent difficulties across the video game sector in securing access to the talent required to staff this growing industry. 61% of respondents to the Ukie survey highlighted that hiring additional UK talent was significantly challenging. One argued that "the UK recruitment pool for high-end game development is small and becoming exhausted", adding that "if EEA vendors become more expensive due to the loss of VGTR on their costs, we may not be able to find UK employees to engage".

61. The 2021 Screen Skills Assessment noted that there are reports of shortages across particular areas within the video games industry, such as for 3D programming skills, and with similar shortages reflected across other screen sectors.[13] This skill shortage has been exacerbated by the UK's decision to leave the European Union, as hiring skilled workers from the EEA has become more expensive. This has made it harder to hire talent from abroad. As a result, the proportion of individuals working in the sector from the EU has dropped at a time when there are known skills shortages. The difficulty in securing overseas talent has also been reflected in the 2021 Screen Skills Assessment, which found that 37% of respondents are less likely to recruit overseas talent due to Brexit[14].

[13] https://www.screenskills.com/media/4587/2021-06-08-screenskills-assessment-2021.pdf
[14] Ibid.

62. The video games sector has historically looked to secure talent from overseas to meet demand. This will need to continue to help alleviate the skills shortages which remain across the sector. The shift to remote working and the adoption of increasingly distributed teams has increased the mobility of the video games workforce and UK firms are increasingly fighting to secure talent against international competitors and from other sectors within the UK economy who are seeking workers with similarly applicable skills. The Government will need to remain aware of the potential impacts that this may have across the video game sector, along with other parts of the economy.

63. The Government should act to support the talent pipeline, both in technical and creative skills, as that is fast becoming a potential barrier to growth for the industry. Industry has already acted in this space, reaching just under 180,000 pupils, through the Digital Schoolhouse programme, and companies themselves are constantly investing in in-house training, but further action is needed from the Government to help meet the scale of the skills shortages.

64. A measure to increase the talent in the UK in the short term would be to maintain current shortage roles such as programmers, and add new relevant positions where necessary, to the Shortage Occupation List. Additionally, the Government should minimise the costs of visas for skilled workers, making it easier for skilled European staff to work in the UK.

65. The Government's own curriculum changes in recent years have also had an impact with the focus on STEM education at the expense of other subjects such as art. Whilst we welcome the focus on computer science in the curriculum the video games industry often require workers with a diverse range of skills, particularly in the case of technical art and 3D animation and other related disciplines – and this is mirrored in our survey responses which saw art and animation as one of the priority roles for subcontracting expenditure.

66. Regarding education, the Government should support the delivery of a two-year Games Trainee Programme with a £4 million investment to shore up the talent pipeline that the sector needs. Such support would make a significant difference in the ability of firms to hire and train up new graduates, allowing firms to invest in future growth and setting up the UK for success through the creation of high skilled, well-paying and highly productive jobs across the whole country.

67. The industry is keen to collaborate with the Government to understand how to solve the skills issue, including to revisit the effectiveness of the apprenticeship levy, adapting it to this diverse sector.

Co-Development

68. The majority of our survey respondents (52%) said that they would be somewhat more likely or much more likely to pursue co-production projects with international partners if they were more easily eligible for tax relief, while some suggested that this would be beneficial to their business, may help accelerate growth and help the UK look a more attractive option for investment if co-development was more easily eligible for VGTR.

69. It is important to note that, as it currently stands, it is difficult for UK companies to claim VGTR on true co-productions given the requirements in the VGTR legislation for there to only be one "video games development company".

70. We understand that co-production agreements in Film and TV are underpinned by international treaties or trade agreements. We urge HMT and DCMS to explore with other relevant Government departments , Ukie and the BFI how an equivalent regime might be extended to VGTR/co-development to make it easier for UK video games companies to claim VGTR on co-productions.

71. A benefit of co-development is that it allows UK companies to engage with international partners to receive resourcing support, including in skills, which the UK is currently lacking.

Increase eligible activities beyond core development

72. Game roles and game-making has evolved significantly over the last several years - particularly since the rise of live service games which means new content is produced and released for games regularly. VGTR needs to be updated in line with new trends in technology, and new roles and expertise required for the development of games.

73. In addition to this, games are increasingly expected or obligated by wider legislative such as the Age Appropriate Design Code and soon the Online Safety Bill to build in greater safety and community management features by design to protect players and provide a safer experience. These features require considerable development costs and maintenance. As such HMT should also consider including such development which is now critical in developing the game experience – including LiveOps, specialised customer support and community management to be considered as part of claims. This would make the VGTR more competitive and appealing.

74. It's not currently clear whether this work should fall within the Research & Development relief, and even were it to do so that relief is less favourable than VGTR. However, it is important work inside the games space that drives innovation and often goes on to benefit other industries.

Increasing the overall rate of relief

75. Overall, survey respondents would want to see the overall (and effective) rate of relief increased due to the benefits the VGTR brings to the industry and the economy as a whole. The UK continues to be lagging behind key competitor markets in terms of the generosity of its headline rate – particularly Canada, France, Australia and now Ireland (see Annex), however we recognise that the UK VGTR regime is one of the least restrictive regimes in terms of its eligibility criteria.

76. An increase to 32% (on the current system – not a new RDEC based system) was the most desired amount among the survey respondents.

77. While the industry recognise that this proposal is outside the scope of this technical consultation, they would like for this to be the start of the conversation about how significant reforms such as those

mentioned above can truly strengthen the UK video games industry and increase foreign direct investment into the sector.

Not merging the VGTR with the other Audio-Visual Tax Reliefs

78. Following our discussions with HM Treasury and HMRC, we are assuming that Government is not considering merging the VGTR with the other reliefs in audio visual into a single scheme. Our discussions with industry support this position and we would recommend that this is not considered due to the different nature of the production of film, high end TV and the development of games as well as the wider administrative differences in claiming the respective reliefs.

Question 20: Is there anything within the design of the current schemes that might be lost if they were reformed?

79. As outlined in our answer to *Question 7*, the removal of EEA expenditure from qualifying spend to the VGTR will have a negative impact on the sector, that will not be entirely negated by the removal of the subcontracting cap.

80. In addition to this, as discussed earlier in our response, the Government needs to consider the importance of cashflow to the operations of small businesses. The current system allows for many small businesses to obtain finance on the basis of receiving VGTR and so any changes must have sufficient flexibility to ensure that these routes are not disrupted. Some cited a potential impact that small companies may end up being classified as large companies in accordance with stated thresholds in the Companies Act, thus having to recognise a HMRC debtor.

Question 21: Do you expect the Subsidy Control Act 2022 to impact the reforms proposed in this consultation? If so, please describe how.

Question 22: What changes could be made to the reliefs to safeguard them from abuse?

81. Due to the comprehensive administrative steps video game developers have to undertake to claim the VGTR, such as the Cultural Test, there has been little to no evidence that suggested the VGTR was prone to abuse.

82. The consensus among our survey respondents was that abuse is not being regarded as a material issue and not something that they have come across when dealing with claiming the relief.

Annex: Examples of International Tax Reliefs

- **Ireland**: In November 2022, Ireland introduced the **Digital Gaming Tax Credit**. Under the scheme, which will run until end of 2025 the maximum amount of the tax credit will be equal to 32% of eligible costs, expenditure must be incurred on the development of a digital game spent in the EEA, and 80% of total expenditure incurred on its development or 25m Euro, whichever is lowest. The credit is subject to a maximum limit of €25 million per project and a per project minimum spend requirement of €100,000.

- **Australia**: In November 2022, the Australian Government introduced legislation to set up the **Digital Games Tax Offset (DGTO).** The 30% refundable tax offset will be available to eligible games developers that spend a minimum of A$500,000 on qualifying Australian development expenditure effective from 1 July 2022. To be eligible, you need to be an Australian resident or foreign resident with permanent Australian establishment. Games with loot boxes ineligible for relief.

- **Germany:** In 2020 Germany introduced the **Development Tax Credits for the Games Industry - DGTC** - The amount of funding awarded is dictated by cost: projects with costs between €100,000 and €2 million will be funded up to a maximum of 50%; projects with costs between €2 million and €8 million euros will receive between 25% and 50% funding; projects with costs above €8 million will receive a maximum of 25%.

- **Greece**: In 2019, the Greek government has introduced incentives for video game production. These include a 35% cash rebate (with no cap) as well as a 30% tax deduction for audio-visual productions.

- **France:** Since 2008, the tax credit for video games consists of a tax credit of 30% on eligible expenses with a maximum threshold of 6 M€ per exercise. When an exercise takes less or more than twelve months, the amounts vary proportionally to the length of the exercise. The French government has extended its video games tax credit scheme for an additional six years until 2028, with a new focus on original creations (meaning new IP and/or new narrative or visual concepts), technological innovations, and projects that highlight the European identity and/or are inspired by European heritage.

- **Canada:** Funding for In-Development or Published Video Games is delivered through the Scientific Research & Experimental Development (SR&ED) Tax Credit, which is a tax incentive program providing a retroactive tax credit from four to 12 months after a project's approval. This program is a retroactive tax credit that only applies to completed projects and costs that have already been incurred. Tax credit of up to 69% of labour and overhead costs, 36% of contractor costs, and 45% of material costs. All expenses must be commensurate with the needs of the scientific research and experimental development activity taking place within the company.