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HOUSE OF REPRESENTATIVES

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INCOME TAX ASSESSMENT AMENDMENT (DIGITAL GAMES TAX OFFSET)  
BILL 2021: MEASURE FOR CONSULTATION

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EXPOSURE DRAFT EXPLANATORY MATERIALS



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## ***Glossary***

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This Explanatory Memorandum uses the following abbreviations and acronyms.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
AAT	Administrative Appeals Tribunal
ABN	Australian Business Number
Commissioner	Commissioner of Taxation
ITAA 1997	Income Tax Assessment Act 1997
Arts Minister	Minister for the Arts
MEC Group	Multiple Entry Consolidated Group



# ***Digital Games Tax Offset***

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## **Outline of chapter**

- 1.1 The Digital Games Tax Offset is one component of the Government’s Digital Economy Strategy. Schedule # introduces a tax offset aimed at promoting the growth of the digital games industry in Australia and attracting games development to Australia.
- 1.2 All legislative references in this chapter are to the ITAA 1997 unless otherwise stated.

## **Context of amendments**

- 1.3 The Government announced the Digital Economy Strategy in the 2021-22 Budget. The strategy targets investment in emerging technologies, building digital skills, encouraging business investment and enhancing Government service delivery. The Digital Games Tax Offset is a part of that strategy.
- 1.4 The intent of the tax offset is to promote growth of the digital games industry in Australia, as the talent in the gaming sector has transferrable digital capabilities that Australia could apply to a range of other sectors.

- 1.5 This measure is expected to strengthen the Australian digital games industry, expand employment opportunities for digital and creative talent, enhance the industry’s international competitiveness and make Australia an attractive destination for foreign investment.
- 1.6 To that end, the Government is introducing a 30 per cent refundable tax offset for eligible companies that spend a minimum of \$500,000 on qualifying Australian development expenditure on eligible games. This will be available from 1 July 2022.

## Summary of new law

- 1.7 Schedule # amends the *Income Tax Assessment Act 1997* to introduce a 30 per cent refundable tax offset and outlines the eligibility criteria, the method for calculating the offset, and how the offset will be administered:

**Table 1.1 Summary of new law**

<b>Criteria</b>	<b>Eligibility</b>	<b>Legislative reference</b>
Which businesses are eligible?	Companies that are Australian residents or foreign residents with a permanent establishment.	Subdivision 378-B, section 378-10
What games are eligible?	A digital game that is developed to be made available to the general public and is not an ineligible game.	Subdivision 378-B, section 378-20
What expenditure qualifies?	Qualifying Australian development expenditure that is incurred in relation to the development of the game and is not excluded expenditure.	Subdivision 378-C
How will the tax offset be administered?	The company must apply for a certificate, stating the amount of expenditure on which the offset will be determined.	Subdivision 378-D
Amount of the tax offset?	The amount of the tax offset is 30 per cent of a company’s total qualifying Australian development expenditure as determined by the Arts Minister under section 378-25. If the amount of a company’s offset exceeds \$20 million, the company’s offset is \$20 million.	Subdivision 378-B, section 378-15



## Detailed explanation of new law

- 1.8 The Digital Games Tax Offset is a refundable income tax offset available to companies that develop digital games. It is designed to support and promote the growth of the Australian digital games industry by providing concessional tax treatment for Australian game development expenditure.
- 1.9 Division 378 of the ITAA 1997 is a new division providing for the Digital Games Tax Offset.
- 1.10 Subdivision 378-A provides a guide to Division 378 by outlining the key features of the tax offset and the structure of the Division.  
*[Schedule #, item 2, sections 378-1 and 378-5 of the ITAA 1997]*

## Key features of the tax offset

- 1.11 The Digital Games Tax Offset is available to an eligible company and is calculated with reference to the qualifying Australian development expenditure incurred by the company. A company is eligible for an offset when the following conditions are met:
- a certificate has been issued by the Arts Minister for the completion of a new game, the porting of a digital game to a new platform, or for ongoing development of one or more existing digital games during an income year; and
  - the company claims the offset in its income tax return in respect of the income year.
- [Schedule #, item 2, section 378-2 of ITAA 1997]*
- 1.12 The Digital Games Tax Offset is 30 per cent of a company's total qualifying Australian development expenditure on new or existing digital games. The amount of the company's qualifying Australian development expenditure on the game is determined by the Arts Minister under section 378-25.  
*[Schedule #, item 2, section 378-15 of ITAA 1997]*
- 1.13 The Digital Games Tax Offset is a refundable tax offset. A refund of the tax offset will occur where the total of the offsets exceeds the amount of income tax and other tax liabilities that the company would have to pay if it had not received those tax offsets (but had received all its other tax offsets). Any amount of offset applied against tax liabilities or refunded to a company would not be assessable income for income tax purposes.  
*[Schedule #, item 1, section 67-23 of the ITAA 1997]*
- 1.14 The amount of the offset is capped at \$20 million per company, per income year even if the company applied for multiple certificates in the income year.

For example, to reach this cap, a company would require \$66.7 million of qualifying Australian development expenditure in an income year. Integrity rules exist to ensure the cap remains effective across closely affiliated companies and consolidated groups.

- 1.15 This cap applies to the offset for a single company. But the cap also applies to any amount of cumulative offset to which a group of related companies would be entitled to. A related company is a company that is connected with or is an affiliate of a company.
- 1.16 The definitions of a company's affiliate and where a company is connected to another company are provided in sections 328-130 and 328-125 of the ITAA 1997 respectively. Generally, an affiliate of a company is a company which acts, or could reasonably be expected to act, in accordance with the first company's direction or wishes.
- 1.17 Applying the cap across a company and its related companies is an integrity measure aimed at addressing corporate structuring specifically design to defeat the \$20 million offset cap.
- 1.18 When the cumulative offset for a company and its related companies exceeds \$20 million, the company and its related companies must each provide the Commissioner with a notice in the approved form specifying an amount that will be that company's digital games tax offset in relation to that income year. The amount nominated in each company's notice cannot be greater than the offset that the company would have been entitled to had the cap not applied in this way.
- 1.19 The amount on the notice provided to the Commissioner by a company is that company's digital games tax offset, provided that the sum of notices provided to the Commissioner by the company and its related companies does not exceed \$20 million.
- 1.20 If no notice is lodged by a company and its related companies, the digital games tax offset reduces to nil for that income year for the company and its related companies.

*[Schedule #, item 2, section 378-15 of the ITAA 1997]*

## Eligibility for the Digital Games Tax Offset

### Company Eligibility

- 1.21 Only entities that are companies for tax purposes are entitled to this offset. A company is entitled to the offset for an income year if:
  - it is an Australian resident company, or an Australian permanent establishment of a non-resident company when it lodges the income tax return and when the tax offset is due to be credited; and

- the Arts Minister has issued to the company one or more certificates; and
- the company claims the offset in its income tax return for the income year.

*[Schedule #, item 2, section 378-10 of the ITAA 1997]*

- 1.22 The purpose of the residency or permanent establishment requirement is to ensure that only companies that carry on their game development business in Australia are eligible for the offset.
- 1.23 Section 378-20(8) outlines when companies are eligible for a certificate and when that company is eligible for the certificate in relation to a game. The certification process is outlined in subdivision 378-D and paragraphs 1.99 to 1.115 below.
- 1.24 A company is eligible for a certificate in relation to an eligible game where the company is primarily responsible for the actual development of the game. This would be a company that owns or controls the rights to develop the digital game and that itself undertakes the development of the game. This is regardless of whether the game is a new game or an existing game.
- 1.25 A company that has been engaged to develop the game by the entity who owns or controls the rights to develop the game is also eligible for a certificate in relation to the game if, it is primarily responsible for undertaking activities that are necessary for the development of the digital game in Australia. A company that makes an unauthorised modification of a game is not an eligible company.
- 1.26 Where a company that is responsible for the actual development of the game is part of a consolidated group or a MEC group, due to the operation of those tax rules, the head company for tax purposes may apply for the relevant certificate(s) (see paragraph 1.101).

*[Schedule #, item 2, section 378-20(8) and 378-50 of the ITAA 1997]*

***Example 1.1 Only the company primarily responsible for the development is eligible for the offset***

Choice Pty Ltd is a video game publisher and holds the rights to a wizard adventure game but does not itself have the capability to develop the digital game. Choice Pty Ltd then engages Sprint Games Pty Ltd, a company that specialises in digital game development to develop the game. Sprint Games Pty Ltd engages employees and independent contractors to work on the game and incurs qualifying Australian development expenditure exceeding \$500,000. Sprint Games Pty Ltd is eligible for the offset as the company that has primary responsibility of developing the game.

## Game eligibility

1.27 A game will be eligible for the offset if it is a digital game that has been primarily developed to be made available to the public for entertainment or education purposes. This requirement applies to all three certificates.

1.28 The eligibility requirements require that the digital game be:

- made available for use over the internet; or
- primarily played through the internet; or
- the game operates only when a player is connected to the internet.

This is to ensure the game is made available widely over the internet.

1.29 A digital game is defined in section 995-1 of the ITAA 1997 as a game in electronic form that is capable of generating a display on a computer monitor, television screen, liquid crystal or similar medium that allows the playing of an interactive game. An interactive game is not defined in the Act, but it is generally understood to be a game where the sequence of events is determined in response to the decisions, inputs and direct involvement of the player(s).

1.30 A game which had been refused or is not likely to obtain a classification, or which contains gambling elements or is not a game made for the purposes of entertainment or education is not an eligible digital game. Expenditure on such games cannot be claimed towards a Digital Games Tax Offset.

1.31 A digital game is not eligible if it is:

- a gambling service (within the meaning of the *Interactive Gambling Act 2001*) or substantially comprises gambling or gambling-like practices; or
- a game containing elements that are likely to lead to the game being refused classification under the *Classification (Publications, Films and Computer Games) Act 1995*; or
- a game that is primarily developed for industrial, corporate, or institutional purposes; or
- a game that is primarily developed to advertise or promote a product or entity or service.

1.32 Whether or not a digital game substantially comprises gambling elements will depend on the composition of each game.

1.33 However, the policy for excluding a digital game that substantially comprises gambling or gambling-like practices is intended to also exclude digital games that substantially comprise, have reliance on, or give prominence to, certain types of 'loot boxes'. The Arts Minister will issue guidance to assist taxpayers to understand how the definition of 'substantially comprises gambling elements' including in relation to loot boxes will be applied in practice.

- 1.34 Loot boxes are not defined in the Act, but loot boxes likely to make a game ineligible are understood to expressly allow a player the ability to directly or indirectly purchase with real currency unknown virtual items determined by randomisation or chance and allow, within the game, for those items to be transferred or cashed out for real currency.

**Example 1.2 Games that substantially comprise gambling elements are ineligible**

Gamado Games Pty Ltd develops a slot machine simulator game to be released to the general public for entertainment purposes. The slot machine game would not be an eligible digital game even though it did not involve any real money or money equivalent as it is comprised of gambling-like practices.

However, a few months later, Gamado Games Pty Ltd develops and releases an adventure game in which a player may advance to a higher level by winning a game of poker. The adventure game may be an eligible digital game because that element of the game is not a substantial component of the game.

- 1.35 Eligible games that are complete but not sold or otherwise made available to the general public are not games on which development expenditure can be claimed. For example, a game which is intended to be an in-house interactive training game is not an eligible game. Similarly, an interactive installation at a museum which can only be accessed while onsite is not an eligible game. Games that are released to the general public but are for advertising or promoting an entity, product or service are also ineligible games.
- 1.36 Games which are restricted to one or a very small number of locations such that they cannot be considered to be effectively available to the general public are also ineligible games.
- [Schedule #, item 2, subsection 378-20(7) of ITAA 1997]*

**Certificates for the offset**

*Arts Minister to determine a company's qualifying Australian development expenditure*

- 1.37 When a company applies for a certificate, the Arts Minister will determine in writing, as soon as possible, the total amount of the company's qualifying Australian development expenditure in respect of the completion, porting or ongoing development of a digital game.
- 1.38 The determination is not a legislative instrument. The amount of eligible expenditure that is prescribed on a certificate is the only amount that the company can use when it works out its digital games tax offset in its income tax return.

- 1.39 A company may apply for a completion certificate which relates to a new game, a porting certificate which relates to a game that has been ported to a new platform and/or an ongoing development certificate that relates to an existing game. A certificate in relation to an eligible game is issued by the Arts Minister if certain criteria in relation to the certificate are satisfied.

***[Schedule #, item 2, section 378-25 of the ITAA 1997]***

### *Completion certificate*

- 1.40 The completion certificate is for the development of new games, where eligible expenditure incurred in developing a new game can be incurred over multiple income years. Provided the new digital game is an eligible game, a company may apply for this certificate to access an offset in respect of a particular income year when:

- the game is completed in that income year;
- the company has made an application for a completion certificate in relation to the game for that income year;
- the total of the company's qualifying Australian development expenditure incurred in completing the game (possibly over multiple income years) is at least \$500,000; and
- the Minister is satisfied that the eligibility conditions relating to the company applying for the certificate are met (see paragraph 1.21 above).

- 1.41 Before a company applies for a completion certificate, the digital game must be complete. A digital game is completed when it is first released for sale or otherwise made available to the general public (not merely for testing purposes).

- 1.42 If the company has developed the game under an arm's length contract for another company, the game is considered complete when the first company has handed the game to the second company in a state where it could be reasonably be regarded as ready to be released to the general public. The completion certificate is intended to be available for games that are new and have not yet been released to the public.

- 1.43 A company can only apply for a completion certificate in relation to a new game in the income year in which the game was completed; however, the qualifying Australian development expenditure for this certificate can be incurred across multiple income years before the game is complete.

***[Schedule #, item 2, section 378-20(1) and (2) of the ITAA 1997]***

### *Porting certificate*

- 1.44 A company may apply for a porting certificate in relation to a ported game. A digital game is ported when a game that has already been completed is first made available to the general public (not merely for testing purposes) on a new platform.
- 1.45 Provided the ported digital game is eligible, once it is ported, a company may apply for a porting certificate to access the offset in respect of a particular income year when:
- the game is ported in that income year; and
  - the company has made an application for a porting certificate in relation to the game for that income year; and
  - the total of the company's qualifying Australian development expenditure incurred in porting the game is at least \$500,000 (possibly incurred over multiple income years); and
  - the Minister is satisfied that the conditions relating to the company applying for the certificate are met (see paragraph 1.21 above).
- 1.46 If a company has ported a game under an arm's length contract with another company, the game is considered to be ported where the first company has handed the ported game to the second company.
- 1.47 This certificate is intended for a completed game that is ported onto a new platform, and it covers the qualifying Australian development expenditure that is incurred in porting the game.
- 1.48 The games is considered ported when the game is first released to the public or, where the game is developed under an arm's length contract, when the company first provides the ported game in a state where it could reasonably be regarded as ready and available to the general public on the new platform – whichever event is earlier.

***[Schedule #, item 2, subsections 378-20(3) and (4) of ITAA 1997]***

### *Ongoing development certificate*

- 1.49 A company can apply for an ongoing development certificate for an income year in relation to the ongoing development of one or more digital games. Ongoing development means activities undertaken to update, expand or improve a digital game that has already been completed. This development activity can include the addition of new levels, maps, characters, vehicles, storylines, cosmetic items, addressing 'bugs' or porting to new platforms. The ongoing development certificate can be claimed with respect to expenditure on multiple eligible games incurred in the income year to which the certificate relates.

- 1.50 A company may apply for the ongoing development certificate in relation to a particular income year if:
- Ongoing development occurs in relation to eligible games in that income year;
  - the total of the company's qualifying Australian development expenditure on the ongoing development of the games in the income year is at least \$500,000.
  - the Minister is satisfied that the conditions relating to the company applying for the certificate are met for each game that expenditure is claimed in relation to (see paragraphs 1.27 to 1.36).
- 1.51 Unlike the completion and porting certificates, the ongoing development certificate allows a company to claim qualifying Australian development expenditure on multiple eligible games in the same income year towards its \$500,000 threshold.
- 1.52 However, the company can only claim qualifying Australian development expenditure in the income year it was incurred. This makes it different to the completion and porting expenditure that can be recognised in respect of multiple income years.

***[Schedule #, item 2, section 378-20(5) and (6)]***

***In the case of expenditure on porting, companies can choose which certificate is most suitable for their circumstances***

- 1.53 Expenditure related to porting a game to a new platform that occurs before that game has been completed can still be claimed under a completion certificate; similarly, expenditure related to porting an existing game can still be claimed under an ongoing development certificate, at the discretion of the applicant company.
- 1.54 There are situations where the porting of a game and the porting expenditure is eligible for either the completion certificate (for example, a game being simultaneously developed for multiple platforms), porting certificate (a one-off discrete port from an existing platform to another platform) or the ongoing development certificate (porting an existing game to one or more platforms over time). The company may choose between the three depending on the circumstances around the development of the game.
- 1.55 One of the factors that would inform the choice of certificate is when the qualifying Australian development expenditure in relation to the game is incurred. Eligible expenditure can be incurred across multiple income years if a company is applying for a completion or porting certificate in relation to the income year in which the game was complete or ported. However, eligible expenditure in relation to an ongoing development certificate (see paragraph 1.49) can only be incurred in relation to the income year in which the company is applying for the certificate, but accrued across multiple game titles.



**Example 1.3 Porting expenditure may be eligible for a porting or ongoing development certificate**

Nordegry Games Pty Ltd develops a sporting game for release on PC. The game was very popular and in future income years, Nordegry Games Pty Ltd ports the game from PC to Playstation. In porting the game, Nordegry Games Pty Ltd incurs \$600,000 in qualifying Australian development expenditure over multiple income years. Nordegry Games Pty Ltd may apply for a porting certificate.

Due to its success in porting its sports game, Nordegry Games Pty Ltd ports its adventure game from PC to Playstation. Nordegry Games Pty Ltd incurs \$400,000 in qualifying Australian development expenditure in a single income year. In the same income year, Nordegry Games Pty Ltd incurred \$150,000 in expanding and updating its sporting game. Nordegry Games Pty Ltd cannot apply for a porting certificate for the adventure game as the \$500,000 threshold has not been met. Nordegry Games Pty Ltd can apply for an ongoing development certificate for both the adventure game and sporting game, as the \$500,000 threshold for the income year has been met across multiple eligible game titles.

## Eligible Expenditure

### Development expenditure

- 1.56 Development expenditure is defined in section 378-30 of the ITAA 1997. Expenditure that is development expenditure is intended to cover expenditure that a company incurs in the development of a game. Some items of expenditure that may fit that definition are specifically excluded. Similarly, some items of expenditure that may fall outside that general definition are included.

#### *General test*

- 1.57 The general test for development expenditure in relation to a digital game is any expenditure that a company incurs in or in relation to the development of the game.
- 1.58 A company develops a game by doing any of the activities necessary to complete, port, expand or improve an eligible game. Subject to the specific inclusions and exclusions, expenditure will count as development expenditure when it has been incurred, which can be a different time to when a payment actually occurs. This will allow expenditure to count on accruals basis as some part of the payment for developing game may be unpaid at a particular time, for example at the time of completion.

**[Schedule #, item 2, section 378-30(1) of the ITAA 1997]**

**Specific inclusions**

- 1.59 Without limiting the general test for development expenditure, the specific inclusions are targeted to support the type of expenditure that contributes to the growth of the digital games industry. The purpose of this provision is to provide certainty to the company that claiming such expenditure will be eligible in the calculation of the offset by explicitly listing activities that would be expected to be directly relevant to the development of an eligible game.
- 1.60 Specific inclusions for development expenditure includes:
- remuneration provided to employees and independent contractors engaged by the company who carry out work in connection with the development of the game. The legislation lists the specific development roles that are included in this item, but is described broadly by including technical coding roles, project management roles and creatives.
  - expenditure on research for the game;
  - expenditure on prototyping for the game;
  - expenditure on user testing, debugging, and collecting user data for the game;
  - expenditure on updating the game; and
  - expenditure on obtaining or maintaining a classification under the *Classification (Publications, Films and Computer Games) Act 1995*.
  - expenditure on adapting the game for use on particular platforms.

**[Schedule #, item 2, section 378-30(2) of the ITAA 1997]**

**Specific exclusions**

- 1.61 Similarly, to improve certainty for the applicant company, there are a number of specific exclusions for expenditure that will not be eligible to be included as development expenditure, even if the expenditure is captured by the general test. The specific exclusions are to ensure that only activities that are directly, clearly and unambiguously related to the game development activity are counted as development expenditure for the purpose of this offset. The exclusions in this section are fundamental to delivering the policy intent of this measure by focusing eligible expenditure on game development jobs and not subsidising expenditure that is merely incidental or unrelated to game development activity.

**[Schedule #, item 2, section 378-30(3) of the ITAA 1997]**

- 1.62 Expenditure on further subcontracting for the development of the game is excluded as an integrity measure. Expenditure incurred by the primary

development company engaging an independent contractor is eligible expenditure; however, under this provision, if that independent contractor further sub-contracts then the expenditure on the independent contractor is no longer eligible expenditure. Without this provision, an entity could engage in complex structuring arrangements that would be able to circumvent other integrity rules, including those relating to excluding expenditure to related parties. This provision helps ensure that the offset remains targeted at companies that are directly responsible for the development of the game, whilst retaining sufficient flexibility for those companies to source specialist or creative goods and services, but avoids creating integrity risks.

- 1.63 Expenditure incurred on activities that are incidental to, but not directly attributable to, the development of the game is excluded. Common examples in the games industry of such expenditure includes expenditure on social media managers, forum administrators or moderators.
- 1.64 Company's general business overheads are excluded. This includes expenditure on ongoing or operating business expenses because they are not reasonably attributable to activities developing a particular game. The reason for this exclusion is that the offset is not intended to support fixed or corporate costs a company may incur whilst carrying on its development business.
- 1.65 Development expenditure also excludes expenditure incurred on or in connection with engaging employees and contractors:
- whose roles are not related to the development of the game such as administrative employees; and
  - who were not Australian residents at the time the expenditure was incurred, in order to promote employment in Australia and to provide consistent eligibility between employment and the purchase of goods and services in Australia.
- 1.66 Employees and contractors have to be Australian tax residents at the time expenditure on them was incurred – this is consistent treatment with the expenditure on Australian goods and services, and promotes employment in Australia which is a key policy objective of the offset. Whether or not an employee or contractor was an Australian resident takes on its ordinary meaning in the context of the tax law.
- 1.67 Any expenditure on travel, accommodation, catering, entertaining or hospitality expenditure for employees, regardless of whether their roles are directly and substantially related to the development of the game or not is excluded.
- 1.68 Expenditure on marketing, advertising or promotion of the game or company is excluded. For example, press expenses, photography, public relations and similar expenses.

- 1.69 Expenditure on purchasing or renting computer hardware and servers is excluded as it does not directly contribute to employment in the games development industry.
- 1.70 Expenditure incurred on software, to acquire copyright, or a license in relation to copyright is also excluded. Expenditure on accessing existing copyrighted material – as opposed to the creation of new works – is not new game development activity.
- 1.71 Expenditure incurred on the use of land or premises, for example on rent is excluded.
- 1.72 Expenditure incurred by way of or in relation to financing of the game or company is not development expenditure. This exclusion will specifically cover interest, or other returns, on amounts invested in the game or company and costs connected with raising and servicing finance for the game or company.
- 1.73 Expenditure incurred in relation to insurance, audit services, accounting services, recruitment services and legal services is excluded even if the expenditure relates to the game.
- 1.74 Any expenditure (even if it satisfies the general test) that:
- is claimed for the purposes of another tax offset, including for the purposes of section 355-100 (tax offsets for R&D); or
  - gives rise to notional deductions for the purposes of section 355-205 (about deductions for R&D expenditure);
- is excluded. Similarly, expenditure claimed for the DGTO cannot also be counted towards the R&D intensity test.
- 1.75 This means that if a company has used its expenditure incurred in developing the game towards either claiming an R&D Offset or towards the intensity test in relation to the R&D offset, the expenditure cannot be also claimed as development expenditure. This treatment recognises that the government is already providing an incentive for companies to engage in R&D activity, and such expenditure cannot be double-counted for the purposes of the Digital Games Tax Offset.
- 1.76 Expenditure incurred in relation to applying for the digital games tax offset, or any assistance programs administered by the Commonwealth or the States is excluded. If a company is receiving assistance in developing a game from an Australian Government agency, such assistance does not preclude eligibility for the offset.
- 1.77 There are two specific exclusions that are integrity measures. These exclusions are for expenditure incurred:

- in connection with a transaction in which the company and another party to the transaction did not deal with each other at arm's length; and
  - in relation to an entity that is not wholly independent from the company.
- 1.78 'Arm's length' is defined in section 995-1 of the ITAA 1997 to mean that when determining whether parties deal at arm's length, consider any connection between them and any other relevant circumstance. However, 'wholly independent' is not defined and takes on its ordinary meaning. Whether or not the expenditure will be excluded under these provisions will be a matter of fact and degree.
- 1.79 Where the company incurs expenditure directly or indirectly under an arrangement and any parties to the arrangement did not deal with each other at arm's length, there is no apportionment - the whole amount is excluded. This treatment provides a powerful disincentive to engage in non-commercial transactions which would have the unjustifiable effect of increasing the amount of eligible expenditure and the tax offset.
- 1.80 For instance, an example of expenditure that would fail an arm's length test is where an independent contractor is obligated to source goods and services (such as a game engine) from a particular provider at inflated prices, which if not prevented under this section would artificially increase the amount of offset provided to the company. In such circumstances, all the expenditure will be excluded.
- 1.81 Similarly, expenditure incurred in relation to an entity that is not wholly independent from the company is totally excluded. An entity may not be wholly independent on the basis of a range of factors, including the degree of influence it may be under, due to common ownership, or due to the personal relationships of key individuals. Given the scope that related parties have to determine non-commercial prices and relationships that would affect the amount of eligible expenditure, this treatment provides a powerful disincentive to engage in transactions with related parties. Nevertheless, a company is not prevented from engaging in a transaction with a related party; it is only unable to claim such expenditure as eligible expenditure under the DGTO.
- 1.82 Expenditure incurred on distributing the game is excluded. It is not expenditure that is generally incurred in developing the game.
- 1.83 Expenditure incurred acquiring users for the game is excluded.
- 1.84 Expenditure incurred on acquiring or licensing software is excluded.
- 1.85 Expenditure incurred on obtaining permission to use the image, likeness or a person or entity, or obtaining an endorsement by a person or entity is excluded.

- 1.86 Expenditure incurred on recruitment including visas or work permits is excluded. This expenditure may be incidental to engage an employee or contractor specifically included in this division; however, this expenditure is generally not incurred in developing the game.
- 1.87 Where a depreciating asset has declined in value and the decline in value may be attributable to the use of the asset in the development of the game, the legislation makes clear that you cannot claim the decline in value as development expenditure in relation to a game.

*[Schedule #, item 2, section 378-30(3) and (4) of the ITAA 1997]*

### **Qualifying Australian development expenditure**

- 1.88 The amount of a company's digital games tax offset is 30 per cent of a company's total qualifying Australian development expenditure. This expenditure is a subset of a company's development expenditure.
- 1.89 If a company has incurred an item of development expenditure, that item can be claimed as qualifying Australian development expenditure if it is incurred for, or is reasonably attributable to, goods and services provided or acquired in Australia. This test connects particular items of development expenditure to Australia, thereby promoting opportunities for Australian taxpayers and for the Australian digital games industry, which is the major purpose of the digital games tax offset.
- 1.90 An item of expenditure will be able to be fully claimed as qualifying Australian development expenditure if it is substantially attributable to developing the game. Substantially attributable is intended to mean that a large portion of an item of expenditure, such as 90% or more, can be in fact attributable to the development of the game. For instance, an employee may be developing an eligible game 90% of their time, but she also attends meetings, training and team-building activities that account for the remainder of her time – the purpose of this provision is that all of the expenditure on that employee is eligible for the purposes of the DGTO, rather than requiring complex and burdensome time accounting arrangements for the company.
- 1.91 If an item of expenditure is directly but may be in part - but not substantially - attributable to developing the game, the item is claimable to the extent that the expenditure is attributable to developing the game. For instance, where an employee is developing both an eligible game and an ineligible game, only the expenditure in relation to the eligible game is claimable.
- 1.92 These rules avoid unnecessary apportionment of an item of expenditure where the item is substantially incurred for the development of the game and ensures an appropriate balance between administrative complexity and proper targeting of the measure.

*[Schedule #, item 2, sections 378-35(1) and (2) of the ITAA 1997]*

*Where a company can no longer claim qualifying Australian development expenditure*

- 1.93 There are certain points in the development of a new game, or the porting of an existing game, where a company can no longer claim expenditure on that game as qualifying Australian development expenditure.
- 1.94 In relation to a completion or a porting certificate, if expenditure would otherwise be qualifying Australian development expenditure but is incurred after the earlier of the following events:
- the day on which the game is completed or ported;
  - the date on which the company applies for a completion or porting certificate in relation to the digital game; or
  - the date on which the completed or ported digital game has been available to the public for the purposes of conducting testing for one year;

that expenditure is not qualifying Australian development expenditure. This condition ensures there is an appropriate event – which is clearly discernible and under the control of the company – where it would be unreasonable for the company to continue to incur qualifying Australian development expenditure with respect to a completion or porting certificate. This relates only to expenditure, it does not otherwise affect when the game is complete or ported for the purposes of subsections 378-20(2) and (4), see paragraphs 1.38 – 1.45.

*[Schedule #, item 2, section 378-35(3) and (4) of the ITAA 1997]*

- 1.95 In a situation where you have incurred development expenditure for porting a game that could count as qualifying Australian development expenditure for either the porting certificate or the ongoing development certificate, the expenditure can only be counted as qualifying Australian development expenditure under one certificate.

*[Schedule #, item 2, section 378-35(5) of the ITAA 1997]*

*Amount of expenditure does not include GST*

- 1.96 The amount of expenditure for the purposes of the offset does not include GST.

*[Schedule #, item 2, section 378-45 of the ITAA 1997]*

*Deductibility of qualifying Australian development expenditure*

- 1.97 Although used to calculate the amount of the digital games tax offset, qualifying Australian development expenditure may still be deducted in accordance with and subject to Division 8 of this Act. Generally, this means that eligible expenditure for the digital games tax offset remains deductible for company income tax purposes, thereby ensuring that the digital games tax offset remains additional and effective.

*Expenditure incurred by a prior company*

- 1.98 In some cases, a company will take over the development of a game from another company (which may itself have taken over the development of the game from another company, and so on). In those cases, each company developing the game is taken to have incurred the development expenditure of the previous companies. Its development expenditure excludes, then, any expenditure incurred to enable it to take over the development of the game (taking over is not part of actually developing the game, in the same way that, financing, promoting and distributing the game are not part of making the game).

*[Schedule #, item 2, sections 378-40 of the ITAA 1997]*

## Administration of the Digital Games Tax Offset

### **Certification**

- 1.99 The certification process is the same for all the three certificates. The offset is administered by the Arts Minister.

#### *Requirements for certification*

- 1.100 Once a digital game is completed, ported or the company has finished incurring its development expenditure for the income year, the company may apply to the Arts Minister for a certificate in relation to the offset. A certificate allows the applicant to receive the offset provided by the certification, calculated with reference to the game's qualifying Australian development expenditure.
- 1.101 A company may apply for a certificate or certificates depending on its development activity. Where the company that undertakes the development of the game is a member of a consolidate group or a MEC group, the head company of the consolidated or MEC group may apply for the certificate in relation to the development of the game. This is due to the operation of the single entity rule outlined in section 701-1 of the ITAA 1997 which provides that, in working out a group's tax liability, the actions of all subsidiaries of a group are taken to be the actions of the head company. For example, the game development activity undertaken by a subsidiary company in a group will be taken to be undertaken by the head company when working out the head company's tax liability.

*[Schedule #, item 2, section 378-50 of the ITAA 1997]*

- 1.102 Certification requires that the Arts Minister is satisfied of a number of requirements. The Arts Minister must be satisfied that the digital game is completed, ported or ongoing development activities have been completed.



- 1.103 Additionally, the Arts Minister will determine the form of the application in the rules (see paragraph 1.108-1.109) issued by the Arts Minister for that purpose. A company must determine if it satisfies the eligibility requirements including the residency requirements.

#### *Issuing of a certificate*

- 1.104 For a company to be entitled to the digital games tax offset for a game, the Arts Minister must have issued a certificate for the game. Further, the Arts Minister will determine the level of qualifying Australian development expenditure for the certificate being applied for. Allowing the Arts Minister to determine the qualifying Australian development expenditure will provide certainty to applicants as to the amount of offset claimable under each certificate. A determination of qualifying Australian production expenditure is not a Legislative Instrument within the meaning of the *Legislative Instruments Act 2003*.
- 1.105 Any certificate that the Arts Minister issues is expected to be in writing, to state the company's ABN, the date of issue of the certificate, that the game is eligible for the offset and the company's qualifying Australian development expenditure.
- 1.106 The Arts Minister must notify the Commissioner of the issue of the certificate within 30 days, and will give the company's name and address, the qualifying Australian development expenditure determined by the Arts Minister, and such other information as the Arts Minister and the Commissioner agree.  
*[Schedule #, item 2, section 378-60 of the ITAA 1997]*

#### *Revocation and refusal of certificates*

- 1.107 The Arts Minister will have the power to revoke the certificate if the issue of the certificate was obtained based on inaccurate information, fraud or by serious misrepresentation. If a certificate is revoked, it is taken to have never been issued. As such, revocation will have the effect of requiring full repayment of any offset given through a tax return process.
- 1.108 Where a certificate is either not issued or revoked, the Arts Minister must give written notice to the company to which the certificate was issued including reasons for the decision.
- 1.109 If the Arts Minister decides not to issue a certificate, the company seeking a certificate must receive written notice of that decision including reasons for that decision.
- 1.110 The decision not to issue a certificate, and a decision to revoke a certificate or amend a certificate, is a decision which is reviewable by the AAT on application by the company the interests of which have been affected. A determination of qualifying Australian development expenditure by the Arts Minister is also a matter which can be reviewed by the AAT.

- 1.111 The notice of refusing to issue a certificate or to revoke a certificate and determination of qualifying Australian development expenditure need not set out the findings of material questions of fact, refer to the evidence and other material on which the findings were based or the reasons for the decision. The notice must, however, include advice that an application can be made to the AAT and that a statement outlining the above matters (unless reasons have already been supplied) may be requested. A failure by the Arts Minister to comply with these obligations will not, however, affect the validity of the decision to refuse to issue a certificate or to revoke a certificate or the determination of the qualifying Australian development expenditure.
- 1.112 Where a certificate issued to a company has been revoked under section 378-205 or amended under section 378-230, the income tax assessment of the company will need to be amended to reflect the revocation or amendment. The relevant period in which the Commissioner may amend assessment will be during a period of four years starting immediately after the revocation or amendment of the certificate.  
***[Schedule #, item 2, sections 378-55, 378-65, 378-75, 378-80, 378-90 and 378-95 of the ITAA 1997]***

#### *Rule-making powers*

- 1.113 The Arts Minister may make rules by legislative instrument for determining administrative requirements for applications for certificates for the offset, including:
- the application form;
  - type of information to be provided;
  - methods of verification of that information; and
  - procedures around the provision of supplementary or additional information that the Arts Minister.
- 1.114 The Arts Minister may also make rules that will outline how amendments of certificates are to be made including the circumstances in which an amendment may be requested and the form in which the request of the amendment may be made.  
***[Schedule #, item 2, section 378-85 of the ITAA 1997]***

#### *Digital game to be made available to the National Film and Sound Archive of Australia*

- 1.115 A company that has been issued with a certificate under section 378-20 must make a copy of the digital game named in the certificate available to the National Film and Sound Archive of Australia. The game must be made available with any ancillary items that would generally be available for sale to the public. The National Film and Sound Archive of Australia does not have to

accept a game despite the game being made available to it.  
*[Schedule #, item 2, section 378-100 of the ITAA 1997]*

## Consequential amendments

- 1.116 The consequential amendments are made in relation to section 995-1 of the ITAA 1997 affecting:
- the definition of development expenditure as it applies to films and games; and
  - the insertion of digital game, ongoing development, ported and qualifying Australian development expenditure into the dictionary of the ITAA 1997.

*[Schedule #, items 3 and 4, section 995-1 of the ITAA 1997]*

## Commencement, application, and transitional provisions

- 1.117 The amendments commence on the first 1 January, 1 April, 1 July or 1 October to occur after the day this Act receives the Royal Assent.
- 1.118 The amendments apply in relation to expenditure incurred by a company on or after 1 July 2022.
- 1.119 Only expenditure incurred after 1 July 2022 on a new game or ported game can be claimed with respect to a completion or porting certificate.
- 1.120 Only expenditure incurred after 1 July 2022 in relation to the ongoing development of an existing game can be claimed with respect to an ongoing development certificate. The game to which the expenditure relates can be a game that has been released before 1 July 2022.
- 1.121 When goods and services are considered incurred could be different to when they are actually paid for or received.

*[Schedule #, item 5]*