TAX GUIDE

FOR THE INDUSTRY OF THE

VIDEO GAMES IN THE CANARY ISLANDS

Gobierno de Canarias

www.canaryislandsfilm.com

CanaryIsland GAMES

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1 Introduction

The Canary Islands offer several attractive tax advantages that are successfully applied for the development of video games. This is possible thanks to our Economic and Fiscal Regime (REF)[1] of the Canary Islands within the legal framework of the EU and Spain.

This consolidates the Canary Islands as one of the best places in Europe for the development of video games, technology, and audiovisual projects, since these benefits are combined with other advantages such as its climate, quality of life, industry and local talent, and infrastructure, among others.

THE TAX INCENTIVES ARE:

- Tax credit for videogames development in the Canary Islands.[2]

- The Canary Islands Special Zone (ZEC)[3].
  The companies created in the Canary Islands, also known as ZEC entities, are subject to a reduced tax rate of 4% in the Corporate Income Tax in force in Spain. Besides, this is also compatible with the other tax benefits mentioned above

Other incentives of interest and compatible with the ones mentioned above are:

- 25% tax credit for investment in fixed assets.

- 10-15% tax credit on promotion and advertising expenses.

According to the REF of the Canary Islands, for the specific Technological Innovation activities incentives in the Corporate Tax Act[4], the amount of tax credits is increased by 20 percentual points regarding the rest of the national territory.

The development of video games is much more advantageous in the Canary Islands, as it is considered a Technological Innovation activity.

[1] 20/1991 Royal Decree-Act of December 19th, amending the Economic and Fiscal Regime of the Canary Islands.
[2] The development of video games in Spain applies the tax incentive for R&D&I activities regulated by Article 35 of the 27/2014 Corporate Income Tax Act "Tax credit for Research and Development and Technological Innovation activities".
[3] 19/1994 Act, of July 6th, amending the Economic and Fiscal Regime of the Canary Islands, in 15/2014 Act, of December 19th.
[4] Article 35 of the 27/2014 Corporate Income Tax Act. "Tax credit for Research and Development and Technological Innovation activities".

2 Tax Credit for Videogames Development

Video game development studios incorporated in Spain it can be a branch will be entitled to apply this tax credit on eligible expenses. To benefit from the 45% tax credit exclusive to the Canary Islands, the expenditure has to be done in the Canary Islands.

It is compatible with any subsidy (the proportional part of the subsidy received must be deducted), as well as with other incentives, such as the rebates on Social Security contributions for personnel dedicated to R&D&I activities[5].

INCENTIVE	Spain	Canary Islands Special Case
Expenditure on Technological Innovation	12%	45%
Exclusive R&D Personnel (Additional)*	(+)17%	28%
Investments allocated to R&D activities (fixed assets)	8%	28%
Quota limits	25 - 50 %	60 - 90 %**
Deadline to apply the tax credits ***	18 years	18 years

** A 30.6% increase in the tax credit (45% + 30.6% = 75.6%) will be applied to R&D expenditure for the year if it exceeds the average spending on R&D activities of the two immediately preceding years. In the case of the State, this increase is only 17%.*

*** The maximum tax credit limit is 60% of the positive adjusted gross income tax liability (box 00582 of the Corporate Income Tax), rising to 90% when the amount of the R&D&I tax credit corresponding to the expense for the year exceeds, by itself, 10% of the positive adjusted full quota.*

**** If the activity generates more tax credit than the taxes to be paid in the relevant tax year, or more than the amount that can be cashed-back, it is possible to carry forward on the 18 following years.*

There is also the possibility of cash-back the tax credit for Video Game Innovation/Tech Development.

The cash-back of this tax incentive is not compatible with the ZEC

[5] The compatibility of these benefits requires the company to be included in the registry of Innovative SMEs of the Ministry of Science, Innovation and Universities, regulated by Order ECC/1087/2015, of June 5th.

3 What kind of development can be eligible?

All those developments in **Research, Development and Technological Innovation activities.** (which includes the videogames development)

ALL DEVELOPMENTS IN VIDEOGAMES

(Including R&D+i regarding technology)

RESEARCH

Original and planned investigation aimed at discovering new knowledge and superior understanding in the scientific and technological field.

There must be a significant technological or scientific improvement and an objective innovation, i.e., the company must be the first to face this challenge. Besides, it must imply that the company assumes a risk, since there is uncertainty as to whether the expected results will be achieved.

DEVELOPMENT

Application of research results for the manufacture of new materials/ products or for the design of new processes/ production systems, as well as for the substantial technological improvement of pre-existing materials, products, processes, and systems.

As in Research, there must be an objective innovation. For example, advanced software development may be considered R&D if it causes significant technological progress, excluding usual or routine activities related to software[6,7].

TECHNOLOGICAL INNOVATION

Activity whose outcome is a technological advance in obtaining new products, production processes or substantial improvements to existing ones.

The innovation must be subjective, which means that the competition may already have it solved, but for the company that is going to deal with it, it will involve some complication, and therefore it will have to dedicate resources for its implementation.

Initial demonstration projects or pilot projects related to animation and video games qualify as technological innovation.

[6] Binding Query V1292-03
[7] Binding Query V0054-02

4 What kind of expenses can be deducted?

During the development of a videogame the following activities, phases, and tasks that can be considered as deductible:

PHASE:
REQUIREMENTS, DESIGN, AND COMPONENTS DEFINITION ANALYSIS.

- Work plan: where the required resources are indicated, including hardware and specific software licenses to be used during the development of the project´s production. Additionally, it includes the elaboration of resource planning documents, milestones, and costs of the complete prototype.
- Elaboration of technology documents and tools at technical and conceptual level, to be applied and/or developed for the operation of the video game, using interaction schemes, design documents, diagrams, etc. The technical requirements and tools to be developed or used are established, the peripherals to be included and their interaction with the development are studied, the external systems in which the prototype will have to be implemented in order to be executed and its implication in massive or multiplayer environments are designed and defined, as well as establishing a programming plan where the work methodologies are defined.
- Proof of concept design: to validate the initial proposed game design and whether the team can carry it out or not.

PHASE:
PROTOTYPES DEVELOPMENT AND IMPLEMENTATION.

Production: Tasks for the fulfillment of the planned work plan and the interrelation between the different departments involved in the project, as well as the verification and execution regarding the design of the mechanics proposed in the "gameplay" and the proposed level of quality.

ALPHA VERSION:

In this phase a prototype´s version that contains all the defined content and that is playable from start to finish, even if it has errors or bugs, is made. It includes programming, graphic art, music creation, sounds and effects, as well as validation tests.

BETA VERSION:

In which validation, programming, quality, and usability tasks are performed to obtain a stable and relatively error-free version of the Alpha version.

PHASE:
IMPLEMENTATION AND VALIDATION.

With these debugging tasks, the prototype´s final version is obtained. This would be the definitive version, completely stable and with all the features, ready for its final test and its subsequent commercialization.

5 Who can benefit from the tax credit?

Video game development done in the Canary Islands will be able to apply to this incentive, doing their expenses and investments in the Islands

TO HAVE ACCESS TO THIS: **45%** TAX CREDIT

THE EXPENDITURE MUST BE **DONE IN THE CANARY ISLANDS**

6 How is the tax credit obtained?

There are two main ways to obtain the tax tax credit:

A. Qualification of the tax credit by the studio, without the assistance of third-party certifiers

It is usually used for low budget projects where there is no doubt about the nature of the project. In other cases, to confirm a possible categorization criterion for the activity carried out, a Tax ruling or an Advanced Price Agreement can be filed.

B. Validation report, done by third-party certifier.

This is the most commonly method used by videogames and innovation. In order to obtain the Reasoned Report, it is necessary to go through the Project Certification phase, through an external entity accredited by ENAC, whose procedure involves a direct cost for the interested party. Once the Certificate has been obtained, it must be uploaded to the Electronic Office of the Ministry of Science, Innovation and Universities so that, once reviewed by the Ministry, the corresponding Reasoned Report is issued. This report certifies the validity of the project.

7 Legal Regulations

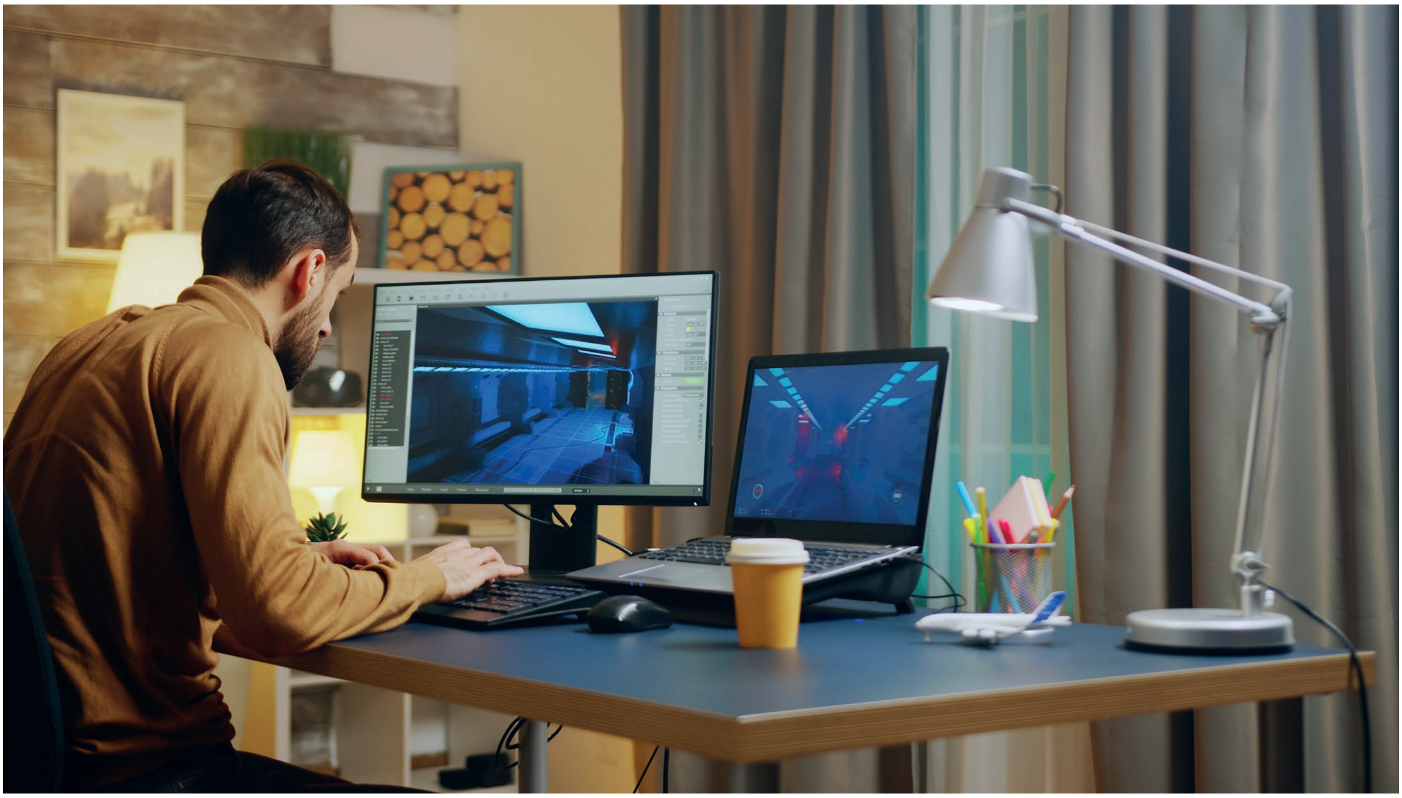
Article 35 of 27/2014 Act (former RDL 4/2004 – TRLIS) on Corporate Income Tax (in force on 01/01/2015). "Tax credit for Research and Development and Technological Innovation activities".

R.D. 1432/2003, of November 21st, which regulates the Issuance by the Ministry of Science and Technology of Reasoned Reports to compliance with scientific and technological requirements, for the purposes of the application and interpretation of tax tax credits for Research and Technological Development and Innovation activities.

19/1994 Act, of July 6th, amending the Economic and Fiscal Regime of the Canary Islands.

14/2013 Act, Act, of September 27th, on support for entrepreneurs and their internationalization, Article 26, Section 1.

20/1991 Act, which establishes the increased rates and limits.



8 Canary Islands Special Zone(ZEC)

Entities developing videogames or related activities in the Canary Islands may be registered in the Canary Islands Special Zone and apply a 4% corporate income tax (no withholding taxes and no VAT in certain cases and no stamp duties or transfer taxes). It is important not to perform activities before registering in the Zone:

58.21 Videogame edition.

58.29 Other computer software edition.

59.20 Sound recording and music publishing activities.

62.01 Computer programming activities.

63.11 Data processing, hosting and related activities

REQUIREMENTS TO BECOME A ZEC ENTITY:

- Be a newly created entity – or Branch -.
- At least one of the administrators must be a resident of the Canary Islands.
- Create at least 6 jobs/ 4 jobs (depending on whether the activity is carried out on the capital islands or not).
- The business purpose has to be within the list of activities within the scope of the Zone. All video games activities are included in the list.

BENEFITS FOR ZEC ENTITIES:

- 4% Corporate Income Tax Rate.
- Exemption on stamp duties and transfer taxes
- Exemption on regional VAT on imports, and exemption in operations between ZEC entities.

The ZEC tax incentive, compatible with the tax incentives for audiovisual detailed in this document, was authorized by the European Commission in 2000 to promote the economic and social development of the archipelago

For more information canariaszec.com

9 OTHER INCENTIVES IN THE CANARY ISLANDS

TAX CREDIT FOR PROMOTION AND ADVERTISING EXPENSES

Tax credits will be available for advertising and publicity expenses for the launch of products, opening and attendance to events, such as international fairs or exhibitions held in Spain.

This tax credit will be 15% of the amount paid or 10% for companies whose net turnover does not exceed € 50 million, and the average workforce is less than 250.

25% TAX REBATE FOR INVESTMENT IN FIXED ASSETS

Tax credit of 25% of the amount of the investments done in fixed assets (over the acquisition price or the production cost), to be used to the declared economic activity. They must remain in operation 5 years or the time of its useful life, if it is less.

TAX CREDITS FOR INVESTMENT IN AUDIOVISUAL PRODUCTIONS[9] (FILM, ANIMATION AND POST-PRODUCTION): 50%-45%.

Tax credit of up to 50% on eligible expenses for international audiovisual productions, requiring a minimum expenditure disbursed in the Canary Islands of € 1M (live action) or € 200,000 (animation and post-production).

0% VAT (IGIC, CANARY ISLANDS GENERAL INDIRECT TAX):

The IGIC zero tax rate is applied to deliveries and imports of goods and services rendered for the execution of feature films or fiction, animation, or documentary audiovisual series, under certain conditions. The application of the zero rate requires the prior acknowledgment of the Canary Islands Tax Agency.

[9] For live-action, animation and post-production projects.

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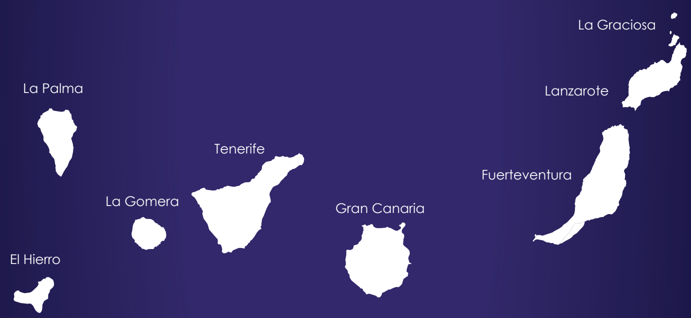

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