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Video Games Tax Relief

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Video Games Tax Relief (VGTR) is a Corporation Tax relief that is available to companies who produce British video games. The relief comes in the form of an additional deduction of up to 80% of qualifying expenditure which reduces the developing company's profits chargeable to Corporation Tax and therefore reduces the Corporation Tax payable to HMRC. Where the additional deduction creates or increases a loss, the company may surrender an amount of the loss equal to the lower of the VGTR enhancement and the available loss, for a VGTR tax credit equal to 25 percent of the loss surrendered.

How does a company qualify for VGTR?

To qualify for the tax relief, a video game developer needs to meet the following 3 criteria:

- the game would need to be certified as a British game,
- the game must be intended for supply to the general public and;
- at least 25% of the qualifying expenditure incurred while producing the game would need to be spent on goods and services sourced within the European Economic Area (EEA).

To be certified as a British game; the game would need to acquire 16 points under 'The Cultural Test'. Under this test points are awarded for meeting criteria such as whether the content of the game contains British or European features, whether the game is attempting to promote, enhance or develop British Culture and whether the key personnel producing the game are located in the EEA. A company must submit its Cultural Test application to the British Film Institute ('BFI'). If the BFI is satisfied that the test is passed it will then issue an interim certificate for a game that is still in production and a final certificate for a game that is completed.

How a claim is made and disclosed?

The VGTR claim must be made within the company's corporation tax return and computations. It must be accompanied by certain other information and documents to include either an interim or final Cultural Test certificate.

Each video game under development is treated as a separate trade of the Development Company on their Corporation Tax return. This means that the profit or loss generated from producing one game is separated from the profit or loss generated from producing another game.

The calculation of profts/losses of each video game trade

The profit or loss generated by each video game trade is the total of income attributable to the game for the period minus the core development expenditure incurred during that period.

Income

The Developer is required to estimate the total income that the game is expected to generate for the company and estimate the total of core expenditure that is expected to be incurred during development. The income earned in each year of the development phase is calculated by multiplying the total estimated income by the proportion of total core expenditure that has been incurred in that year.

Expenditure

Core expenditure includes the costs directly related to the game's production phase such as designing, producing and testing the game during development. Costs relating to designing the initial concept of the game, debugging the completed game and maintaining the completed game are not core expenditure for VGTR purposes. Indirect expenditure incurred by the developer that does not relate directly to the game's production would also not be classed as core expenditure. This includes marketing expenses and most administrative expenses.

The additional deduction

Core expenditure is also referred to as qualifying expenditure and is eligible for an additional deduction in the tax return under the VGTR scheme. The additional deduction is capped at the lower of 80% of the total qualifying expenditure and the total of qualifying expenditure that was sourced in the EEA. The additional enhancement is then deducted with the core expenditure from the income attributable to the trade in the period.

Multi-period developments

If the game's production phase spans more than one year then qualifying expenditure after year 1 is assessed on a cumulative basis. For example, qualifying expenditure included in the tax return for Year 2 would be the total cumulative qualifying expenditure (Year 1 + Year 2) minus qualifying expenditure included in tax return of Year 1.

Similarly, the additional deduction is also dealt with on a cumulative basis such that the additional deduction due in Year 2 would be equal to the additional deduction due on total cumulative qualifying expenditure to date less the additional deduction claimed in Year 1.

If the video game development trade makes a loss

It is common for the deduction of the additional enhancement to create a lossmaking position in the video game development trade. If a loss arises, the Developer can surrender the loss for a Corporation Tax credit at a rate of 25%. The loss that can be surrendered is restricted to the lower of the available loss and the additional enhancement deducted in the year. The available loss is the current year taxable loss of the video game development (after the deduction of the additional enhancement) trade plus losses of this trade that were not surrendered for a VGTR credit in prior years.

It should be noted that during the development phase of a game the losses of a video game development trade are effectively ring fenced.

They can only be carried forward and offset against income relating to the game and cannot be offset against other income of the company or group relieved. However, any losses that aren't surrendered for a VGTR credit by the end of the development phase can be carried forward to be offset against future profits of the video game when it is released or offset against other future income of the Development Company or surrendered via group relief to other 75 percent group companies.

How VGTR works: Worked Example

Company A incurs qualifying expenditure of £1m on a production of a new video game, spending £600,000 in Year 1 and £400,000 in Year 2. All expenditure is incurred in the EEA. The company receives revenue of £350,000 in both years in connection with the production of the game.

Expenditure

In Year 1, Company A is entitled to an additional enhancement of £480,000 (being 80% of £600,000.

In Year 2, Company A is entitled to an additional enhancement of £320,000 (being 80% of £1m less £480,000 claimed already in Year 1).

The total additional enhancement deductible over both years is £800,000 which is equal to 80% of the Company's total qualifying core expenditure spend of £1m.

Income

In Year 1, Company A has incurred 60% of total core expenditure budgeted over the total development phase (£600,000 / £1m). Therefore, 60% of total income expected to arise over the development phase is treated as 'earned' in Year 1 (£350,000 x 2 = £700,000 x 60% = £420,000).

In Year 2, all of the remaining budgeted expenditure has been incurred meaning the remainder of expected income is recognised of £280,000 (£700,000 - £420,000).

Loss surrendered

In Year 1 the available loss is £660,000 and the additional enhancement is £480,000. The lower of these two figures can be surrendered for a tax credit. The tax credit is therefore £120,000 (£480,000 x 25%). In Year 2 the available loss is £620,000 (£440,000 loss for the year plus £180,000 available losses from Year 1 that were not surrendered in Year 1). The additional enhancement is £320,000. Therefore, the tax credit reclaimable in Year 2 is £80,000 (£320,000 x 25%).

Losses carried forward

At the end of Year 2, there are losses of £300,000 that could not be surrendered. These losses are ring fenced during the development phase in that they can only be carried forward and offset against income related to the game. However, once the game is completed any losses still remaining can be offset against other income of the company or group relieved.

	Year 1	Year 2	Cumulative Total
	£	£	£
Revenue 'earned'	420,000	280,000	700,000
Expenditure incurred	(600,000)	(400,000)	(1,000,000)
Loss	(180,000)	(120,000)	(300,000)
Additional enhancement	(480,000)	(320,000)	(800,000)
Loss after enhancement	(660,000)	(440,000)	(1,100,000)
Loss surrendered for tax credit	480,000	320,000	800,000
Loss carried forward	(180,000)	(120,000)	(300,000)
Tax credit claimed (25% of loss surrendered)	120,000	80,000	200,000

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