



TIGA:
**RESEARCH &
DEVELOPMENT**
TAX
INCENTIVE
GUIDE

**HOW VIDEO GAME COMPANIES CAN GET THE
MOST OUT OF RESEARCH AND DEVELOPMENT
TAX INCENTIVES (R&DTI)**



WINNER 2015

TIGA GAMES INDUSTRY AWARDS

TIGATM



Technology Tax Experts



A GUIDE TO RESEARCH AND DEVELOPMENT TAX RELIEF FOR VIDEO GAME COMPANIES

IN ASSOCIATION WITH



Technology Tax Experts

How video game companies can get the most out of
Research and Development Tax Incentives (R&DTI)

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1. INTRODUCTION TO THE R&D TAX INCENTIVES

The R&D Tax Relief scheme has been in existence since 2000 but with the introduction of the Video Games Tax Relief the way that many games companies claim the R&D Tax Incentives will be impacted. TIGA and MMP want to assist members in particular and games businesses in general to maximise their benefit from the R&D Tax Incentives and the Video Games Tax Relief (VGTR).

Please note that this publication is an overview of the R&D Tax Incentives and that advice should be sought prior to claiming due to the complex nature of the R&D Tax Incentives' rules. More information on the R&D Tax Incentives can be found on the government's website:

www.gov.uk/corporation-tax-research-and-development-rd-relief

THE POTENTIAL FOR SUBMITTING BOTH R&DTI AND VGTR CLAIMS

This is an area of great complexity and for many game companies it will be well worth taking independent advice to determine which schemes are the best to claim under. VGTR can only be claimed on a per game basis. For many smaller studios claiming the schemes will be very complex and time consuming. This is because many smaller studios do not use special purpose vehicles (a company registered specifically for the costs associated with a single game); meaning that separating out the costs associated with each game will require forensic examination of all the company's financial information. This onerous process

and the surrounding complexity will stop many companies from also considering the R&DTIs.

Since the R&DTIs can be more generous than VGTR, companies will lose out if they do not consider which scheme(s) will be most generous for their particular circumstance. Therefore, it makes sense to carefully review your activities and costs for eligibility to the schemes to obtain the maximum benefit for your company. This approach can result in claims under both schemes, but involves careful and forensic examination of both technology and costs. Again, independent advice here is critical.



2. ABOUT TIGA

TIGA represents developers, digital publishers, service companies and education providers and is the trade association for the video games industry. Our core purpose is to strengthen the games development and digital publishing sector. We achieve this by campaigning for the industry in the corridors of power, championing the industry in the media and helping our members commercially.

TIGA is intent on building an enduring organisation which continually improves; a business that will make a significant impact on the games industry and so benefit our membership and the wider economy. Since 2010, TIGA has won 24 business awards and commendations, an achievement which reflects TIGA's drive for improvement and to meet best practice.

OUR CORE PURPOSE IS TO STRENGTHEN THE GAMES DEVELOPMENT AND DIGITAL PUBLISHING SECTOR.

3. ABOUT MMP TAX

MMP, winner of the best Tax firm award from TIGA, is a specialist technology tax consultancy. The Company provides corporate tax consultancy services across government led tax incentive schemes in clearly demarcated areas such as R&D Tax Relief, Patent Box Tax Relief, Games Tax Relief and technology-based Capital Allowances.

The Company employs a mix of engineering, scientific, finance and tax specialists. The team has decades of specialist tax consultancy experience; working with the government to develop various technology-based tax schemes. MMP has extensive professional and academic qualifications in addition to wide-ranging practical experience in industry. MMP applies these skills in a client focused way, ensuring robust claims are delivered with the minimum of fuss.

4. WHAT ARE THE R&D TAX INCENTIVES?

The R&D Tax Incentives are designed to encourage investment in R&D by UK companies. The R&D Tax Relief and R&D Tax Credit schemes were introduced in 2000 for Small and medium-sized enterprises (SMEs), with a separate scheme for large companies added in 2002.

The definitions of eligible R&D and costs are quite broad, and eligible R&D can be found in unexpected areas.

The benefit of the reliefs range broadly from 7.9% to 33% of identified and qualified eligible expenditure depending on whether you are a large or small company.

There are two ways to benefit if the company is an SME:

- For profit making companies, there is tax relief scheme which reduces the amount of tax to be paid.

- For loss making companies, there is a payable tax credit scheme which provides a cash payment as a proportion of the eligible R&D investment.

There are also currently two ways for a large company (LC) to benefit from the scheme:

- There is the R&D tax relief scheme which reduces the amount of tax to be paid, this is for expenditure from 1 April 2002 to 31 March 2016.
- There is the R&D Expenditure Credit (RDEC) scheme which was introduced from 1 April 2013. This scheme operates above the line and provides a credit to companies. Depending on the company's financial position, this can result in a reduction in corporation tax or a payable tax credit.

5. WHAT IS A QUALIFYING COMPANY?

To be eligible for R&D Tax Incentives you must be:

- a company;
- subject to UK corporation tax;
- carrying out eligible R&D related to the company's trade;
- a going concern.

6. WHAT IS ELIGIBLE R&D?

Eligible R&D is sometimes difficult to identify because it can have a very broad definition, it can also be found in unexpected areas.

Broadly, to qualify as eligible R&D the project must be:

- seeking to achieve an advance in science or technology;
- subject to scientific or technological uncertainty;
- conducted in a systematic and thorough fashion.

If these three aspects are present in a project then parts of the project are likely to qualify for the R&D Tax Incentives. Complex system uncertainty, indirect R&D activity, project planning, abortive projects, prototypes or pilot plants, design, or seeking to achieve cosmetic and aesthetic effects are all examples of projects or activities which are commonly misconstrued as being ineligible. These areas may in fact be eligible provided they encompass the three requirements listed above.

7. WHAT SCHEME CAN I CLAIM UNDER?

If the company is a qualifying company carrying out eligible R&D then the next stage is to determine if the company is a LC or SME, in order to claim under the appropriate scheme. The definitions of large and small companies are driven by the EU classification with UK modifications.

There are three main questions that should be asked:

1. Does the company have more than 500 employees?
2. Is the turnover greater than €100 million?

3. Is the balance sheet total greater than €83 million?

The company is likely to qualify as an SME if the answer to the first question is no and it also answers no to question 2 or 3.¹

A SME may be required to claim under the large company scheme in certain circumstances. For instance, it is not possible to claim under the SME scheme for expenditure that is subsidised. In cases where a qualifying project has received a subsidy it is possible to claim for relief under the large company scheme.

8. WHAT COSTS ARE ELIGIBLE?

All costs should be analysed and a bottom up approach should be utilised to identify the eligible costs related to each area of eligible expenditure. Broadly, the following types of costs are eligible:

- consumable costs;
- utility costs;
- staffing costs;
- software;
- contractors;
- subcontracted expenditure.

¹ Please note there are additional criteria the company needs to meet to be considered as an SME. Please consult the relevant EU SME legislation for a complete evaluation of your company's status, alternatively MMP will conduct this review as a part of an engagement.



9. CALCULATING THE R&D TAX INCENTIVE

The calculation depends on which scheme the company is claiming under. The high level percentages needed for the calculations are provided below followed by examples showing how these percentages are utilised in the R&D Tax Incentive calculations.

SME R&D Tax Credit and Tax Relief Scheme percentages

DATE FROM	ENHANCED DEDUCTION	APPLICABLE RATE
1 April 2000	150%	16%
1 August 2008	175%	14%
1 April 2011	200%	12.50%
1 April 2012	225%	11%
1 April 2014	225%	14.50%
1 April 2015	230%	14.50%

Large Company R&D Tax Relief Scheme (also known as the super deduction scheme)

DATE	ENHANCED DEDUCTION
01/04/2002	125%
01/04/2008	130%

Example 1: Loss making SME example calculation

A technology developing company has incurred a loss of £700,000 for the financial year-ended 31 December 2016; it is therefore a loss making company and could be entitled to a payable R&D tax credit. £100,000 of eligible R&D expenditure is identified. The following steps are used to calculate the payable credit:

First the surrenderable loss needs to be calculated, it is the lower of:

- Amount of unrelieved trading loss in the period:
£130,000 (130% of eligible expenditure) + £700,000 = £830,000
- The enhanced eligible R&D expenditure:
£100,000 * 230% = £230,000

So the surrenderable loss is £230,000

Payable R&D tax credit=surrenderable loss×applicable rate

Payable R&D tax credit=£230,000×14.5%=£33,350

Payable R&D tax credit net benefit = £33,350 or 33.35%

Large Company R&D Expenditure Credit (RDEC) Scheme

DATE	PAYABLE CREDIT
01/04/2013	10%
01/08/2015	11%

Example 2: Profit making SME example calculation

In June 2015 Company X had a profit of £200,000. £100,000 was identified as eligible for the R&DTR. The following steps are used to calculate the reduction in tax liability.

Net benefit through a reduction in tax
liability=£100,000*130%*20%=£26,000

SME R&D Tax Relief net benefit = £26,000 or 26%



10. SUBMITTING THE R&DTI CLAIM

The following main documents must be included in the submission to HMRC: CT600s, tax computations which include the R&DTI figures, relevant R&D documents and a summary of the eligible R&D and related eligible costs. This summary is best presented in the form of a report and should include the following:

- A description of the advance in science or technology that was being sought.
- A definition of the R&D project, and the larger commercial project.
- An explanation of the particular scientific or technological uncertainties that needed to be resolved to seek the advance.
- An explanation of how the project goes beyond what was the current state of knowledge.

- Why the knowledge or capability sought was not readily deducible by a competent professional.
- An account as to when the particular uncertainties were overcome.
- The activities within the project fall within the statutory definition of R&D for tax purposes.
- A detailed description of the company's R&DTI calculation methodology.

Where to submit:

Most companies should submit their claims to their designated specialist R&DTI unit. The address of your company's unit can be found in the CIR² manual. For very large companies, the company's claim should be submitted to its LBS³ or normal tax office.

² Corporate Intangibles Research and Development Manual

³ Large Business Service

11. SHOULD I CLAIM UNDER THE R&DTI

OR THE VGTR?

Video Game Tax Relief is available for expenditure incurred on eligible video game projects from 1 April 2014. Similar to R&DTI, the relief is intended to encourage investment in the UK but is aimed at supporting the video game industry. The VGTR differs from the R&DTI in the following ways:

- The video games must be intended for commercial release.
- No eligible R&D needs to be carried out to claim this incentive.
- Games with the primary purpose of advertising or gambling or pornography are excluded on the basis of self-certification by companies.
- Core expenditure on the game production is eligible.
- The video game must pass the BFI⁴ cultural test.

The particulars of your company, the costs and the activities being carried out need to be analysed to determine whether it is best to claim under one of the R&DTIs or the VGTR. As a general rule of thumb, it is usually of greater benefit to the video game developer to claim under the R&DTI, instead of the VGTR, if they are doing work that is of a more innovative nature. Below are two examples: one showing where the R&DTI scheme would be more beneficial and the other showing where the VGTR scheme would be more beneficial.

Example where claiming under the R&DTI scheme would be more beneficial

In the financial year-ended 31 December 2016, a small loss making Video Game Development Company, with losses of £2.5m, produces a new video game with a total expenditure of £1m. The majority of the work carried out has been on creating a novel game physics engine and is completely innovative work. Because of this 75% of the total expenditure is eligible for R&DTI. All of the total expenditure is EEA⁵ eligible; therefore under the VGTR 80% of the core expenditure is used (as this is lower than the EEA expenditure).

VGTR calculation

Core expenditure = £1,000,000

Core expenditure of which is EEA spend = £1,000,000

80% of the core expenditure = £800,000

To calculate the VGTR the lesser of the EEA spend and the 80% of the core expenditure is used:

Total VGTR = £800,000 × 25% = £200,000

SME R&D Tax Credit calculation

Eligible R&D = £1m * 75% = £750,000

Surrenderable loss is equal to the lower of enhanced loss (£750,000 * 130% + £2.5m = 3,475,000) or 230% of the eligible R&D expenditure (£1.725m)

Payable R&D tax credit = surrenderable loss × applicable rate

Payable R&D tax credit = 1,725,000 × 14.5% = £250,125

It can thereby be seen that, in this instance, there is a £50,125 benefit in claiming R&DTI over VGTR.

Example where claiming under the VGTR scheme would be more beneficial

The above example is repeated and the Video Game Development Company still has a total spend of £1m however, in this instance the

game is a sequel and the majority of the work was done on routine game creation. Therefore because of the nature of the work being performed, only 20% is eligible for R&DTI. It can be seen in the following calculation, that in an instance such as this it would be more beneficial for the company to claim under VGTR:

VGTR calculation

Core expenditure = £1,000,000

Core expenditure of which is EEA spend = £1,000,000

80% of the core expenditure = £800,000

Total VGTR = £800,000 × 25% = £200,000

SME R&D Tax Credit calculation

Eligible R&D = £1m * 20% = £200,000

Surrenderable loss is equal to the lower of enhanced loss (£200,000 * 130% + £2.5m = 2,760,000) or 230% of the eligible R&D expenditure (£460,000)

Payable R&D tax credit = surrenderable loss × applicable rate

Payable R&D tax credit = 460,000 × 14.5% = £66,700

It can thereby be seen that, in this instance, there is a £133k benefit in claiming VGTR over R&DTI.

⁴ British Film Institute

⁵ European Economic Area (EEA)

12. FREQUENTLY ASKED QUESTIONS

Is there a minimum R&D expenditure needed to claim the R&DTI?

No, there used to be a £10,000 minimum limit but this was removed from 1 April 2012.

Is there a maximum or limit per project that I can claim under the R&D scheme?

Yes, there is a €7.5m maximum limit on total amount of aid for any one R&D project.

Do we need to finish the project before making a claim?

No, as long as R&D work was carried out during the timeframe of the claim then it is eligible.

Is there any guidance on how HMRC will apply the rules?

Yes, guidance can be taken from HMRC's Corporate Intangibles R&D Manual (CIRD).

Do I need to own the intellectual property?

No. The condition requiring ownership of the intellectual property arising out of the R&D was abolished as of 9 December 2009 for SMEs. From this date there was no requirement to own the intellectual property for SMEs or LCs.

How long does HMRC take to approve the claim?

HMRC aims to respond as quickly as possible and try to respond to R&D tax credit claims within 28 days however, in some cases this process can take longer for example if an enquiry is opened. In instances such as these there is no set time length for the approval of a claim and approval can take months, if not years.

Does the R&D have to be in the UK to be eligible?

There is no requirement for the R&D or the subcontractors carrying out the R&D to be in the UK.

Does the project have to be a success?

No, as long as there was an intention to achieve an advance in science or technology, regardless of whether the scientific or technological uncertainty was resolved, then the project is still eligible for the R&D scheme.

Can I claim both R&DTI and VGTR on the same game?

In some limited circumstances it is possible to claim both on the same game but not on the same expenditure. This is a complex area so specialist advice should be sought.

I've received a grant; does that have an impact on my R&D tax incentive claim?

Receiving a grant can have a significant impact on your R&D claim. Detailed advice should be sought.

I've just improved an existing technology, is that eligible?

Yes, an appreciable improvement to an existing process, material, device, product or service through scientific or technological changes is considered eligible. So too is

using science or technology to duplicate the effect of an existing process, material, device, product or service in a new or appreciably improved way.

We've been contracted by a publisher to develop a game; we need to do R&D to achieve this, can I still claim the R&D tax incentive?

Subcontracting legislation varies depending on company size and relationship between parties, detailed advice should be sought regarding these situations.

I've subcontracted some of the work, is this still eligible R&D expenditure?

For an SME, the company's relevant R&D related work that is subcontracted to another company is eligible. For a LC only R&D work contracted to a qualifying body, individual, or a partnership (each member of which must be an individual) is eligible. Additional information can be found in the CIRD manual.

I've received my R&D tax credit, does that mean my claim is approved?

No, this means that the claim has been processed but not necessarily approved. Claims are subject to the normal two year approval time limit and HMRC could open up an enquiry within this time.

Can I claim for work I did last year?

Yes, the time limit for making claims is two years from the end of the accounting period.

Do I really need to write a report?

HMRC requires a summary of the eligible R&D and related eligible costs (as well as relevant R&D documents, CT600s and tax computations); this is usually presented in report format and will aid HMRC in processing the claim.

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This R&D Tax Incentive Guide has been prepared in association with MMP, the Technology Tax Experts. The publication provides an overview of the R&D Tax Incentive Scheme. Appropriate advice should be sought prior to making actual claim under the Scheme due to the complex nature of the governing rules. Further information on the R&D Tax Incentive Scheme can be found on the government's website: www.gov.uk/corporation-tax-researchand-development-rd-relief

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