

***Pre-Budget
Report 2009
TIGA's Submission***

1. Introduction

TIGA is the trade association representing the UK video games industry. The majority of our members are either independent video game developers or in-house publisher owned developers. We also have outsourcing companies, technology businesses and universities amongst our membership. TIGA's vision is to make the UK the best place in the world to do games business. We focus on three sets of activities: political representation, raising our industry's profile and developing services that enhance the competitiveness of our members. This means that TIGA members are effectively represented in government and parliaments, their voice is heard in the media and they receive benefits that make a positive material difference to their businesses, including a reduction in costs and improved commercial opportunities.

The Pre-Budget Report gives the Government an opportunity to establish an environment in which businesses that generate Intellectual Property (IP) can flourish. IP businesses raise revenue for the Government.

Creative industries often deliver faster growth in Gross Domestic Product (GDP) than other sectors.^[1] For instance, the DCMS noted in its Creative Industries Fact File in 2002: "The Creative Industries are a significant contributor to the UK economy - accounting for 7.9 per cent of GDP, and growing significantly faster than the economy as a whole."^[2]

The video games industry is a creative industry par excellence with a significant potential to generate IP. TIGA's submission of proposals to the Government in advance of the Pre-Budget Report on December 9th 2009 aim to power the growth of the UK video games industry, thereby benefiting the wider UK economy.

2. Macro-economic policy

Like most UK firms, games businesses need a relatively stable macro-environment within which to prosper and grow.

Fiscal policy should be gradually tightened – details should be published in the Pre-Budget Report and implemented over the remainder of this Parliament and during the next Parliament. The public finances have deteriorated as tax receipts have plummeted and public expenditure soared. Public spending has soared from 2000, rising from 36.3 per cent of Gross Domestic Product (GDP) to 47.6 per cent. This year the Government is expected to borrow £175 billion, equivalent to 12.4 per cent of GDP.^[3] Debt servicing costs will increase by more than 50 per cent next year, almost equal to the entire defence budget.^[4] The size of the UK's budget deficit is highly alarming. The deficit must be brought under control as soon as practically possible. Otherwise the UK could lose its triple AAA credit rating.^[5] If this happened, the cost of servicing the budget deficit would increase.

The fiscal adjustment should take the form of lower public expenditure rather than increases in taxation. Lower government spending, particularly government consumption spending, increases economic growth.^[6] Real increases in public spending should be funded through productivity gains. In principal the scope for productivity gains should be substantial. Public sector productivity actually fell by an average of 0.3 per cent per annum between 1998 and 2007.^[7] Higher taxes can reduce economic growth by damaging the supply side of the economy.^[8] Therefore, there should be no increases in business taxation in the forthcoming Pre-Budget Report. Broadly speaking taxes should be kept relatively simple, stable and low. TIGA's Pre-Budget Report Submission suggests some specific tax proposals below.

Conversely, monetary policy should be kept relatively loose. Indeed, a tight fiscal policy will enable monetary policy to be more relaxed than would otherwise be the case. If demand pressures are curtailed through a strict fiscal policy, then the Bank of England will be able to keep base rates comparatively low, while aiming to hit its inflation target of 2 per cent on the Consumer Prices Index. This is good for business, including the games development sector. 48 per cent of games developers rely on bank overdrafts to finance their operations.^[9]

A looser monetary policy could also help to keep sterling relatively competitive, other things being equal. This would help UK exporters, including video games developers. On average, 46 per cent of UK game developers' turnover is generated from the export of games.^[10]

3. Specific tax policies

3.1 Games Tax Relief^[11]

Proposal

A Games Tax Relief should be introduced, with the following attributes:

- Eligibility for the Games Tax Relief would cover any company within the scope of UK Corporation Tax.

Video games would need to pass a cultural test, scoring against criteria of European heritage and game locations, languages, innovation, narrative, and location of development and key development staff.

- The Games Tax Relief would be calculated and applied in a similar way to the existing tax relief for British films. A development company

would be entitled to an additional deduction in computing their taxable profits equal to the UK expenditure incurred in developing a game, or 80 per cent of the total expenditure incurred in developing a game, whichever is the lower. The development company would then be entitled to a tax credit calculated on the amount of the deduction, which it would either be set off against the income from the game or recovered as a payment from HMRC.

- The Games Tax Relief should have three tiers of benefit: 20 per cent of core expenditure for budgets above £6,000,000, 25 per cent for budgets over £3,000,000 but less than £6,000,000 and 30 per cent for budgets of over £100,000 but under £3,000,000. The three tiers are designed to reflect average production budgets of video games on different games platforms, and correspondingly different sizes of company.
- An independent organisation with knowledge and experience of video games production would administer the cultural tests, checking submission criteria are met and policing the Relief. It would issue interim certificates or letters of comfort confirming a product has passed or provisionally passed the cultural test to ensure candidate projects are funded.

Reason

Overseas government support for video games development over the last decade has created an increasingly uneven international playing field, making it difficult for UK games developers to compete. Between July 2008 and July 2009 the headcount at British video games studios fell by 4 per cent, and 15 per cent (44) of British video games development studios, publishing and service companies went out of business. Yet global industry sales grew by 20 per cent in 2008 compared to 2007. In turn, between July 2008 and July 2009 the UK video games industry's contribution in tax revenues to the Exchequer fell by £17 million and the sector's contribution to Gross Domestic Product (GDP) declined by £41 million.

British-made video games are facing a long-term decline in the global sales charts, despite a record 2008. The UK is expected to fall to 5th place in 2009, overtaken by Canada and South Korea, whose studios are heavily government supported. British consumers have a strong preference for British made video games, purchasing four times more British-made video games than US consumers. Yet decline means that the British public faces decreasing access to British-made video games.

A brain drain, in particular of skilled and experienced staff, to subsidised studios overseas is beginning to bite, with a recent survey finding this issue and overseas subsidies the top concerns of senior UK industry executives.^[12]

Effect

Games Tax Relief is expected over a five year period to: create or save 3,550 graduate level jobs (or the vocational equivalent); increase or safeguard £457 million in development expenditure; and secure £415 million in new and saved tax receipts over five years. This measure will drive sustained growth in the UK studio sector and halt the current decline in investment in and jobs. The outlay for the Government is anticipated to be £192 million over the same period.

3.2 Corporation tax

Proposal

The Government should indicate in the Pre-Budget Report that the small companies' rate and the main rate of corporation tax should be frozen in the March 2010 budget. The small companies' rate and the main rate of corporation tax should ideally be cut by one per cent during the next Parliament. Failing this, the rates should be frozen.

Reason

The tax burden on UK business has risen over the last decade. In 1997 the UK's principal corporation tax rate was five per cent below the OECD average. In 2008, it was 4.5 per cent above the OECD average.^[13] Higher taxation leaves business with fewer resources available for investment and deters foreign direct investment.

A reduction in the small and large corporation tax rates over the course of the next Parliament would give a signal that the UK was determined to maintain a competitive tax system. This would serve to strengthen the attractiveness of the UK as a destination for overseas investment. The lower tax rates would provide business with additional resources for investment and expansion.

Effect

A cut in the small companies' rate of corporation tax from 21 per cent to 20 per cent would cost HM Treasury £450 million in 2010-11, rising to £650 million in 2011-12. ^[14] Reducing the main corporation tax rate from 28 per cent to 27 per cent would cost HM Treasury £1 billion in 2010-11, rising to £1.1 billion in 2011-12. ^[15]

Companies pay different rates of corporation tax and are not always liable for the full rate. An examination of six games business's accounts from 2007 and 2008 indicates that a one per cent cut in corporation tax would, on average, save each of them £16,560.

3.3 National Insurance Contributions Proposal

The Government should indicate in the Pre-Budget Report that Employers' National Insurance Contributions (NICs) should be frozen in the March 2010 budget. NICs should ideally be cut by one per cent during the next Parliament. At the very least there should be no increase in NICs: a cut in other business taxes would be completely negated by a rise in NICs.

Reason

NICs are a tax on employment. The cost of games development in the UK is already relatively high. ^[16] The cost of games development needs to be lowered in order to encourage employment growth by UK developers and to promote inward investment by overseas publishers into the country.

Effect

Cutting NICs will reduce the cost of hiring employees and so encourage businesses, including games developers, to expand employment. It will also serve to make the UK a relatively more attractive place to invest in. Reducing the Class 1 employee main rate by one per cent would cost HM Treasury £4.1 billion in 2010-11. ^[17]

3.4 Research & Development Tax Credits Proposal

Extend the definition of 'qualifying costs' within the R&D tax relief rules to include benefits in kind and premises costs (such as rent and rates).

Reason

This measure would ensure that companies who provide benefits to their employees are not put at a disadvantage. It would also provide relief for the premises costs associated with carrying out valuable R&D activities.

Effect

This would provide a fair system for companies that reward their employees in different ways. TIGA carried out a survey of game developers to ascertain the impact of the changes proposed to R&D tax credits. For the average games developer who responded to our survey, the measures might be expected to provide the following annual cash benefits: on benefits in kind £17,000; on premises costs £66,000. As there are approximately 240 games developer companies in the UK, the total cost of these measures could be estimated at £20 million. ^[18]

3.5 Encouraging investment into IP generating businesses

Proposal

Remove the provisions that exclude some IP businesses from attracting tax efficient investment under the Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) scheme.

Reason

Currently, EIS and VCT reliefs are not always available to a company that funds the creation of IP but does not create that IP itself. Although there are ways that arrangements can be structured to take advantage of the EIF and VCT reliefs, some of the restrictions applicable to these reliefs have limited their application in relation to the creation and commercialisation of IP. This inhibits investment in companies which are set up to commercialise the IP generated by, say, a group of games development companies.

Effect

Removing these exclusions would further encourage private investment into the original IP generating businesses and in turn encourage investment into the IP commercialisation entities.

3.6 Increasing the value of corporation tax losses

Proposal

Currently, companies can 'carry-back' corporation tax losses against profits of the previous year. During the economic downturn, the government has introduced measures to allow losses to also be carried back to the two years preceding this. However, there is a cap of £50,000 applied to such carry backs, making them worth a maximum of approximately £10,000 to a small company. ^[19] This cap should be removed.

Reason

Removing the cap on loss carry backs into earlier years would allow companies to gain full relief for the losses that they have suffered at the time when they need it most. The £50,000 cap has been set at such a low level that the net cash benefits to the company are too small to make a significant difference to its prosperity.

Effect

This measure would provide additional much needed short term support to those companies which are investing funds in R&D and generating valuable IP but struggling to remain cash positive in the current economic conditions. It will help them to survive the economic downturn and contribute to the future success of our economy.

4. Conclusion

TIGA's submission to the Pre-Budget Report sets out a range of tax measures to help the video games industry in particular and the UK economy in general. Games Tax Relief and the suggested R&D changes are not particularly expensive. The most important and targeted measure – Games Tax Relief – would cost just £192 million over a five year period. This particular measure would more than pay for itself: over five years, Games Tax Relief would serve to generate additional tax receipts and protect existing tax revenue for HM Treasury to the tune of £415 million. Similarly, the proposals relating to R&D tax credits would have the positive effect of stimulating more R&D and strengthening the UK games sector.

Corporation tax and NICs rates should be frozen. Increases in these taxes would negate the benefits of Games Tax Relief and changes in R&D tax credits. In the next Parliament, policy makers should aim to reduce corporation tax and NIC rates in order to enhance the competitiveness of UK businesses and to increase the attractiveness of the UK as a place to do business. Reductions in corporation tax and NICs are evidently expensive

In the short term they would have to be paid for by spending cuts elsewhere. [20] Nevertheless, this approach would provide a powerful stimulus to job creation and investment, not just in the games industry but also in the wider economy.

Ultimately, the most important, proportionate and cost effective measure to assist the UK games industry would be the introduction of TIGA's proposed Games Tax Relief. If enacted, it would provide a powerful stimulus to the sector. This has been the experience of other countries. Interestingly, former Quebec Premier Bernard Landry recently hailed the impact of tax credits for multimedia development companies in his Canadian province: "Thirty years ago, our main exports were minerals, hydro-electricity and lumber. Today, we export airplanes, train parts, and video games." [21]

We hope that the Government will take the opportunity afforded by the Pre-Budget Report to announce its plans to introduce this tax measure.

5. Acknowledgments and Endnotes

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[1] This has been noted in Singapore http://app.mica.gov.sg/Data/O/PDF/6_MTI%20Creative%20Industries.pdf and Germany http://www.innovasjon Norge.no/Landbruk_fs/Germany.pdf

[2] www.culture.gov.uk/PDF/ci_fact_file.pdf

[3] HM Treasury, *Budget 2009*, April 2009, Tables C4 and C5. At the same time, the Government will be spending around £650 billion.

[4] Taylor, Corrin, "Cuts needed", *IoD News*, September 2009, p. 11.

[5] Bawden, Tom, "Pound backtracks after Fitch warns that huge budget deficit threatens UK's rating", *The Times*, November 11th 2009.

[6] *How to Save £50 billion: Reducing Spending for Sustainable Public Finances* (Institute of Directors/Taxpayers' Alliance, 2009), pp. 12-13.

[7] Duncan, Gary, "As government spending rose, value for money fell in Labour's first ten years, figures reveal", Duncan, Gary, *The Times*, June 10th 2009. Between 1998 and 2007 public spending grew by more than 75% to £582 billion. The new official measures of public sector productivity which gauges the additional services produced in return for extra resources and effort show that this fell by a total of 3.2% over the 10 years to 2007, falling by an average of 0.3% per annum. Apparently, productivity did creep in the final two years, 2006 and 2007 by 0.8 and 0.6% respectively.

[8] *How to Save £50 billion: Reducing Spending for Sustainable Public Finances* (Institute of Directors/Taxpayers' Alliance, 2009), pp. 12-13.

[9] Wilson, Richard, *State of the UK Video Game Development Sector* (TIGA, January 2009), p. 5.

[10] Wilson, Richard, *State of the UK Video Game Development Sector* (TIGA, January 2009), p. 5.

[11] For more information on TIGA's proposed Games Tax Relief, see Gardner, P., Gibson, R., and Wilson, R., *Investing in the Future: a Tax Relief for the UK Video Games Development Sector* (TIGA, 2009).

[12] Time to Play (NESTA, 2009). See <http://www.nesta.org.uk/time-to-play/>

[13] Taylor, Corrin, (June 2009), "The worst of all worlds?" (*IoD News*), p. 11.

[14] *Tax ready reckoner and tax reliefs* (HM Treasury, November 2009), Table 5, p. 11.

[15] *Tax ready reckoner and tax reliefs* (HM Treasury, November 2009), Table 5, p. 11.

[16] Gibson, N., and Gibson, R.; Mateos-Garcia, Juan (ed.), *Raise the Game* (NESTA, 2008), especially p. 11. See http://www.nesta.org.uk/assets/Uploads/pdf/Research-Report/raise_the_game_report_NESTA.pdf

[17] *Tax ready reckoner and tax reliefs* (HM Treasury, November 2009), Table 5, p. 11.

[18] These figures should be treated as indicative.

[19] Small Company Corporation Tax Rate currently hovers between 19-21% (depending on the relevant financial year) and can go higher when the marginal rate between small company and large company tax rates is used. You need to consider the net benefit of the losses when subject to the prevailing tax rate. So, losses of £50,000 can now be carried back two years to reduce historic profits by £50,000 which, at a tax rate of 20%, effectively creates a £10,000 historic overpayment of corporation tax which can be reclaimed as cash in the current year by the small company.

[20] For one account of how to save £50 billion, see: http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_paper_save_50_billion.pdf

[21] See <http://www.gamepolitics.com/2009/11/17/ex-quebec-premier-developer-tax-credits-helped-shape-economy>



