

Ontario Interactive Digital Media Tax Credit Bulletin

November 2, 2015

On April 23, 2015, the government announced proposed changes to the Ontario Interactive Digital Media Tax Credit (OIDMTC). A bulletin with details about the proposed changes was released on May 6, 2015. Draft regulations to implement the proposed changes were posted for consultation on Ontario's Regulatory Registry on November 2, 2015. This Bulletin provides an overview of the draft regulations. For further details, applicants should consult the draft regulations. Amendments to the *Taxation Act, 2007* are also required to implement the changes.

Background

The OIDMTC is a refundable tax credit available to qualifying corporations for expenditures related to the creation, marketing and distribution of eligible interactive digital media products. A 40 per cent refundable tax credit is available for qualifying corporations that develop and market their own products. The credit is 35 per cent for products developed under a fee-for-service arrangement. A 35 per cent refundable credit is also available to qualifying digital game corporations and specialized digital game corporations.

The OIDMTC was introduced in 1998 with broad eligibility criteria to support the growth of Ontario's emerging digital media industry and the creation of highly skilled jobs. As interactive digital media products have become mainstream, the existing eligibility criteria of the OIDMTC limit the ability of the credit to target innovative products.

Between 2003-04 and 2014-15, the OIDMTC is estimated to have grown by over 40 per cent annually. Ontario announced a review of the OIDMTC in the *2014 Ontario Economic Outlook and Fiscal Review*. Further to this announcement, the government has held discussions with industry stakeholders on ways to contain costs and modernize support to the industry.

Overview

The 2015 Ontario Budget announced proposed changes to the OIDMTC that would:

- Amend the primary purpose test to focus on products that entertain the user and products that educate users under the age of 12;
- Exclude certain types of products, including most websites;
- Strengthen the rules concerning promotional products; and
- Improve the product certification process by amending the development requirement.

Subject to the approval of the legislature, the proposed amendments to the OIDMTC described in this Bulletin would be implemented in the Ontario *Taxation Act, 2007* and related regulations. As set out in the 2015 Ontario Budget, the proposed amendments would, if enacted, be applied retroactively to the dates set out in this Bulletin. These changes do not

apply to the credit available to qualifying digital game corporations and specialized digital game corporations.

In addition to these proposed changes, the Province will invest \$6 million in 2015–16 and \$10 million per year starting in 2016–17 in a renewed Interactive Digital Media (IDM) Fund to help support some co-production opportunities and activities that would not be eligible for the OIDMTC after the proposed changes described in this bulletin. Through the redesign, Ontario will ensure that the Fund will continue to support early product development, intellectual property investment, and company incubation, while also broadening its scope to include co-productions and magazines. This investment is made possible by the savings from the proposed changes to the OIDMTC.

The following table summarizes the proposed changes to the OIDMTC:

	Before 2015 Budget Announcement	After 2015 Budget Announcement
Primary purpose requirement	To qualify for the OIDMTC, a product’s primary purpose must be to: <ul style="list-style-type: none"> • Entertain the user; • Educate the user; or • Inform the user. 	A product would only qualify for the OIDMTC if its primary purpose is to: <ul style="list-style-type: none"> • Entertain the user; or • Educate users under the age of 12. A product can only have one primary purpose.

	Before 2015 Budget Announcement	After 2015 Budget Announcement
Specific product exclusions	N/A	<p>Products that would not be eligible for the OIDMTC include:</p> <ul style="list-style-type: none"> • Products providing any content that is news, current events or public affairs programming, opinion, commentary, advice or weather or financial market reports; • Products produced primarily for industrial, corporate or institutional purposes; • Products that are primarily reference materials, such as software user guides, dictionaries and maps; • Products that aggregate content from various internet sources; • Products used to filter and organize specific content from the internet; • Search engines; • Blogs; and • Databases, such as real estate or recipe databases. <p>Websites, and products the majority of the content of which is available on a website, would be eligible products only if the website primarily hosts:</p> <ul style="list-style-type: none"> • Digital games; • Content related to film, television or online streaming intellectual properties; • Virtual or augmented reality experiences; or • Content that is designed to educate users who are under the age of 12.
Promotional products	<p>To qualify for the OIDMTC, a product must not be used primarily to:</p> <ul style="list-style-type: none"> • Present or promote the developer or the purchaser; or • Present, promote or sell the products or services of the developer or the purchaser. 	<p>In addition to meeting the existing rules for promotional products, a product would be required to have a revenue generating stream. Examples of revenue generation models include:</p> <ul style="list-style-type: none"> • Sale of the product; • Fees for the use of the product, including licence fees and subscription fees; • In-product purchases; • Third party advertising within the product; or • Sale or licence of another product that is an extension or upgrade of the product.

	Before 2015 Budget Announcement	After 2015 Budget Announcement
Development requirement	To qualify for the OIDMTC, all or substantially all (at least 90 per cent) of the product must be developed in Ontario by the applicant company.	<p>To qualify for the OIDMTC, a minimum of 80 per cent of the total labour costs for the product would have to relate to services rendered personally in Ontario:</p> <ul style="list-style-type: none"> • By the applicant company’s employees; • By individuals providing services as part of sole proprietorships that do not have employees; or • By individuals providing services through personal corporations that do not have employees other than the individual. <p>As well, a minimum of 25 per cent of the total labour costs for the product would have to be paid to employees of the applicant company for services personally rendered in Ontario.</p>

Primary Purpose Requirement

The OIDMTC is currently available only for products with a primary purpose to educate, inform, or entertain the user.

This requirement would be amended to provide that the OIDMTC is available only for products with a primary purpose to:

- Entertain the user; or
- Educate users under the age of 12.

A product can only have one primary purpose.

Primary purpose of entertaining the user

In order for a product to have the primary purpose of entertaining the user, the product should be designed for recreation. A product with the primary purpose of informing or educating the user is not considered to have the primary purpose of entertaining. For example, news products would not be considered to have the primary purpose of entertaining the user, even if the user engages with the product during leisure time.

A product that is a digital game would be considered to have the primary purpose of entertaining the user.

Primary purpose of educating users under the age of 12

In order for a product to have the primary purpose of educating users under the age of 12, the product should be designed as a tool for teaching children under the age of 12. This could include, for example, a product that is designed to teach the letters of the alphabet. A product

that is designed primarily to educate youths and adults would not be considered to have the primary purpose of educating users under the age of 12.

Implementation

These proposed changes to the primary purpose requirement would apply to expenditures incurred after April 23, 2015. Expenditures that are incurred on or before April 23, 2015 in respect of previously eligible products would not be affected.

Excluded Products

The 2015 Ontario Budget announced that certain products would no longer qualify for the OIDMTC. These include:

- Products that provide any content that is news, current events or public affairs programming, opinion, commentary, advice or weather or market reports. Some examples of excluded products include a website or app for a newspaper, magazine or blog. Products with non-qualifying content would be excluded, even if the content is only available online.
- Products produced primarily for industrial, corporate or institutional purposes, including vocational training products and other types of job training products. This would include any product that is designed to provide job training to employees or to inform or educate employees.
- Products that are primarily reference materials. This would generally include any product that is designed to be used as a resource for finding information, such as a user guide for equipment or software, a dictionary or a map.
- Products that aggregate content from various internet sources and consolidate it in one place.
- Products that are used to filter and organize specific content from the internet.
- Products that are internet search engines.
- Products that are blogs.
- Products that are primarily databases. This includes any product the primary purpose of which is to facilitate searching and retrieval of stored information, such as a real estate database or a recipe database.

In addition to the excluded products listed above, a product that is a website would also be excluded unless the website primarily hosts:

- One or more digital games;

- Content related to one or more film, television or online streaming productions that is hosted under a licence agreement in respect of a copyright that relates to the film, television or online streaming production, but that is not a broadcast of all or part of the film, television or online streaming production;
- One or more virtual or augmented reality experiences;
- Content that is designed to educate users who are under the age of 12; or
- Any combination of the above.

Exceptions to the websites exclusion:

Digital game

Under the proposed changes, a website that primarily hosts one or more digital games would be an eligible product for the purpose of the OIDMTC, provided the product meets all of the other eligibility criteria. A product that is a digital game would include the following characteristics:

- Is played by one or more users;
- Sets out goals and rules for game play; and
- Challenges the user and has an uncertain outcome.

Film, television or online streaming production

Under the proposed changes, a film, television or online streaming production must be produced for

- Commercial release in theatres,
- Broadcasting on television, or
- Broadcasting over the internet where the end user is required to pay a purchase, licence or subscription fee.

Under the proposed changes, a film, television or online streaming production does not include a production described in paragraph (b) of the definition “excluded production” in subsection 1106(1) of the Federal *Income Tax Regulations*.

Educational Products for Users Under the Age of 12

Under the proposed changes, a website that primarily hosts content designed to educate users under the age of 12 would be an eligible product for the purpose of the OIDMTC, provided the product meets all of the other eligibility criteria.

Product that hosts virtual or augmented reality experiences

Under the proposed changes, a website that primarily hosts one or more virtual reality or augmented reality experiences would be an eligible product for the purpose of the OIDMTC, provided the product meets all of the other eligibility criteria.

Similar content products

If a majority of the content of a particular product is available on a website that is excluded, then the particular product would also be excluded. For example, if a product is an app and the same content is available through a website that is excluded, the app would also be an excluded product.

Implementation

The product exclusions would apply in respect of expenditures incurred after April 23, 2015. Expenditures that are incurred on or before April 23, 2015 in respect of previously eligible products would not be affected.

Promotional Products

In order to qualify for the OIDMTC, a product must not be used primarily to present or promote the developer or the purchaser of the product. As well, a product must not be used primarily to present, promote or sell the products or services of the developer or the purchaser.

The 2015 Ontario Budget proposed to strengthen the rule that excludes products that are primarily used for promotion. The rule would be strengthened by deeming products with no revenue generating stream to be excluded promotional products.

Revenue generating stream

Products which have no revenue generating stream would generally be excluded products. In the case of a product that is a specified product, the product must result in a revenue stream to the purchaser. In the case of a product that is not a specified product, the product must result in a revenue stream to the developer.

For the purposes of this rule, a revenue stream is the generation of revenue through:

- The sale of the product,
- Fees for the use of the product, including licence fees and subscription fees,
- In-product purchases,
- Third-party advertising, or
- The sale or licence of another product developed by the developer that can reasonably be considered an extension or upgrade of the product.

An in-product purchase, also called an in-game or in-app purchase, occurs when the user can purchase an enhancement to the product.

Third party advertising relates to marketing and promotion of a corporation or person, or products or services of a corporation or person, that is not related to the product developer or the purchaser.

Implementation

The proposed new requirement to have a revenue generating stream would apply to expenditures incurred after April 23, 2015. Expenditures that are incurred on or before April 23, 2015 in respect of previously eligible products would not be affected.

Development Requirement

The OIDMTC is only available for a product if all or substantially all (at least 90 per cent) of the product is developed in Ontario by the company claiming the credit. This rule is often referred to as the “90 per cent rule”.

The 90 per cent rule is intended to ensure that the credit supports companies that create permanent employment in Ontario and that most of the work is provided in Ontario. The rule is also intended to ensure that there is only one applicant in respect of each product.

However, the 90 per cent rule has resulted in long delays for those that have applied to have their products certified and created uncertainty around whether their products would meet the requirement.

In order to improve application processing times and provide certainty to applicants, the 2015 Ontario Budget proposes that the OIDMTC be amended by replacing the current 90 per cent rule with a new quantitative rule based on the labour costs of developing a product. The new quantitative rule would have two concurrent tests that would have to be met, an 80 per cent test and a 25 per cent test.

Simplified formulas for 80 per cent and 25 per cent tests are provided below. For further details, applicants should consult the draft regulations.

The 80 per cent test would generally require that the following formula is 80 per cent or greater:

$$\frac{A}{B}$$

Where:

A is the total amount of eligible labour expenditures attributable to services rendered personally in Ontario:

- By employees of the applicant;
- By certain individuals providing services to the applicant as part of sole proprietorships that do not have any employees;
- By certain individuals providing services to the applicant through personal corporations that do not have employees other than the individual.

B is the total amount of labour expenditures that are attributable to services rendered that are directly attributable to the development of the eligible product.

The 25 per cent test would generally require that the following formula is 25 per cent or greater:

$$\frac{C}{D}$$

Where:

C is the total amount of eligible labour expenditures attributable to services rendered personally in Ontario by employees of the applicant.

D is the total amount of labour expenditures that are attributable to services rendered that are directly attributable to the development of the eligible product.

Expenditures are not eligible for the OIDMTC if they are claimed for other credits. Similarly, certain types of assistance reduce the amount of expenditures that are eligible for the OIDMTC. However, for the purposes of determining the amounts for A and C in the formulas, the amount of an applicant's eligible labour expenditure will not be reduced as a result of receiving assistance or claiming other credits. For example, an expenditure in respect of which an applicant receives the scientific research and development credit could be an eligible labour expenditure for the purposes of the formulas. Expenditures will continue to be ineligible for the OIDMTC if they are claimed for other credits, even if they are treated as being eligible for the purposes of the formulas.

The amounts determined for B and D would include, for example, expenditures attributable to services rendered

- By an employee of the applicant, whether or not the services are rendered in Ontario;
- As part of a sole proprietorship, whether or not the proprietorship has employees; and
- By a corporation, whether or not the corporation has employees.

The amount determined for A, B, C and D would only include expenditures incurred during the 37-month period ending at the end of the month in which development of the eligible product is completed.

The new rule would not change the definition of expenditures that are eligible for the credit.

Implementation

To expedite certification, the new development requirement would apply to all products in respect of which a determination of eligibility has not been made on or before April 23, 2015, including those awaiting certification on April 24, 2015. However, only the 80 per cent test would apply to products for which certification was applied for before April 24, 2015. Both the

80 per cent test and the 25 per cent test would need to be met for products that apply for certification after April 23, 2015.