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**Subject: State aid SA.36139 (2013/C) (ex 2013/N) – United Kingdom
UK video games tax relief**

Sir,

The Commission wishes to inform the UK that, having examined the information supplied by your authorities on the aid/measure referred to above, it has decided to initiate the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union.

1. PROCEDURE

(1) On 25 January 2013 the UK authorities notified the Commission of their intention to introduce a tax relief for video games from 1 April 2013 to 31 March 2017. The Commission wrote to the UK authorities requesting additional information on 7 March 2013 which the UK authorities provided on 22 March 2013.

2. DESCRIPTION

(2) The objective of the measure is to provide an incentive to video games developers to produce culturally British or European games.

(3) The measure is modelled on the UK film tax incentive approved by the Commission in 2006¹ and extended in 2011² until 31 December 2015.

¹ Decision N461/2005 UK Film Tax Incentive, 22 November 2006, OJ C/9/2007, 13.01.2007.

² Decision SA.33234 UK Film Tax Incentive Extension, 27 October 2011, OJ C/142/2012, 22.05.2012.

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(4) The proposed budget of the measure is as follows:

1 GBP = 1.14866 EUR as at 7 March 2013	Video games tax relief
2013/14	£10m (€1.49m)
2014/15	£35m (€40.20m)
2015/16	£35m (€40.20m)
2016/17	£35m (€40.20m)
Total	£115m (€32.09m)

(5) The UK authorities have provided the draft clauses & explanatory notes proposed in the UK Finance Bill 2013 to be introduced in the Corporation Tax Act 2009.

(6) The aid is granted by HM Treasury³.

(7) All companies subject to UK Corporation Tax which develop qualifying video games would be able to claim relief on development expenditure 'used or consumed' in the UK at a tax relief rate of 25% over a maximum of 80% of the production budget⁴. A video games tax relief would give an additional deduction for qualifying 'core expenditure'. This additional deduction, together with the tax deductible development expenditure, is deducted from the income arising from the video game. Any resultant loss may be surrendered for a payable tax credit. To calculate the actual relief given, the additional tax deduction is based on 'enhanceable expenditure' which is defined as the lower of (a) UK core expenditure; or (b) 80 per cent of total core expenditure. Between 101 and 500 companies are expected to benefit from the scheme.

(8) The following example illustrates how the aid operates.

³ The UK's economics and finance ministry.

⁴ Eligible expenditure for the tax credit corresponds to expenditure on conception and creation. Artistic expenditure covers the personnel costs (wages and social security contributions) for the producer, the assistant producer, the artistic director and the persons responsible for the scenario, the animation and the sound environment. It does not include the personnel costs for the persons responsible for programming, depreciation on assets other than buildings directly assigned to the creation of video games, and other operating expenditure.

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Example: A video game company produces a game with total budget of £1 million, all of which is UK expenditure. Its trading profits after deducting these costs are £0.1 million. The game is eligible for an enhanced tax deduction of 100% of the qualifying UK costs and the payable tax credit rate is 25%. The “enhanceable expenditure” is 80% of the expenditure used or consumed in the UK, ie, £0.8 million.

Actual trading profit [P]	£0.1 million
Additional deduction [AD] (= 100% x Enhanceable expenditure of £0.8m)	(£0.8 million)
Adjusted trading profit (loss) [P-AD] (Actual profit less additional deduction)	(£0.7 million)

The loss which qualifies for the cash payment is the lower of (1) the trading loss of £0.7m and (2) the total enhanceable expenditure of £0.8m. So, in this case, the film production company can get cash payment for the whole trading loss.

The amount of the cash payment is the credit rate of 25% multiplied by the loss, giving a payment of £175,000 (£0.7m x 25%). This is equal to 17.5% of the budget.

- (9) Companies applying for the aid will have to disclose other sources of aid to the funding body as part of the application process. If the funding body determines that the aid intensity exceeds, or might exceed, the maximum level, the funding body will automatically reject the application and will not accept any future application until the applicant’s finance plan complies with State aid regulation. Where a company claims tax relief under one creative sector relief, they will not be able to claim relief under another creative sector tax relief⁵. Where there is expenditure that could qualify for the UK’s SME Research and Development relief⁶, only one relief will be available.
- (10) The UK video games tax relief is subject to a cultural test similar to that of the UK film tax incentive. Both tests are divided into four sections (Cultural content, cultural contribution, use of UK cultural hubs, and use of UK/EEA national/resident cultural practitioners) and have a maximum score of 31 points. Productions must have a score of at least 16, of which at least 6 points must be scored in the 'cultural content' section.
- (11) The points for cultural content and cultural contribution are based on the following criteria:

⁵ The UK authorities also notified two other creator sector reliefs for high-end TV and animation (SA.35563 & SA.35564) in January 2013.

⁶ SA.22081 (ex-N816/2006) R&D tax credits for SMEs.

Criterion	Maximum points
A – Cultural content (Maximum total : 16 points)	
A1 Video Game content set in the UK, another EEA state ⁷	4
A2 Lead characters are British/EEA citizens or residents ⁸	4
A3 Video game based on British/EEA subject matter or underlying material	4
A4 Original dialogue/voice-over recorded mainly in English ⁹	4
B – Cultural contribution (Maximum total: 4 points)	
• Video game represents/reflects a diverse British culture / British heritage / British creativity	4

(12) The British Film Institute Certification Unit will be responsible for assessing applications for the certification of British programmes, including the cultural test.

(13) The UK authorities have undertaken to implement any changes to the scheme required if the relevant State aid rules are amended during the proposed 4-year duration of the scheme, between 1 April 2013 and 31 March 2017.

3. ASSESSMENT

3.1. Existence of aid

(14) As the notified measure is financed and operated in a similar way to the UK film incentive, the measures constitute State aid within the meaning of Article 107(1) TFEU, for the reasons set out in paragraphs 24-28 the Commission's 2006 decision approving the UK film tax incentive¹⁰. In addition, video games are produced in other Member States and there is an internal market for such video games.

3.2. Compatibility

(15) The UK authorities consider that the UK video games tax relief should be compatible under Article 107(3)(d) TFEU.

⁷ 4/3/2/1 points if at least 75%/66%/50%/25% is set in the UK or another EEA state. 3/2/1 points are awarded if there is a connection with UK/European culture and at least 66%/50%/25% is set in an undetermined location.

⁸ 4/3/2/1 points depending on the proportion of lead characters which are British/EEA citizens or residents or, provided there is a connection with UK/European culture, whose nationality/species cannot be determined.

⁹ 4/3/2/1 points if at least 75%/66%/50%/25% of the original dialogue is recorded in English.

¹⁰ State aid N461/2005.

- (16) To assess whether the notified measure is compatible under Article 107(3)(d), the Commission must ensure that it respects the general legality principle; that it is necessary, proportionate and well-designed; that the aid is directed towards a cultural product; and balance this with the effects on trade and competition within the EU.
- (17) Although the UK has not proposed that the relief is compatible under Article 107(3)(c), it could be argued that this might offer an alternative basis on which to assess whether the scheme is compatible with the Internal market. For an assessment under Article 107(3)(c), the Commission would need to carry out a similar assessment as set out in paragraph (16) apart from the requirement that the aid is directed towards a cultural product. On the basis of the elements provided by the Member State and by the interested parties, it should be determined whether the aid will facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent that is contrary to the common interest.

3.2.1. General legality

- (18) The UK authorities have proposed that the tax relief would only be available on expenditure on goods or services used or consumed in the UK.
- (19) The UK authorities have based the design of the proposed scheme on that of the UK film tax incentive. However, that scheme makes use of a special exception to the usual ban on territorial restrictions, which was allowed by the 2001 Cinema Communication¹¹. Moreover, the State aid assessment criteria of the 2001 Cinema Communication only covered production support for films and TV programmes, not video games.
- (20) Bearing in mind that video games can (and often are) developed by people working on computers in different countries, even if aid were necessary for the development of video games, the Commission doubts that it is necessary or proportionate to have territorial conditions attached to such aid.
- (21) Consequently, the Commission doubts that it would be legal and compliant with the internal market rules for the video games scheme to treat expenditure on goods or services 'used or consumed' only in the UK as being eligible.

¹¹ Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on certain legal aspects relating to cinematographic and other audiovisual works (COM(2001)534 final, 26/9/01, OJ C 43 pp6-17, 16/2/02); prolonged in 2004 (OJ C 123 pp1-7, 30/4/04), 2007 (OJ C 134 p5, 16/6/07) and 2009 (OJ C 31 p1, 7/2/09) until 31 December 2012.

3.2.2. Necessity

- (22) According to a special report on video games in *The Economist*¹² in December 2011, "Video games will be the fastest-growing and most exciting form of mass media over the coming decade". In addition, the rise of smartphone games has removed previous barriers to entry for European SMEs. For example, the most popular game in the world, Angry Birds¹³, was developed by Finnish SME Rovio¹⁴. As the UK authorities observe, "The worldwide video games sector grew by 23 per cent during the financial crisis and PwC predicts that the global market for video games will expand to \$82 billion in 2015, an 8.2 per cent compound annual increase from \$56 billion in 2010."
- (23) Nonetheless, according to the UK authorities, "There is a market failure in the underproduction of culturally British video games, with producers increasingly unable to invest in culturally relevant products and consumers facing limited choice."
- (24) The UK authorities have provided quotes from video games developers who have transferred work from the UK to, for example, the US¹⁵, or who are marginally unprepared to take the risk of investing in developing a new game in the UK.
- (25) The UK authorities have also provided the following overview of video games incentives provided by other countries:

¹² <http://www.economist.com/node/21541164>.

¹³ <http://www.rovio.com/en/our-work/games/view/1/angry-birds>.

¹⁴ <http://www.rovio.com/en/about-us/Company>.

¹⁵ As a result of US incentives for video games.

Territory		Tax incentive
France		20 per cent corporation tax credit for the creation of video games
Canada ¹⁶	Nova Scotia	35 per cent corporation tax credit for games production
	Ontario	Up to 37.5 per cent of games production salaries
	Quebec	Up to 37.5 per cent of games production salaries
	British Columbia	Subsidises 17.5 per cent of games production salaries
United States ¹⁷	Georgia	30 per cent corporation tax credit for games production
	Louisiana	25 per cent tax credit for development expenditure and 35 per cent credit for payroll expenditures for Louisiana residents.
	Michigan	Up to 42 per cent refundable credit
	New Mexico	25 per cent tax rebate on all direct development expenditure
	Rhode Island	25 per cent tax credit for video games developers
	Wisconsin	25 per cent corporation tax credit for games production
South Korea		Several hundred million dollars spent in recent years as part of a concerted effort to boost the size of the domestic industry ¹⁸ .

¹⁶ Other Canadian states also offer tax incentives for video games, including Prince Edward Island and Manitob.

¹⁷ This is only a sample of the reliefs available in US states. Arkansas, Colorado, Connecticut, Florida, Hawaii, Indiana, Kentucky, Maine, New Jersey, North Carolina, Ohio, Texas and Virginia all have some form of targeted tax incentive available to video games developers.

¹⁸ http://www.gamasutra.com/php-bin/news_index.php?story=21368;
http://www.gamasutra.com/php-bin/news_index.php?story=23510.

- (26) The main motivation provided by the UK authorities for offering the proposed UK video games tax credit is to avoid video games companies migrating from the UK to "countries that provide incentives for video games development, notably Canada, South Korea, Singapore, and a large number of US States". The UK authorities suggest that a British game being made in these countries could influence the cultural character of games and that there is a "market failure in the underproduction of culturally British video games".
- (27) Noting that the necessity of State aid for video games has to be assessed on a case-by-case basis, the Commission doubts that the evidence provided by the UK authorities in the present case suggests that video games would not be produced without aid. Rather, it implies that certain video games may not be produced in the UK without aid as a result of incentives elsewhere, particularly outside the EEA.

3.2.3. *Design*

- (28) In view of the various international incentives identified by the UK authorities and reproduced in the table in paragraph (25), it would appear that there is a global subsidy race to attract major video games developers. According to press reports¹⁹, the declared aim of the UK authorities is to offer an incentive which is "among the most generous in the world".
- (29) As more and more countries compete for inward investment from what is perhaps a limited number of such video games, the Commission notes that Europe's competitiveness could be undermined by the issue of video games developers migrating from Europe to third countries providing incentives for video games development.
- (30) At the same time, it is necessary to avoid a subsidy race within the Union. The Commission doubts that offering this type of aid against the background of a global subsidy race could avoid fuelling a subsidy race between Member States. The Commission also doubts that the potential distortions of competition are balanced by any positive effects.

¹⁹ Such as <http://www.digitalspy.co.uk/gaming/news/a443228/uk-games-industry-to-benefit-from-25-percent-tax-relief-rate.html>.

3.2.4. Cultural test

(31) An analysis provided by the UK authorities reveals that, out of the 28 video games released in the fourth Quarter of 2012 in the UK, the following seven games would have passed the proposed UK video games cultural test:

Game Title	Release Date	Game Type	Platform	Genre	Games Publisher
Everything's Rosie	07/12/2012	Regular Game	Nintendo DS	Educational	Avanquest Software Publishing Ltd
Big Sky Infinity	28/11/2012	Regular Online Game	PlayStation Vita	Action	Ripstone Ltd
Sniper Elite V2: High Command Edition	22/11/2012	Regular Game	PC	Action	Mastertronic Group Limited
007 Legends	16/11/2012	Regular Game	Nintendo Wii U	Action	Activision Blizzard UK Ltd
Wonderbook: Book of Spells	14/11/2012	Regular Game	Playstation 3	Other	Sony Computer Entertainment Europe
LEGO The Lord of the Rings	02/11/2012	Regular Game	Nintendo 3DS	Action	Warner Brothers Entertainment UK Ltd
When Vikings Attack™	17/10/2012	Regular Online Game	Playstation 3	Action	Sony Computer Entertainment Europe
Harry Potter For Kinect	12/10/2012	Regular Game	XBox 360	Action	Warner Brothers Entertainment UK Ltd

(32) The criteria used are principally based on the UK/EEA link of content, characters, subject matter, and a game is able to get the necessary 16 points without that it represents/reflects a diverse British culture / British heritage / British creativity. However, the Commission considers that the cultural quality/aspects of games is less evident than for films and that therefore the test should put more emphasis or weight on these aspects of the content than on a mere link to a territory.

(33) Consequently, as in the Commission's preliminary assessment of the French video games tax credit²⁰, the Commission doubts that the proposed UK video games cultural test would ensure that the aid would support only games with cultural content without leading to undue distortion of competition in this very competitive market.

3.3. Statement of doubts

(34) As explained above, the Commission doubts that:

- 1) the aid is necessary;
- 2) it would be legal and compliant with internal market rules for the video games scheme to treat expenditure on goods or services 'used or consumed' only in the UK as being eligible;
- 3) offering this type of aid against the background of a global subsidy race could avoid fuelling a subsidy race between Member States; and that
- 4) the proposed UK video games cultural test is sufficiently restrictive to ensure that the aid supports only games with cultural content without leading to undue distortion of competition in what seems to be a very competitive market.

(35) The Commission therefore has doubts about the compatibility of this aid measure with the internal market.

In the light of the foregoing considerations, the Commission, acting under the procedure laid down in Article 108(2) of the Treaty on the Functioning of the European Union, requests the UK to submit its comments and to provide all such information as may help to assess the aid/measure, within one month of the date of receipt of this letter.

The Commission wishes to remind the UK that Article 108(3) of the Treaty on the Functioning of the European Union has suspensory effect, and would draw your attention to Article 14 of Council Regulation (EC) No 659/1999, which provides that all unlawful aid may be recovered from the recipient.

The Commission also warns the UK that it will inform interested parties by publishing this letter and a meaningful summary of it in the *Official Journal of the European Union*. It will also inform interested parties in the EFTA countries which are signatories to the EEA Agreement, by publication of a notice in the EEA Supplement to the *Official Journal of the European Union* and will inform the EFTA Surveillance Authority by sending a copy of this letter. All such interested parties will be invited to submit their comments within one month of the date of such publication.

²⁰ Paragraphs 37-44, State aid C47/06, OJ C 297/19, 7.12.2006.

As this letter does not include any of the information regarding the notified scheme which the UK has identified as being confidential, you are deemed to agree to the disclosure to third parties and to the publication of the full text of this letter in the authentic language on the Internet site:

<http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President