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Digital Games Tax Credit: Can Ireland Become the Next “Hollywood of Video Games”?

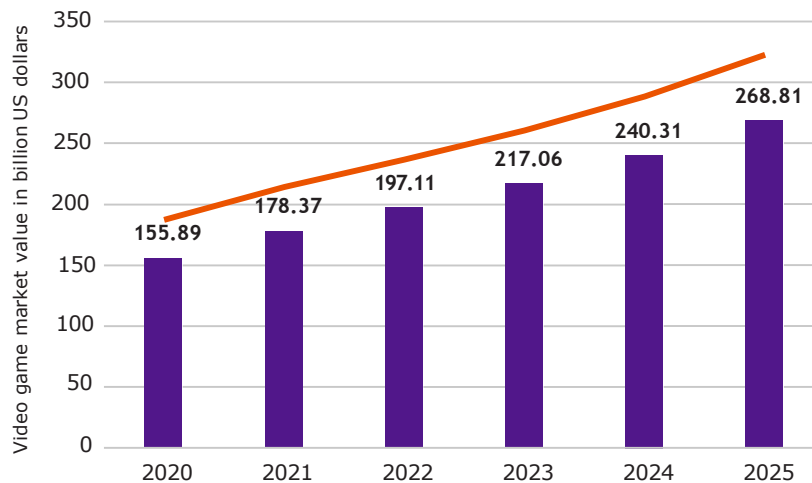


Introduction

First mentioned in Budget 2021 discussions, the digital games tax credit (DGTC) was introduced in Finance Act 2021, which was signed into law by the President on 21 December 2021. Although subject to Ministerial Order to come into operation (pending European Commission approval), the DGTC is a massive step towards Ireland

becoming a major player in the gaming industry. It follows the recent introduction of a number of university courses geared towards video game development.

Worldwide, the gaming industry has been growing steadily for a number of years, reaching a value of c. US\$180bn in 2021 and expected to reach c. US\$270bn by 2025.

Fig. 1: Global video game market value, 2020–2025.

Source: J. Clement, <https://www.statista.com/statistics/292056/video-game-market-value-worldwide/>

Video games in Ireland have a great history, with a significant number of indigenous developers operating at the moment, as well as the majority of the big names in the industry having operations here. Couple that with the pool of Irish talent in the audio and visual arts, and we have a perfect recipe for a successful industry. However, without an appropriate incentive to stimulate growth and attract new talent, Ireland has been falling behind countries such as the UK, France, Canada and Germany.

The introduction of the DGTC should help Ireland to bridge the gap to industry leaders and, perhaps at some point in the future, unseat Montreal as the world's capital of video game development.

Overview of the DGTC

The DGTC will provide for a cash-refundable tax credit (where the amount of DGTC exceeds the corporation tax liability of the company claiming the credit) for expenditure incurred by a digital games development company on the design, production and testing of a digital game. The rate of credit will be 32% of the **lowest** of:

- the eligible expenditure (being a portion of the qualifying expenditure expended in the State or in the European Economic Area (EEA));
- 80% of the qualifying expenditure (being the total expenditure incurred by the company on the design, production and testing of a digital game – regardless of the territory in which it was spent); and
- €25m.

The effective rate of the DGTC will be heavily affected by the portion of spend incurred within the EEA. In the above example, the effective rate of DGTC is 17.1% (i.e. €2.4m/€14m) as a significant portion of the expenditure was incurred outside of the EEA (i.e. €6.5m), which doesn't qualify. The maximum effective rate of the DGTC would therefore be 25.6% where all expenditure incurred on the design, production and testing of a digital game was incurred within the EEA. It is important to note that there is also a minimum amount of qualifying expenditure that must be incurred before a claim for DGTC is made, which is €100,000.

There are aspects of the DGTC that will likely prove key to whether the regime will be a success, namely: the certification process;

Table 1: Example of DGTC calculation.

	Total expenditure	Total available for DGTC	Total
EEA eligible expenditure		€7.5m	
Total qualifying expenditure of €14m	€14m		
Total qualifying expenditure of €14m @ 80%		€11.2m	
Max. expenditure		€25m	
Lowest of the above			€7.5m
DGTC rate			32%
DGTC amount			€2.4m
Total cost of developing the game			€14m
Less DGTC amount			(€2.4m)
Net game development cost			€11.6m

which companies will meet the definition of “digital games development company”; the requirement for the game to be developed **and completed** by the Irish entity; the ability to track all development expenditure and documentation per game; and indeed the limit applied to the DGTC for a single game.

Certification process

The cultural test to be satisfied for companies to avail of the DGTC is a common control point in video game incentives in many countries. As is typical with tax incentives, the scheme must be approved by the European Commission to ensure that competition within the Single Market is not disrupted by providing State Aid to certain groups of companies. The cultural test helps to satisfy the requirement that video games promote culture and heritage conservation, which in turn allows the credit to be compatible with the Single Market (Article 107(3)(d) Treaty on the Functioning of the European Union).

One would expect that the cultural test could be administered in a similar way to the film credit. Applicants would likely be required to assess the game based on a number of conditions (e.g. location of the story within Ireland or elsewhere in the EEA, whether it concerns historical figures connected with Irish or European culture, whether the story

addresses issues relevant to Irish people or people from another EEA country etc.), with the Department of Tourism, Culture, Arts, Gaeltacht, Sport and Media issuing the certificate after a review of the submission and the game’s meeting some or all of the cultural test criteria. Although it is expected that further regulations and guidance will be published, the importance of satisfying the cultural test cannot be overestimated. In this respect, the contribution that the development of the digital game is expected to make to the promotion and expression of Irish and European culture needs to be considered, by reference to the following (s481A(5)(b) TCA 1997):

- “
- (i) the cultural content of the game, including its setting, principal characters, language and subject matter;
 - (ii) any cultural creativity employed in the development of the game, including innovation in the portrayal of Irish or European culture, the use of materials written or created in Ireland or Europe as the basis for the game, technological innovation or the use of music created by a composer who is a national of or ordinarily resident in Ireland or another EEA state;
 - (iii) the contribution of the game to the development of a concentration of

cultural activity, by reference to such matters as the proportion of the creative work carried out in Ireland or another EEA state, the number of key positions in the development of the game occupied by persons who are nationals of or ordinarily resident in Ireland or another EEA state, and the proportion of the members of the development team who are nationals of or ordinarily resident in Ireland or another EEA state;

- (iv) *the concomitant cultural contribution of the game, by reference to matters including the educational content of games aimed at children and the inclusion of themes relating to diversity and equality;*
- (v) *whether the content of the game promotes the protection, restoration and promotion of sustainable use of Irish or European terrestrial ecosystems or the raising of awareness of the exigencies of increasing environmental sustainability and minimising climate change."*

Currently, the cultural test for film relief requires the applicant to pass three of eight requirements. It will be interesting to see how this compares with the requirements of the gaming cultural test.

Qualifying companies

Although it might appear relatively straight forward, the conditions that a company must satisfy to be considered a "digital games development company" could have some negative influence on how successful the DGTC regime is in Ireland.

It appears from the legislation that the company must have filed tax return(s) in the past, essentially removing new companies from the equation, at least in their first year of trading. This rule could be seen as favouring indigenous and/or long-established companies and could potentially have an impact on future investments by gaming companies in Ireland. It could also have an effect on existing games

development companies that may be acquired by foreign entities interested in setting up operations in Ireland and availing of the credit. The impact on start-up companies in the games development industry in Ireland should not be overlooked either. Having to trade for a period of time before making the claim delays access to the incentive for companies.

Another point to consider is the requirement to be carrying on a trade of developing digital games. Guidance would be welcome on whether this means that the company's principal or only trade must be the development of digital games or whether such trade can fall under the broader umbrella of software development. Requiring games development to be the only trade of a company wishing to claim the credit could disincentivise multinational companies from setting up or expanding their operations in Ireland. The latter option (i.e. developing digital games as part of a software development trade) seems to be the ideal option, eliminating any additional administrative costs. We understand that the intention behind the DGTC is not to create an additional burden on companies wishing to avail of the incentive by mandating the establishment of a separate digital games development trade and that, as long as a company is developing a digital game, it should meet this requirement.

Developed and completed

Another aspect to consider can be derived from s481A(2)(b) Taxes Consolidation Act 1997 concerning the final certificate: "...in relation to a digital game that is developed and completed by the company...". This could be interpreted as requiring the digital games development company wishing to avail of the credit to be the "principal" developer of the game, i.e. carrying out a substantial portion of the overall development work and finalising the product. This test will likely be more influenced by whether the activities carried out by the Irish company meet the cultural test rather than the amount/significance of the work carried out.

Guidance in this area would be very welcome to ensure a level of certainty for investors

before they choose Ireland as their place of business, as well as for smaller companies looking to enter the premium games sector by cooperating with well-established games developers and publishers.

Limit on DGTC per game

The DGTC is available in many jurisdictions in one form or another. The limit applied on a per-game basis could place Ireland behind competitor locations such as the UK, Germany and Canada (Quebec). The cost of developing a video game in the current economic environment can range from tens of thousands to hundreds of millions euro. It is hoped that the €8m maximum credit per game available in Ireland (i.e. €25m at 32%) will not be a disincentive for any of the largest games developers in the world when deciding whether to set up development operations in Ireland and/or which games could be developed here. Needless to say, such games tend to create the most jobs and take significantly longer to develop. It would be very beneficial if the maximum amount of DGTC was removed, capped at a much higher amount or changed to an annual limit.

Interaction with Other Reliefs

It is not immediately apparent, but the DGTC could potentially be combined with the R&D tax credit. Although the legislation prevents companies from claiming both incentives on the same expenditure, the R&D tax credit could come into play for the larger games, those exceeding the €25m threshold. However, an important takeaway here is the fact that legislators have formally (albeit indirectly) recognised that qualifying R&D activities can take place in the games development sector. This is an important message, as the gaming industry has typically not been considered "R&D prone", with naysayers often commenting that it is focused on audio-visuals, story, social interactions and other, non-scientific, aspects. Examples of where R&D activities can potentially be found in games development are:

- projectile tracking and guidance,
- collision detection,
- pathfinding,
- developing a new graphics and/or physics engine,
- multiplayer queuing and matchmaking and
- new compression techniques/algorithms to reduce loading times and file size.

The legislation also denies a claim for a DGTC where the claiming company obtained relief on the same expenditure under the R&D tax credit, the Knowledge Development Box or film relief, or indeed where the expenditure has been met by grant aid.

Conclusion

Once approved and implemented, it is hoped that the DGTC will be a "game changer" (no pun intended!) in attracting, promoting and growing the digital games industry in Ireland. The skills and talent in this space that are available here combined with the attractiveness of this regime could be a recipe for success.

There are, however, some aspects of the regime that could slow down Ireland's progress. Most notably, additional guidance would be welcome to assess the flexibility of the regime and its competitiveness relative to other, long-established regimes. Factors such as the proportion of development done in Ireland vs overseas, the rules governing the cultural test and the level of documentation required will no doubt play a pivotal role in determining how successful this regime will be. Perhaps the DGTC could be expanded for micro enterprises to foster entrepreneurship in the industry. It might also be beneficial to increase the upper limit of the credit, provide a different credit rate where expenditure on a single game exceeds €25m or change the limit to annual rather than per game. Only time will tell whether the regime as it stands will generate sufficient up-take.