



EUROPEAN COMMISSION

Brussels, 27.03.2014

C(2014) 1786 final

PUBLIC VERSION

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COMMISSION DECISION
of 27.03.2014
ON THE STATE AID SCHEME
SA.36139 (2013/C) (ex 2013/N)
which the United Kingdom is planning to implement
for video games

(Only the English version is authentic)

(Text with EEA relevance)

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular the first subparagraph of Article 108(2) thereof,

Having regard to the Agreement on the European Economic Area, and in particular Article 62(1)(a) thereof,

Having called on interested parties to submit their comments pursuant to those provisions¹ and having regard to their comments,

Whereas:

I. Procedure

- (1) On 25 January 2013 the United Kingdom notified the Commission of its intention to introduce a tax relief for video games from 1 April 2013 to 31 March 2017. The Commission requested additional information by letter dated 7 March 2013 which the United Kingdom provided by letter dated 22 March 2013.
- (2) By letter dated 16 April 2013, the Commission informed the United Kingdom that it had decided to initiate the procedure laid down in Article 108(2) of the Treaty in respect of the planned aid measure.
- (3) The Commission decision to initiate the procedure (the "opening decision") was published in the *Official Journal of the European Union*². The Commission called on interested parties to submit their comments.
- (4) The United Kingdom submitted its comments on the decision by letter dated 17 May 2013. The Commission also received comments from interested parties. It forwarded them to the United Kingdom, which was given the opportunity to react; its comments were received by letters dated 22 August 2013. By letter dated 7 October 2013 the Commission asked the United Kingdom for additional information. The United Kingdom replied by letter dated 4 November 2013.

¹ Commission Decision in Case SA.36139 – UK video games tax relief (OJ C 152, 30.5.2013, p. 24).

² Cf. footnote 1.

II. Description of the measure and reasons for opening the procedure

- (5) The objective of the United Kingdom video games tax relief measure is to provide an incentive to video games developers to produce culturally British or European video games. The measure is modelled on the United Kingdom film tax incentive approved by the Commission in 2006³ and extended in 2011⁴ until 31 December 2015.
- (6) The proposed overall budget of the measure, which is planned to run until March 2017, is GBP 115 million. The intended expenditure for the financial year 2013/2014 is GBP 10 million and for the three following financial years GBP 35 million each. The aid is financed by HM Treasury. The British Film Institute Certification Unit will be responsible for assessing applications for the certification of British cultural games.
- (7) Companies subject to United Kingdom Corporation Tax which develop qualifying video games would be able to claim tax relief on expenditure on goods and services used or consumed in the United Kingdom up to a value of 25% of the production budget. The relief is obtained by an additional deduction of the qualifying production costs from the taxable income arising from the video game. However, not more than 80% of the production budget may be deducted additionally. In case the beneficiary has incurred a loss in the accounting period, it may claim a payable tax credit. According to section 1217CF(3) of the draft amendment to the Corporation Tax Act 2009, eligible expenditure is limited to core expenditure on designing, producing and testing the game.
- (8) The United Kingdom video games tax relief is subject to a cultural test similar to that of the United Kingdom film tax incentive. Both tests are divided into four sections, Cultural content, cultural contribution, use of United Kingdom cultural hubs, and use of United Kingdom or EEA national or resident cultural practitioners.
- (9) As the notified measure is financed by a deduction of taxes normally due to the State budget, it is financed by the State. Video games are produced in several Member States and there is an internal market for such video games. Support for them may therefore affect trade and competition between Member States. Accordingly, the Commission found in the opening decision that the measure constitutes State aid within the meaning of Article 107(1) of the Treaty. The Commission also doubted whether the aid could be considered compatible with the internal market.
- (10) Firstly, the Commission doubted that it is necessary or proportionate to have territorial conditions attached to such aid. The United Kingdom has based the design of the proposed scheme on that of the United Kingdom film tax incentive. Therefore it has proposed that the tax relief would only be available on expenditure on goods or services used or consumed in the United Kingdom. However, the film incentive scheme makes use of a special exception to the usual

³ Commission Decision of 22 November 2006 in Case No N 461/2005 - UK Film Tax Incentive (OJ C 9, 13.01.2007, p.1).

⁴ Commission Decision of 27 October 2011 in Case No SA.33234 - UK Film Tax Incentive Extension (OJ C 142, 22.05.2012, p.1).

ban on territorial restrictions, which is allowed by the Cinema Communication⁵ only with regard to production support for films and TV programmes, not with regard to video games.

- (11) Secondly, the Commission doubted that aid to games would be necessary, because they constitute a fast-growing market. The United Kingdom did not provide convincing evidence that there would be a market failure leading to the underproduction of culturally British video games in the absence of State aid.
- (12) Furthermore, the United Kingdom considers that the United Kingdom video games tax relief is compatible with the internal market in accordance with Article 107(3)(d) of the Treaty. The Commission was however not convinced that the cultural test proposed by the United Kingdom would in practice lead to a selective identification of the limited number of video games which represent a cultural quality which is not sufficiently offered by the market without aid and which would be essential to ensure that British and European cultural themes are represented and reflected in video games.
- (13) Finally, the Commission was concerned that the aid could fuel a subsidy race within the Union and doubted that the potential distortions of competition would be balanced by any positive effects.

III. Comments from interested parties

- (14) The Commission received comments from one Member State, France, national game developers associations of the United Kingdom, France, Germany, Finland, the European Game Developer Federation ('EGDF'), United Kingdom public bodies involved in the promotion of films, a broadcaster, and film production trade associations from the United Kingdom. All contributors underlined the cultural quality and importance games may have. They saw insufficient market incentives for the production of culturally more relevant games. None of them considered that there was a danger of a subsidy race among Member States.
- (15) Regarding the necessity of the aid, interested parties pointed out that the United Kingdom was losing its leading position in the video games market, that in 2012 less than 10% of United Kingdom released games were developed in the United Kingdom, that the market was dominated by North America and Asia and that there was a staff drain to Canada. Contributors also pointed to the fact that the main challenges for Member States would be to address the competition from third countries which heavily subsidise games, in particular Canada.
- (16) The United Kingdom Independent Game Developers Association ('TIGA') submitted numerous examples of plans and projects in which United Kingdom/Europe based video games could have been made with the help of a tax break but which were not in fact made. United Kingdom Interactive Entertainment ('Ukie'), which represents the games and interactive entertainment industry,

⁵ Communication from the Commission on State aid for films and other audiovisual works (OJ C 332, 15.11.2013, p. 1). This was also the case in the 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 (OJ C 43, 16.02.2002, p. 6), which applied when the procedure laid down in Article 108(2) of the Treaty was initiated.

observed that in the global games market there would be pressure on game developers to target products towards the widest possible market. This would in particular mean making them accessible to the North American market and increasingly to Far Eastern markets and meeting the cultural norms and expectations of those markets. This would place constant pressure on games developers in Europe not to emphasise the culturally European elements of their game in order to sell it to a global audience. Consequently, it would be less easy for developers of culturally European games to obtain private funding. Ukie therefore considered that the aid would assist in remedying a market failure.

- (17) France observed the tendency that games follow increasingly "international stereotypes".
- (18) On the other hand, TIGA reported that 54% of independent United Kingdom developers' turnover is constituted by British sales. This would suggest a strong preference of United Kingdom purchasers for United Kingdom productions. Furthermore, according to TIGA, between 2008 and 2011 there were more business start-ups (216) than closures (197) in the sector.
- (19) Regarding a possible distortion of competition among Member States, TIGA admitted that lower costs influence decisions regarding the location of video games production companies; but it considered that the principal distortion would come from third countries, like Canada, where the industry would grow because of public support. According to TIGA, between 2008 and 2010 Canada's employment in the sector grew by 33% while it declined in the United Kingdom by 9%.

IV. Comments from the United Kingdom

1. Territorial spending obligations

- (20) Following the expression of the Commission's doubts whether territorial spending conditions inherent in the "used or consumed in the UK" test would be appropriate, the United Kingdom has undertaken to address these concerns and to change the proposed legislation from "used or consumed in the UK" to "spent in the European Economic Area (EEA)", clarifying that any expenditure incurred in the EEA may be eligible for relief. Furthermore, they will seek to limit the amount of subcontracting costs which are eligible for funding. The supported producer may spend up to EUR 1 million of eligible core expenditure per project on subcontractors, in line with the video games tax relief in France⁶. This ensures that an essential part of the game development is done by the beneficiary itself.
- (21) The United Kingdom considers that this limitation on the eligibility of subcontracted costs has a minor effect on trade between Member States. Discussions with representatives from across the video games industry, including small and large developers, have indicated that like other creative sectors, video games development is a highly collaborative process with the core development activities such as programming, design and lead art work typically carried out in the same location.

⁶ Commission Decision of 25 April 2012 in Case No SA.33943 - Prolongation du régime d'aide C 47/2006 - Crédit d'impôt en faveur de la création de jeux vidéo (OJ C 230, 1.8.2012, p. 3).

2. Necessity of aid

- (22) Regarding the necessity of the aid due to an underproduction of cultural games, the United Kingdom has provided evidence demonstrating that such games are in decline, in relative and in absolute terms. The United Kingdom agrees that in general the video games sector is dynamic and growing. However, in 2012 less than 10% of United Kingdom released games were developed in the United Kingdom, compared to 16% in 2008. The United Kingdom also carried out a further analysis of games released in the United Kingdom between 2003 and 2012. The figures show a constant decline in the number of culturally British games and a sharp fall in their share of the market from 9% of all games released in the United Kingdom (including games from other countries) in 2003 to 4% in 2006, staying at 3% from 2009 to 2012. In 2003, 41% of the United Kingdom developed games would have passed the cultural test compared to only around 25% in 2012.
- (23) The United Kingdom agrees that the rise of smart phone games has removed certain barriers to entry for smaller developers looking to enter the video games market. Indeed, figures released in 2011 show that the number of video games developed by start-up companies has increased in the last year. However, with a view to the content of the games, a survey by the Abertay University video games prototype programme shows that of 306 mobile and online games proposals presented to the University over the last 2 years from small and micro-businesses all around the United Kingdom, the overwhelming majority - 255 - featured neither a United Kingdom setting, character nor story⁷.
- (24) This could be explained by the fact that culturally significant games may have production costs equal to "global games" but a significantly smaller market. Their production thus would involve a higher economic risk. Thus video games with culturally British/European content would be less commercially viable than those with more globalised content. Both international publishers and domestic developers are less likely to take risks in producing culturally relevant content and instead create more generic content aimed at international markets.
- (25) A survey by the United Kingdom found that the culturally British elements of game narratives are being eroded in an attempt to secure the global publishing deals needed to fund their development and ensure the survival of the developer. Nearly three quarters of British video games developers claimed that original Intellectual Property development had slowed or stopped in the previous five years. The survey found that many developers have had to change the cultural content of their games to satisfy commercial requirements. Fifty-three per cent of respondents said they had changed characters and settings away from British or European subjects.
- (26) In view of this, the incentive objectives of the fund would be to make cultural products that are likely to be uneconomical, commercially viable, thereby promoting the production of new cultural products that would not have been made in the absence of the tax relief, and to support the development of skills for the sustainable production of cultural products, relevant British/EEA video games.

⁷ The university collected the data in the course of its video games prototype programme which intends to help small enterprises turn their games into working prototypes.

3. A discriminating cultural test

- (27) Finally, as regards the cultural test, which ensures that the scheme only covers distinctively cultural games, the United Kingdom explained that firstly, the tax authority, HM Revenue & Customs ('HMRC'), has a dedicated and specialist "Creative Industries Unit" which will be responsible for administering and policing claims for the video games tax relief. The unit will risk assess claims, and this process includes ensuring that the rules for qualification are properly adhered to. There is thus a clear process in place for the application of the test.
- (28) As regards the elements of the test which help to determine the cultural quality of a game, the United Kingdom clarified that the majority of points available within the proposed cultural test relate to content. Up to 20 points out of 31 relate to the cultural content and contribution of the game. This includes elements like the location of the story, the lead characters, the subject matter on which the game is based, the use of the English language and the reflection of British culture and heritage. Only 3 points relate to the location of development activity and the remaining 8 points are available where the relevant cultural practitioners, like scriptwriter, composer, designer, artist, or programmer, are British or EEA citizens or residents. The proposed test therefore has a strong focus on content over the location of activity. This focus on content is further strengthened by the application of a minimum cultural content rule, a 'golden points rule', which will ensure that only games with a sufficient number of cultural content points will pass the test.
- (29) This focus on content represents a constraint on the overall scope of the relief. The United Kingdom has undertaken analysis of games released there in 2006, 2009 and 2012, applying the cultural test retrospectively to all United Kingdom-made games released during this period. Of the 822 released in the United Kingdom in 2012, only 74 were made by United Kingdom developers, 25.7 % of which (19 games) would have passed the cultural test if it had been in existence. For 2006 and 2009, the test showed that the share of such games among the games which were developed in the United Kingdom would have been around 27%, while their share among all games released in the United Kingdom would have been between 3% and 4%.
- (30) The United Kingdom considers a 25.7 % pass rate to be within the range accepted by the Commission in the case of the French video games tax incentive⁸. In that decision, the Commission found that the fact that close to 30% of games are selected indicates that France has drawn up criteria guaranteeing that the content of video games eligible for the tax relief is truly cultural. Likewise, the United Kingdom considers the video games cultural test to be sufficiently restrictive to ensure the aid is targeted at culturally British/EEA video games.

⁸ Commission Decision of 11 December 2007 on State Aid C 47/2006 (ex N 648/05) - Tax credit introduced by France for the creation of video games (OJ L 118, 6.5.2008, p. 16).

(31) The United Kingdom has furthermore agreed to notify the scheme as an initial pilot for four years, and will use this time to monitor the relief and ensure that it is being used as intended.

4. Subsidy race

(32) Regarding the Commission's concern that the aid could fuel a subsidy race within the Union which would lead to undue distortions of competition, the United Kingdom observed that such a subsidy race would be evidenced by a large number of Member States operating schemes to increase the competitiveness of their domestic sectors. The United Kingdom does not consider this likely to be the case. Although tax advantages may be a determinant for decisions on where to locate a business, the aid is mainly an answer to Canadian, United States and South Korean tax relief. France is currently the only other Member State to offer a tax incentive for the production of culturally relevant video games.

(33) Furthermore, a subsidy race would be purely focused on economic competition without any cultural restrictions. Two or more countries looking to protect the production of particular cultural products, according to an agreed cultural test, would not constitute a subsidy race.

(34) The aim of the proposed aid is to protect the production of culturally British/European video games and, as such, the aid will provide relief for only a fraction of video games developed in the United Kingdom and in Europe and support only a small amount of overall video game development expenditure. Following discussions with industry, the United Kingdom estimates that only around 10% of those culturally British/European video games will have a budget above GBP 5 million. The majority of games development expenditure will be on considerably smaller projects.

V. Assessment of the aid measure

1. Classification as State aid

(35) According to Article 107(1) of the Treaty, concerning aid granted by Member States, any aid granted by a Member State or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall be incompatible with the internal market, in so far it affects trade between Member States.

(36) The support for video game production, based on an approval by HMRC, accords a financial advantage by way of a tax relief to undertakings in the game production sector at the expense of the budget of HM Treasury. It is therefore granted through State resources and imputable to the State. The measure is designed to reduce the production costs of the benefiting undertakings and constitutes an economic advantage for them. It is limited to companies in the video game sector and is therefore selective. Finally, it has an effect on trade and competition between Member States, as games are also produced in other Member States and traded internationally. Accordingly, it constitutes State aid within the meaning of Article 107(1) of the Treaty.

2. Compatibility of the aid with the internal market

- (37) Regarding the general legality of the scheme, the Commission notes that the United Kingdom has withdrawn the territorialisation clause which the Commission found problematic in view of the internal market freedoms of movement of goods and provision of services. It agreed to limit the volume of subcontracting costs qualifying as eligible for aid to GBP 1 million.
- (38) The Commission takes the view that this limit is acceptable in this case in so far as, in practice, in view of the size of the production budgets, a ceiling of GBP 1 million for subcontracting expenditure does not appear likely to significantly hamper recourse to subcontracting. The United Kingdom expects that the majority of the video games covered by their cultural test will have a production budget of less than GBP 1 million. Only around 10% of those video games would have a budget in excess of GBP 5 million. Depending on changes in the production budgets for video games in the United Kingdom, the Commission reserves the right to review this ceiling when the aid measure is re-notified within four years of its implementation, in line with the commitments entered into by the United Kingdom.
- (39) The United Kingdom intends to justify the support of game development as aid to promote culture. Accordingly, an assessment would have to take place under Article 107(3)(d) of the Treaty. The Commission has not developed guidelines for the application of this provision on aid to games. However, the Cinema Communication refers to the possibility of granting aid to games. Paragraph 24 of that Communication states that aid measures in support of games will continue to be addressed on a case-by-case basis. To the extent that the necessity of an aid scheme targeted at games which serve a cultural or educational purpose can be demonstrated, the Commission would apply the aid intensity criteria of the Cinema Communication.
- (40) The Commission therefore has to assess the compatibility of the measure directly on the basis of Article 107(3)(d) of the Treaty. It will have to verify, whether it serves the promotion of culture and whether it does not affect trading conditions and competition in the Union to an extent contrary to the common interest. This means that it has to be the appropriate instrument to achieve this objective, in particular that without this support there would not be sufficient incentive for market actors to produce the desired kind of games. Regarding the proportionality of the aid, the maximum aid intensities established by the Cinema Communication may be applied by analogy. The Commission assessed the cultural objective and the necessity of aid to certain video games in the two decisions regarding support to games in France, referred to in recitals 20 and 30.

a) Promotion of culture

- (41) To be compatible with Article 107(3)(d) of the Treaty, the aid to games, as proposed by the United Kingdom, needs to serve the promotion of culture. On the basis of the changes to the scheme and the additional evidence submitted by the United Kingdom, the Commission is satisfied that the United Kingdom would apply a truly selective cultural test ensuring that aid is granted only for the promotion of culture in line with Article 107(3)(d) of the Treaty.
- (42) Firstly, the Commission takes note of the explanations given by the United Kingdom regarding the test used to determine the cultural quality of a game (recitals 27 to 29): the majority of points available within the proposed cultural

test, up to 20 points out of 31, relate to the cultural content and contribution of the game. This is further strengthened by the application of a minimum cultural content rule, the "golden points rule", which will ensure that only games with a sufficient number of cultural content points will pass the test.

- (43) This focus on content represents a constraint on the overall scope of the relief. Simulations of the cultural test on the basis of games released in earlier years revealed that 26% to 27% of the games produced in the United Kingdom would have passed the cultural test. Such a pass rate indicates that the criteria of the test ensure that the content of video games eligible for the tax relief is truly cultural and that the test is sufficiently restrictive to target the aid at culturally British/European video games. In comparison, in its decision of 2007 on the French video games tax incentive⁹, the Commission found that an eligibility of around 30% of games indicated that the test was sufficiently selective.
- (44) Consequently, the doubts raised in the opening decision have been addressed. The fact that only around 27% of games are selected indicates that the objective of the measure is not simply an industrial objective of providing support for a specific sector but a truly cultural objective. The aid measure thus meets a genuine objective of promoting culture.

b) Appropriateness, necessity and proportionality of the measure

- (45) On the basis of Article 107(3)(d) of the Treaty, the video games tax relief should be an appropriate instrument for meeting the objective being pursued. State aid for other purposes which would not focus on this cultural objective is more likely to promote sector related industrial objectives. The Commission acknowledges that, as designed, the tax relief actually allows public support to be channelled to games with a cultural content and that it is therefore an appropriate tool for achieving the cultural objective being pursued.
- (46) In view of the very dynamic development and evolution of the games market, the United Kingdom authorities submitted data to substantiate that the aid is necessary to maintain a reasonable output of such games and that without aid for cultural games their production and market share would decrease considerably. The figures show a constant decline in the number of culturally British games and a sharp fall in their share of the market from 9% of all games released in the United Kingdom in 2003 to 4% in 2006, staying at 3% from 2009 to 2012.
- (47) Culturally significant games may have production costs equal to global games but a significantly smaller market. Their production thus involves a higher economic risk. Thus video games with culturally British/European content are less commercially viable than those with more globalised content. Therefore the market places constant pressure on games developers in Europe not to emphasise the culturally European elements of their game in order to sell to a global audience. Developers of culturally European games find it more difficult to obtain private funding.
- (48) The proposed tax relief should promote the production of video games with a cultural content as opposed to games that are purely for entertainment in that it would reduce the former's production costs. There is, therefore, reason to

⁹ Cf. footnote 8.

conclude that the measure is likely to have a sufficient incentive effect relative to its objective.

- (49) Furthermore the aid measure is proportionate as it limits the aid intensity to 25% of production costs effectively incurred in the manufacture of eligible games. This is lower than the aid intensity of 50% permitted for audiovisual production, according to paragraph 52(1) of the Cinema Communication which applies by analogy as far as the permissible aid intensity is concerned.
- (50) Finally, in order not to affect trading conditions and competition in the Union to an extent contrary to the common interest, the distortions of competition and the effects on trade triggered by the measure should be offset by its positive effects.
- (51) According to the figures provided by the United Kingdom and representatives of the sector, in 2012 less than 10% of United Kingdom released games were developed in the United Kingdom. The market shares of eligible games published in the United Kingdom is rather small (4-5%). Also the proportion of eligible games among the video games manufactured in the United Kingdom is, at around 27%, relatively small.
- (52) Furthermore, no potentially affected third party pointed to a possible adverse effect of the measure. On the contrary, the associations of video game manufacturers that submitted comments following the initiation of the procedure, TIGA and EGDF, underscored the small impact of the measure on their national industries and its overall impact in the face of competition mainly from North America and the Far East. Therefore a subsidy race among Member States would be rather unlikely.
- (53) In any case, it is useful that the United Kingdom is limiting the duration of the scheme to four years to allow an evaluation of its application and a reassessment of the criteria in view of the market developments.
- (54) The Commission consequently finds that the doubts raised in the opening decision have been addressed. The distortions of competition and the effect of the measure on trade between Member States are now limited so that they are not contrary to the common interest.

VI. Conclusion

- (55) The Commission therefore takes the view that the aid will not have the effect of unduly strengthening the market power of beneficiary firms or of hampering dynamic incentives for market operators but, on the contrary, it will increase the diversity of supply on the market. There are grounds, therefore, for concluding that the distortions of competition and the effects on trade that the measure will have are limited so that the overall aid assessment is positive. Accordingly, the tax relief for the creation of video games is compatible with the internal market on the basis of Article 107(3)(d) of the Treaty,

HAS ADOPTED THIS DECISION:

Article 1

The State aid measure which the United Kingdom is planning to implement for video games through an amendment of the Corporation Tax Act 2009 is compatible with the internal market within the meaning of Article 107(3)(d) of the Treaty on the Functioning of the European Union.

Implementation of the aid measure is accordingly authorised.

Article 2

This Decision is addressed to the United Kingdom of Great Britain and Northern Ireland.

Done at Brussels, 27.03.2014

For the Commission

Joaquín ALMUNIA
Vice-president

Notice

If the decision contains confidential information which should not be published, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to publication of the full text of the decision. Your request specifying the relevant information should be sent by registered letter or fax to:

European Commission
Directorate-General for Competition.
State aid registry
1049 Brussels

Belgium
Fax No: +32 2 2961242