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Screen Producers Australia's submission to the *Digital Games Tax Offset – Exposure Draft Legislation*

About Screen Producers Australia

Screen Producers Australia (SPA) was formed by the screen industry businesses representing large and small enterprises across a diverse production all forms and formats of screen content.

As the peak industry and trade body, we consult with a membership of more than 800 production businesses in the preparation of our submissions. This consultation is augmented by ongoing discussions with our elected Council and members. Our members employ hundreds of producers, thousands of related industry practitioners and drive between \$1 billion and \$2 billion worth of annual production activity from the independent sector.

SPA's members are drawn from all elements of the Australian production ecosystem, including emerging and established producers, production businesses, services and facilities. Our members vary in size from large internationally owned entities, to partnerships, to sole traders and other corporate entities, and are found in every region, state and territory of Australia.

SPA's membership includes a number of screen producers who are actively involved in games development. The Australian video games industry is a screen industry success story and last financial year was worth more than \$226 million in revenue. SPA welcomes the Australian Government's recognition of the need for development and production support for this important and growing sector.

On behalf of these businesses, we are focused on delivering a healthy commercial environment for the entire screen industry through ongoing engagement with elements of the labour force, including directors, writers, actors and crew, as well as with broadcasters, distributors and government in all its various forms. This coordinated dialogue ensures that our industry is successful, employment levels are strong and the community's expectations of access to high quality Australian content have been met.

Screen Producers Australia welcomes the opportunity to submit to the *Digital Games Tax Offset Exposure Draft Legislation* (the 'DGTO').

For further information about this submission please contact Jane Mulligan, Policy Consultant (jane.mulligan@screenproducers.org.au)

Executive Summary

- SPA welcomes the Australian Government's recognition of the need for development and production support for this important and growing sector.
- SPA have welcomed the opportunities to consult with officials and to receive detailed briefings for members.
- The SPA submission identifies a number of issues raised by our members, and asks for these to be given consideration before the Legislation progresses further.
- However, given the delays since this offset was first announced, industry remains keen for the swift introduction and passage of this legislation.

Recommendations

1. SPA recommends that the threshold of development expenditure of \$500,000 in any income year be lowered so as not to exclude small games developer businesses.
2. SPA recommends a review process takes place within two-three years of operation of the DGTO to identify any unintended consequences or problems for the sector and to provide the opportunity to address these without delay.
3. SPA recommends that consideration is given to the inclusion of a level of administrative overhead costs, by relative apportionment of administrative overhead costs, as has been the longstanding case with the R+D Tax Rebate for decades.
4. SPA asks that the exclusion of subcontracting arrangements is reconsidered as SPA believes that this is highly restrictive for the sector and does not recognise the high level of subcontracting that characterises the screen industry.
5. SPA recommends that more flexibility is provided for "related party expenditure", rather than a blanket exclusion.
6. SPA recommends that either a cap of the level of administrative expenditure that counts towards eligible expenditure is instituted or, alternatively, that the DGTO creates a SME-specific tier where total budget is below \$5 million and in which directors and shareholders wages would be eligible.
7. SPA recommends that a definition of "interactive game" be included in the legislation and that it addresses the broad nature of gameplay that is inclusive of concepts of interactivity, linearity, inputs and users.

Introduction

SPA welcomes the publication of the Digital Games Tax Offset (DGTO) Exposure Draft Legislation.

This legislation has been keenly anticipated from the gaming industry, since being announced in the 2020-21 Budget.

SPA have welcomed the opportunities to consult with officials from the Office of the Arts and to receive detailed briefings for members which has provided the opportunity to discuss the legislation in detail and understand the administrative process that supports this. SPA itself has had the opportunity to consult with its members and receive their feedback on the DGTO.

Games development is a vibrant and critical part of our overall creative and knowledge economies, making a significant contribution to jobs and investment.

SPA believes that the new incentive will provide much needed support for games development and brings it into alignment with the other elements of our screen content industry which are already supported by incentives through the tax system.

Tax incentives have proven their ability to support success and sustainability in the film and television sectors, and the expansion of this support to cover games development will aid many SPA members who incorporate games and interactive media into their overall content slates.

SPA also believes that this will also make Australia more competitive on the international stage and incentivise economic activity, job creation, business success and exports.

However, there are a number of critical issues arising from the DGTO Exposure Draft Legislation that SPA has identified and which can be addressed and asks Treasury to give these some consideration before the Bill moves forward.

Comments on specific clauses

Development expenditure threshold

SPA notes that in Section 378-20 that each of the certificates requires that development expenditure reaches a threshold of \$500,000 in any income year.

SPA submits that for some games developers that this threshold will be considered high and may inadvertently exclude many smaller games development businesses that operate below this level.

SPA asks that this threshold be reviewed and that consideration be given to a lower level of expenditure.

Definition of “completed

SPA notes that the definition of “completed” (clause 378-20(2)) is when the game is first released to the public.

SPA anticipates that this could be problematic for Australian contractors providing development services to international companies who may delay the public release of the game to which the Australian contractor has contributed.

At this stage, SPA notes this issue and reserves the option of revisiting it if serious issues emerge as the DGTO establishes itself in the industry.

SPA suggests it would be prudent to include a review process to take place within two-three years of operation of the DGTO to identify any unintended consequences or problems for the sector and to provide the opportunity to address these without obstacle.

Development Expenditure Inclusions

SPA notes that the inclusions for development expenditure (Clause 378-30 (1)) are very specific and highly defined and further notes that this clause operates in conjunction with the exclusions specified in Clause 378-30 (3).

We understand that the games industry advocated for simple and clear rules. SPA also notes that around 90% of games development expenditure is on wages, research, prototypes, de-bugging and obtaining and maintaining classifications and that these are covered by the list of inclusions and not excluded.

SPA also notes that if expenditure is not specifically excluded, then it is considered included as “development expenditure”.

Development Expenditure Exclusions

General business overheads – Clause 378-30(3)(c)

The proposed complete exclusion of all the company’s general business overheads is difficult for the games sector as these costs form part of the foundational costs of being a business operation. This is a harsh and extreme measure and the rationale for this is unclear.

SPA suggests that further consideration is given to the relative apportionment of overheads, as has been the longstanding case with the R+D Tax Rebate for decades. This is a straightforward calculation that is determined by the proportion of wages spent on eligible R+D to the total wages of a company and then using that percentage to apply to fixed overheads such as rent, electricity, computer software licenses, equipment rental etc.

The integrity of the DGTO could easily be maintained through additional measures such as a limited list of directly related overhead expenditure but to exclude these common business costs in their entirety is both extreme and harsh.

Subcontracting - Clause 378-30(3)(d)(i)

SPA notes that regarding remuneration provided to contractors that under clause 378-30(3)(d)(i) that remuneration paid to subcontractors is excluded as “development expenditure”.

As contracting and subcontracting arrangements for aspects of games development are a key feature of the industry, SPA believes this provision to be highly problematic for the sector.

SPA asks that the exclusion of subcontracting arrangements is reconsidered as SPA believes that this is highly restrictive for the sector and does not recognise the high level of subcontracting that characterises the screen industry.

Australian residency requirements – Clause 378-30((3)(d)(ii)

SPA notes that the expenditure on employees and contractors is eligible only if these people are Australian residents and that this differs from requirements of other screen industry incentives such as the Location and Producer Offsets.

This differential may cause confusion amongst producers who are more familiar with the existing incentives and offsets and SPA asks that this matter is made explicit in the DGTO Rules.

Related entity and “arms length” expenditure – Clause 378-30(3)(o)-(p)

SPA notes that under this clause that any expenditure which is between related parties is excluded expenditure. This is problematic for the games sector for a number of reasons and ignores the collaborative nature of the industry which is made up of a number of small niche contributors.

In small and medium sized businesses, the owners of the company are very often heavily involved in a project. While SPA understands to objective of quarantining administrative costs from eligible expenditure, this ignores the common situation in which owners of the company, particularly in small and medium sized companies are very often fulfilling key crew roles on the project and hence should be entitled to claim expenditure accordingly.

One solution to this issue is to simply place a cap of the level of administrative expenditure that counts towards eligible expenditure. Alternatively, the DGTO could create a specific SME tier where total budget is below \$5 million and in which directors and shareholders wages would be eligible.

Given the strong SME characteristics of the games industry sector and the options to address this issue without disadvantaging them, SPA asks that this matter be given further consideration.

Definition of “interactive game”

Despite the qualifying material in the Explanatory Memorandum to the Bill, the lack of definition of “interactive game” and the vague “generally understood” proposition creates uncertainty and raises a number of issues.

The rationale for defining a “digital game” but not defining an “interactive game” is unclear and SPA suggests that a definition of interactive game also be included in Section 995-1 of the Act rather than remaining in the loose and contestable realm of “generally understood”.

SPA also asks that the following issues be addressed in the development of a definition of “interactive game”:

“Sequence of events”

- “Sequence of events” implies a connection to non-linearity which is not mutually exclusive to games. This is highlighted in the following article:

A [video game](#) with **nonlinear gameplay** presents players with challenges that can be completed in a number of different sequences. Each player may take on (or even encounter) only some of the challenges possible, and the same challenges may be played in a different order. Conversely, a video game with **linear gameplay** will confront a player with a fixed sequence of challenges: every player faces every challenge and has to overcome them in the same order.¹

- This points to an issue with the concept of “sequence of events” as a criteria for consideration as an interactive game. Linear and Non Linear gameplay can be considered as a style of gameplay.
- A more acceptable concept could refer to “consumption of the content”. This would avoid the potential for only non linear and sandbox style games to be considered eligible.

“Decisions, inputs AND direct involvement”

- The phrase “decisions, inputs AND direct involvement” should be more inclusive and not require that all these elements are required. The current understanding is unnecessarily restrictive and could be changed so that “and” is replaced with “or”. This would ensure an inclusive concept of “interactive game” that would be free from unintended consequences for the sector.

“Player”

- Replacing “Player” with “User” would be a more accepted term in nomenclature for the digital sector.

¹ “Nonlinear gameplay”, downloaded from https://en.wikipedia.org/wiki/Nonlinear_gameplay