Tax incentives for developing games

The UK has a number of tax incentives and reliefs which may assist game developers and publishers both in securing investment (such as the Seed Enterprise Investment Scheme (SEIS) and the Enterprise Investment Scheme (EIS)), and also in developing specific games products (such as the Video Games Tax Relief and the Research and Development Tax Relief).

Seed Enterprise Investment Scheme

SEIS provides generous tax incentives for UK tax resident individuals who make equity investments in new (and often high-risk) start-up companies (such as game developers) by subscribing for new ordinary shares. A business may raise up to £150,000 under the SEIS.

Tax relief

- Income tax – an investor who qualifies for SEIS relief can claim a UK income tax reduction equal to 50% of their investment, up to an annual limit of £100,000 (so the maximum income tax saving is £50,000). The relief can only be used to the extent that the individual has an income tax liability (it cannot create a loss) but investors can also carry the tax reduction back (in whole or in part) against their UK income tax liability for the previous tax year (which may result in repayment of tax previously paid).

- Capital gains tax (CGT) – if an investor qualifies for the income tax relief then, broadly, any capital gain realised on a disposal of the SEIS shares should be exempt from CGT.

- If the investor makes a loss for CGT purposes on a disposal of their SEIS shares they may be able to set those losses against their UK income tax liability.

Time Limits

- SEIS is only available for investments made in small ‘start-up’ companies who are either preparing to, or are, carrying on a “new” trade – i.e. they (or someone else – such as a founder) must not have carried on the trade for more than two years at the time the shares are issued.

- SEIS shares must generally be held for three years from issue to benefit from the full income tax and CGT relief. If SEIS shares are disposed of within three years of issue there is a potential claw-back of the income tax relief claimed and no CGT relief will be available on the disposal of the SEIS shares.

- SEIS relief can only be claimed by an investor (via the UK self-assessment tax return) when the business has either spent 70% of the SEIS monies raised, or has been actively trading for at least four months (as opposed to preparing to trade or conducting R&D in advance of trading).

Are there any restrictions on who can be a qualifying investor?

- The investor must not hold (directly or indirectly) more than 30% of the company’s share capital or voting rights. There are no specific restrictions on how much loan capital in the business the investor can hold (although care must be taken with regard to convertible loan stock).

- Investors who are employees of the company cannot benefit from SEIS, but existing or new directors of the company will be eligible.

Which businesses can qualify for SEIS?

To qualify for SEIS relief the business must meet a number of conditions, of which the main ones are:

- the company must exist wholly for the purpose of carrying on one or more “new” qualifying trades (such as game development – although care should be taken for companies intending to carry on a regulated gaming activity as this may not constitute a trade for UK tax purposes). As discussed above, a “new” trade is one which has not been carried on for more than two years at the time the shares are issued. The company need not carry on a trade immediately – it can be engaged in research and development with the intention of trading;
the company’s gross assets must not exceed £200,000 immediately before the investment, and a company can only raise a maximum of £150,000 under the scheme. Monies raised under SEIS must also be used by the company in its qualifying trade (or in preparing to trade) within three years;

- the company must not have had any investments under EIS or the Venture Capital Trust (VCT) scheme before shares are issued under SEIS;

- the company must have fewer than 25 full time employees;

- the company must have a UK permanent establishment (i.e. a branch, office or agency in the UK);

- the company must not be listed on a recognised stock exchange (but an AIM listed company can qualify); and

- generally, the company must not control or be controlled by another company (but there are exceptions for other qualifying companies).

However, the business must not be a member of a partnership.

Enterprise Investment Scheme

For larger or more established games companies which do not meet the requirements for SEIS, EIS may be available. This is similar in structure to SEIS - providing income tax and CGT reliefs for UK tax resident individual investors who subscribe in cash for ordinary shares in qualifying companies.

A business may raise up to £5million a year under the EIS. This limit is aggregated with investments under the VCT scheme, and other notified State Aid received by the business.

Tax relief

- Income tax – an investor who qualifies for EIS relief can claim an income tax reduction equal to 30% of the money subscribed. The relief is subject to an annual subscription limit, currently £1,000,000 (giving a maximum income tax reduction for the 2015/16 tax year of £300,000).

- CGT – if the shares have been held for the three years from issue, any gain made by the investor on a disposal of EIS qualifying shares is generally exempt from CGT.

If the investor makes a loss for CGT purposes on a disposal of their EIS shares they may be able to set those losses against their UK income tax liability.

How long do the shares need to be held for?

- To benefit from full income tax relief, EIS shares must be (broadly) held for at least three years after the date of their issue. If an investor disposes of EIS shares within three years of their issue, then the EIS income tax relief is withdrawn by reference to the proceeds that the investor receives.

- In addition, if an investor sells his EIS qualifying shares within three years of issue, then any gain ceases to be exempt from CGT.

Are there restrictions on who can be a qualifying investor?

- The scheme is not generally available to directors and employees of the business. However, there is an exception for unpaid directors and directors who have not, prior to their investment, been involved in the business’s trade.

- EIS relief is not available to investors that hold (directly or indirectly) more than 30% of the business’s ordinary share capital or voting rights.

Which companies qualify for EIS?

The scheme is only available for companies who carry on a qualifying trade on a commercial basis. As with SEIS, this should generally include games developers and publishers but care should be taken for regulated gaming (eGaming/gambling) operators who may not be classed as “trading” for UK tax purposes. Availability of the relief is also subject to other qualifying conditions, the main ones being:

- the company must have a UK permanent establishment (i.e. a branch, office or agency in the UK);

- the company must not be listed on a recognised stock exchange (but an AIM listed company can qualify for the scheme);

- generally, the company must not control or be controlled by another company (but there are exceptions for other qualifying companies).
However, the company must not be a member of a partnership;
- the company must have gross assets of no more than £15 million before the investment, and £16 million after the investment; and
- the company must have fewer than 250 full time employees.

Future developments

Subject to receiving EU State Aid approval, the government is proposing a number of changes to the EIS regime including:
- imposing a twelve year age limit on companies raising funds under the EIS;
- imposing an overall limit of £15m for EIS (and other venture capital scheme) investments (increased to £20m for “knowledge intensive” companies); and
- increasing the number of permitted employees for EIS companies involved in “knowledge intensive” activities to a maximum of 499.

To qualify as “knowledge intensive” a company must meet certain criteria, including that it must spend at least 15% of its operating costs on R&D activity in at least one of the previous three years, and it must be involved in the creation of intellectual property. This means that games companies developing their own bespoke platforms may qualify for these enhanced limits.

Games Tax Relief

The UK’s Video Games Tax Relief provides tax relief to incentivise the production of “culturally British” video games in the UK. It should, however, be noted that the Video Games Tax Relief will not be available to developers of regulated gaming (eGaming/gambling) products.

What kind of game will qualify?

Relief is potentially available for a wide range of “video games”, including games developed for consoles, computers and apps. To qualify for relief, games must meet a number of qualifying conditions, the main ones being:
- the game must be developed for commercial exploitation to be supplied to the general public. This means that games produced for advertising and marketing purposes will not qualify for relief;
- the game must not contain pornographic or “offensive” material. “Real money” games (i.e. gambling) will not qualify for relief;
- the game must meet a “culturally British” test, which means that it must score 16 out of a possible 31 points in a cultural test administered by the British Film Institute. Points are awarded against a number of criteria, including:
  - the setting of the game in the European Economic Area (EEA) (including the UK);
  - the depiction of characters who are UK or EEA nationals;
  - the use of the English language; and
  - the production of the game in the EEA; and
- at least 25% of the “core” expenditure on the game (i.e. expenditure on designing, producing and testing the game) must be incurred in the EEA.

What relief is available?

The relief is given through the UK corporation tax system so it is only available to UK tax resident companies or non-UK resident companies which have a UK permanent establishment.

Relief is given as:
- an increased tax deduction for primary expenditure on video games development incurred in the EEA (which should reduce the taxable profits of production companies) giving an effective maximum deduction of 180% of the total expenditure incurred on the game;
- if the production is loss-making, the ability to “surrender” UK corporation tax losses for a cash tax credit of up to 25% of the loss surrendered.

Research and development tax relief

The UK offers specific incentives through the tax system to encourage UK resident companies and non-UK resident companies which have a UK permanent establishment, to undertake innovative research and development projects in the UK.
Research and development is widely drawn and can encompass the development of software and eGaming platforms. They key point is that to qualify as research and development the project must:

- seek to achieve an advance in science and technology or address technological or scientific uncertainties. This means that the project must be innovative and not merely routine – for example, the development of new eGaming platforms and algorithms could qualify as research and development but merely modifying “off the shelf” platforms is unlikely to qualify; and
- be related to a trade that is, or will be, carried on by the company.

The amount of relief available will depend on which of the two research and development relief schemes the company qualifies under:

- the SME scheme – which is available to small and medium enterprises i.e. companies which (together with certain connected and associated enterprises) have fewer than 500 employees and either:
  - annual turnover not exceeding €100 million; or
  - balance sheet assets not exceeding €86 million;
- the large business scheme – which is available to all other companies.

Claims for relief under either scheme are made in the company’s UK corporation tax return, and must be made within two years of the end of the company’s accounting period in which the expenditure was incurred.

**Relief under the SME scheme**

- Companies which qualify for the SME scheme may claim a 225% corporation tax deduction for qualifying expenditure incurred on qualifying research and development activities. This means that, for every £100 of expenditure, an additional £125 tax deduction will be available.
- Loss-making companies may surrender some, or all, of their corporation tax losses to HMRC in exchange for a cash tax credit equal to 14.5% of the loss. This means that, for every £100 of expenditure incurred, a loss-making business can claim a tax credit of up to £32.63.
- To comply with EU State Aid rules, the total relief per project available under the SME scheme is capped at €7.5 million per project (although the large company scheme may be available).

**Relief under the large company scheme**

- Companies which qualify for relief under the large company scheme may claim a 130% corporation tax deduction for qualifying expenditure on qualifying research and development activities. This means that for every £100 of expenditure, an additional £30 tax deduction will be available. From 1 April 2015 this means that, in cash terms, the deduction will be worth up to 6% of the business’s qualifying expenditure.
- The large company scheme will be unavailable from 1 April 2016; instead qualifying companies may claim an ‘above the line’ tax credit equal to 10% of their qualifying research and development expenditure. The credit is payable to companies in cash, although it will be subject to tax in the business’s hands. The ‘above the line’ credit is available to qualifying companies now, and from 1 April 2015. In cash terms, the credit will be worth up to 8% of the business’s qualifying expenditure.