

HEENAN BLAIKIE

Summary of Canadian Financial Incentives for the Production of Animation, Digital Media and Interactive Content



Heenan Blaikie

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Foreword

Digital migration is accelerating and the digital media industry is the entertainment industry's main engine of growth in Canada. It is expected that the video game sector in Canada will expand to over US \$2 billion in 2013, a compound annual growth rate of 6.2%.

The Canadian federal government and certain Canadian provincial governments offer an array of tax incentive programs for corporations that develop digital content, including video games. Canadian provinces that offer

financial incentives for animation, digital media and interactive content production include: British Columbia, Ontario, Quebec, Manitoba, Nova Scotia and Prince Edward Island.

Heenan Blaikie's team of dedicated entertainment and media professionals has the specialized expertise to help you navigate and maximize these incentives. We welcome the opportunity to put our industry expertise and resources to work for you.

Federal Government

The Canadian federal government administers, through the Canada Revenue Agency, the “Scientific Research and Experimental Development Tax Incentive Program” (the “SREDTIP”).

SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT TAX INCENTIVE PROGRAM

Amount

SREDTIP provides for a tax credit up to 35% of the first \$3 million of qualified expenditures for scientific research and experimental development carried out in Canada and incurred by a Canadian-controlled private corporation.

What is a Canadian-controlled private corporation?

Generally, a Canadian-controlled private corporation is a corporation that satisfies the following conditions:

- it is a corporation that was resident in Canada and was either incorporated in Canada or resident in Canada from June 18, 1971, to the end of the tax year;
- it is not controlled directly or indirectly by one or more non-resident persons;
- it is not controlled directly or indirectly by one or more public corporations (other than a prescribed venture capital corporation, as defined in Regulation 6700);
- it is not controlled by a Canadian resident corporation that lists its shares on a designated stock exchange outside of Canada;
- it is not controlled directly or indirectly by any combination of persons described in the three previous conditions;

- if all of its shares that are owned by a non-resident person, by a public corporation (other than a prescribed venture capital corporation), or by a corporation with a class of shares listed on a designated stock exchange, were owned by one person, that person would not own sufficient shares to control the corporation; and
- no class of its shares of capital stock is listed on a designated stock exchange.

Other Canadian corporations, proprietorships, partnerships and trusts can benefit from a tax credit up to 20% of qualified expenditures.

Requirements

Only certain scientific research and experimental development projects qualify for the SREDTIP. They include: (a) experimental development (to create new or improve old materials, devices, processes or products); (b) applied research; (c) basic research; and (d) support work in engineering, design, operations research, mathematical analysis, computer programming, data collection, psychological research, but only to the extent that the work supports (i) experimental development; (ii) applied research and (iii) basic research.

The following projects do not qualify for the tax credits under the SREDTIP: (a) social science and humanities research; (b) commercial production of new or improved material, device or product; (c) style changes; (d) market research or sales promotion; (e) quality control or routine testing; (f) routine data collection; (g) prospecting, exploring or drilling activities; and (h) development based solely on design or routine engineering practice.

British Columbia

The province of British Columbia (“BC”) supports the development of the digital media industry primarily through three programs, including the “BC Interactive Digital Media Tax Credit” (the “IDMTC”).

INTERACTIVE DIGITAL MEDIA TAX CREDIT

Amount

The IDMTC provides for a refundable tax credit of up to 17.5% of qualified labour expenditures incurred by “eligible corporations” to develop “interactive digital media products” in BC.

Requirements

An “interactive digital media product” is a product designed for use by an individual, the primary purpose of which is to educate, inform or entertain, and must include at least two of the following three mediums: (i) text; (ii) sound; and (iii) images.

To qualify as an “eligible corporation”, a corporation must:

- (a) have a permanent establishment in BC;
- (b) be a taxable Canadian corporation throughout the year;
- (c) have more than \$100,000 of eligible salaries and wages; and
- (d) either
 - (i) its principal business is developing interactive digital media products, or
 - (ii) all or substantially all of its business consists of: (1) developing interactive digital media products; and/or (2) providing eligible activities to corporations that have a permanent establishment in BC and whose principal business is developing interactive digital media products.

“Qualified labour expenditures”:

- (a) include salaries and wages incurred on or after September 1, 2010;
- (b) are directly attributable to eligible activities; and
- (c) are paid to individuals who were residents in BC on December 31 of the year preceding the end of the corporation's tax year.

“Eligible activities” include activities undertaken by the corporation that are attributable to the development of the interactive digital media product. Examples include: (i) design; (ii) artwork; (iii) animation; and (iv) project management.

INVESTMENT CAPITAL PROGRAM TAX CREDIT (NEW MEDIA VENTURE CAPITAL)

Amount

British Columbia also offers the “Investment Capital Program Tax Credit (New Media Venture Capital) (the “ICPTC”) program. The ICPTC provides for a tax credit of 30% to a Canadian corporation with a permanent establishment in BC on a **non-refundable** basis for investing in a “qualified corporation,” up to a maximum of \$60,000 per taxation year per individual investor.

BC resident investors also qualify for the ICPTC on a **fully refundable** basis.

“Qualified corporations” are limited to a lifetime maximum investment under the ICPTC of \$5 million.

Requirements

In order for the corporate or BC resident investor to qualify under the ICPTC, the “qualified corporation” must be substantially engaged in the “eligible activity,” being the development for commercial exploitation of interactive digital media products that (a) educate, inform and present information in at least two of the following three mediums: (i) text; (ii) sound; and (iii) visual images; (b) are not primarily used to present, promote or sell the products or services of the “qualified corporation;” (c) are not primarily used for interpersonal communications; and (d) are not products for which public financial support would, in the opinion of a certifying authority, be contrary to public policy.

Furthermore, the “qualified corporation” must: (a) not have more than 100 employees; (b) pay 75% of its wages to BC residents; and (c) be substantially engaged in an “eligible activity.”

DIGITAL ANIMATION OR VISUAL EFFECTS TAX CREDIT

Amount

In addition, BC offers the British Columbia Digital Animation or Visual Effects Tax Credit (“DAVETC”). It provides a tax credit bonus equivalent to 17.5% of eligible BC labour expenditures related to the production of digitally-created motion picture images.

Requirements

In order to be eligible for the DAVETC, the following criteria must be met: (a) the production must be eligible for or

have claimed the (i) British Columbia basic film and television tax credit or (ii) the British Columbia production services tax credit; (b) principal photography must have taken place in BC; (c) the production must consist of DAVETC activities; (d) the effect must be primarily (i.e. 50% or more) made with digital technology; and (e) the DAVETC expenditure is a BC labour expenditure.

DAVETC activities include: (a) designing; (b) modeling; (c) rendering; (d) lighting; (e) painting; (f) animating; (g) compositing; and/or (h) visual effects photography.

Ontario

INTERACTIVE DIGITAL MEDIA TAX CREDIT

Amount

The Province of Ontario supports the development of the digital media industry through the Ontario Interactive Digital Media Tax Credit (the “OIDMTC”). The OIDMTC provides for a general tax credit of 40% of eligible Ontario labour expenditures (no maximum) as well as eligible marketing and distribution expenses up to a maximum of \$100,000 per product incurred by a “qualified corporation” in the development of an “interactive digital media product.”

With respect to “specified products,” the OIDMTC is equivalent to only 35% of eligible Ontario labour expenditures (no maximum). “Specified products” are interactive digital media products that are developed under a fee-for-service arrangement under the terms of an agreement between the qualifying corporation and an arm’s length purchaser corporation.

The OIDMTC is also available for digital media game corporations. For “qualifying digital game corporations” that incur a minimum of \$1 million of eligible Ontario labour expenditures over a three-year period for fee-for-service work done in Ontario that is directly related to the development of a digital game, a 35% tax credit is available. Note that the qualifying digital game corporation is not required to be at arm’s length with the purchaser corporation, or develop all, or substantially all, of the eligible product.

For “specialized digital game corporations” that have either 80% of Ontario payroll or 90% of annual revenues attributable to interactive digital media game development with a minimum of \$1 million on Ontario labour expenditures in the taxation year directly attributable to the development of eligible digital games, a 35% tax credit is also available.

Requirements

Only “qualified corporations” are eligible for the OIDMTC. A “qualified corporation” is a Canadian corporation with a permanent establishment in Ontario **that is either Canadian or foreign controlled**. Furthermore, a “qualified corporation” cannot be a prescribed labour-sponsored venture capital corporation or a corporation exempt from tax or directly/indirectly controlled by a corporation exempt from tax.

An “interactive digital media product” is one whose primary purpose is to educate, inform or entertain, and achieves that by presenting information in at least two of the following three mediums: (a) text; (b) sound; and (c) images. Examples of products eligible for the OIDMTC include games and educational and informational products.

Note that operating system software is not eligible for the OIDMTC.

In addition to the foregoing, to be eligible for the OIDMTC (excluding the case of applications for “specified products”), the product must: (a) have been fully or substantially developed in Ontario by a “qualified corporation;” (b) the product cannot have been developed under a fee-for-service arrangement; (c) the product is not used primarily for interpersonal communications; (d) the product is not primarily used to present or promote the “qualified corporation;” and (e) the product is not primarily used to present, promote or sell the products or services of the “qualified corporation.”

COMPUTER ANIMATION AND SPECIAL EFFECTS TAX CREDIT

Amount

Ontario also offers the Ontario Computer Animation and Special Effects Tax Credit (“OCASETC”). The OCASETC amounts to 20% of qualified Ontario labour expenditures (no maximum).

Requirements

Only “qualified corporations” are eligible for the OCASETC. “Qualified corporations” are Canadian corporations with a permanent establishment in Ontario **that are either Canadian or foreign controlled**. To qualify for the OCASETC, “qualified corporations” must perform “eligible computer animation or special effects activities” for an “eligible production.”

“Eligible productions” are productions produced for commercial exploitation in the film and television industry.

“Eligible computer animation and special effects activities” include designing, modeling, rendering, lighting, painting, animating and compositing but do not include scientific research and experimental development activities.

“Eligible computer animation or special effects activities” do not include: (a) audio effects; (b) in camera effects credit rolls and subtitles; (c) animation or visual effects that are created by editing activities; and (d) animation or visual effects for use in promotional material for an eligible production.

Note that the OCASETC may be claimed on eligible expenditures in conjunction with the Ontario Film and Television Tax Credit or the Ontario Production Services Tax Credit.

Quebec

PRODUCTION OF MULTIMEDIA TITLES TAX CREDIT

Amount

In the province of Quebec, *Investissement Québec* operates the “Production of Multimedia Titles Tax Credit” (the “PMTTC”). The PMTTC is divided into two components: (a) Category 1 titles and (b) Category 2 titles.

Category 1 titles are titles which are destined for commercial markets and which are produced without receiving an order (i.e. as a service for a third party).

Category 2 titles are considered “other multimedia titles.”

The Category 1 threshold is achieved where at least 75% of the qualified corporation’s produced multimedia titles were ordered and destined for commercial markets.

Category 1 certification provides for a 30% tax credit of eligible labour expenditures, which amount can be increased by 7.5% if the product has French language versioning.

Category 2 certification is limited to a 26.25% tax credit of eligible labour expenditures, with no French versioning bonus.

Requirements

Only “qualified corporations” are eligible for the PMTTC. A “qualified corporation” is a Canadian corporation with a permanent establishment in Quebec **that is either Canadian or foreign controlled**.

In order to qualify for the PMTTC, a “qualified corporation” must operate a multimedia title production business whereby 90% or more of its activities are dedicated to the production of eligible multimedia titles.

Multimedia titles must be: (a) for commercial use; (b) interactive; and (c) produced on electronic media.

In addition, a multimedia title must present information in at least three of the following four mediums: (a) text; (b) sound; (c) fixed images; and (d) animated images.

Ineligible multimedia titles include: (a) titles that are essentially interpersonal communication services and on-line transactional services; (b) titles intended to promote a business or its products and services; and (c) titles that encourage violence, sexism or discrimination.

COMPUTER ANIMATION AND SPECIAL EFFECTS TAX CREDIT

Amount

Quebec also offers the Quebec Computer Animation and Special Effects Tax Credit (“QCASET”) to “qualified corporations.” It serves as a bonus tax incentive for “eligible computer animation and special effects activities” incurred in relation to Quebec’s Tax Credit for Film and Television Production (“TCFTP”) and Tax Credit for Film Production Services (“TCFPS”).

In conjunction with the TCFPS, the QSASET grants a 20% tax credit of qualified Quebec labour expenditures incurred in relation to “eligible computer animation or special effects activities.”

In conjunction with the TCFTP, the QSASET only grants a 10% tax credit of qualified labour expenditures, with labour expenditures capped at 50% of total production costs.

This difference can be explained by the basis on which the TCFTP and TCFPS are calculated. The TCFTP is calculated only on labour expenditures; the TCFPS on “all spend” production costs.

Requirements

“Qualified corporations” are Canadian corporations with a permanent establishment in Quebec that are **either Canadian or foreign controlled**. “Qualified corporations” are eligible for the QCASETTC provided they perform “eligible computer animation or special effects activities” for an “eligible production.” “Eligible productions” are productions produced for commercial exploitation in the film and television industry.

“Eligible computer animation and special effects activities” include designing, modeling, rendering, lighting,

painting, animating and compositing but do not include scientific research and experimental development activities.

“Eligible computer animation or special effects activities” do not include: (a) audio effects; (b) in camera effects credit rolls and subtitles; (c) animation or visual effects which are created by editing activities; and (d) animation or visual effects for use in promotional material for an eligible production.

Note that the QCASETTC may be claimed on eligible expenditures in conjunction with the TCFTP or the TCFPS.

Manitoba

In 2008, the province of Manitoba replaced the “Manitoba New Media Production Grant” with the “Interactive Digital Media Tax Credit” (the “IDMTC”).

INTERACTIVE DIGITAL MEDIA TAX CREDIT

Amount

The IDMTC provides for a refundable 40% tax credit of eligible labour expenditures (up to a maximum of \$500,000 per project) for “prototyping” and “product development” beginning before December 31, 2013, in respect to an eligible project.

Requirements

Only “qualified corporations” are eligible for the IDMTC. A “qualified corporation” is a Canadian corporation with a permanent establishment in Manitoba **that is either Canadian or foreign controlled**.

In order to qualify for the IDMTC, a “qualified corporation” must establish that its primary business is the development of interactive digital media projects. Furthermore, in order for a project to qualify for the IDMTC, a minimum of 25% of total labour expenditures incurred must be paid to employees who were Manitoba residents during the project period.

Eligible labour expenditures claimed under the IDMTC cannot simultaneously be eligible for the Manitoba Film and Video Production Tax Credit.

Nova Scotia

DIGITAL MEDIA TAX CREDIT

Amount

The province of Nova Scotia offers the “Digital Media Tax Credit” (the “DMTC”). The DMTC provides for a tax credit equal to the lesser of: (a) 25% of total Nova Scotia expenditures plus the Nova Scotia regional credit of 5% of qualifying expenditures outside the Halifax metro area; and (b) 50% of eligible Nova Scotia labour expenditures plus the Nova Scotia regional credit of 10% of qualifying expenditures outside the Halifax metro area.

Eligible corporations can also receive a credit on marketing and distribution expenditures up to a maximum of \$100,000 per product. Such marketing and distribution expenditures may be made outside of Nova Scotia.

Requirements

Only “qualified corporations” are eligible for the DMTC. A “qualified corporation” is a Canadian corporation with a permanent establishment in Nova Scotia **that is either Canadian or foreign controlled.**

In order to qualify for the DMTC, “interactive digital media” projects must: (a) be interactive; (b) its primary purpose must be to educate, inform or entertain users; and (c) it must do so by presenting information in at least two of the following three mediums: (i) text; (ii) sound; or (iii) images.

The following products are not eligible for the DMTC: (a) operating system software; (b) application software; (c) products developed primarily for interpersonal communications; (d) pornographic or discriminatory products; or (e) any product that is primarily used to advertise or promote a corporation or organization.

Prince Edward Island

INNOVATION AND DEVELOPMENT TAX CREDIT

Amount

The province of Prince Edward Island (“PEI”) offers the PEI “Innovation and Development Tax Credit” (the “IDTC”). The IDTC provides for a refundable tax credit up to 35% of eligible PEI labour expenditures, subject to a 150% increase for overhead and other necessary costs (such as material costs), in support of eligible projects.

Note that compensation in excess of \$40,000/annum paid to related parties is excluded.

Requirements

Only “qualified corporations” are eligible for the IDTC. A “qualified corporation” is a Canadian corporation with a permanent establishment in PEI **that is either Canadian or foreign controlled.**

In order for a project to qualify for IDTC, a “qualified corporation” must undertake to develop and commercialize “new and innovative” products, processes and services (which include interactive, information and communication technologies). Measuring the scope of “new and innovative” is made in respect to commercial activities conducted in PEI.

In claiming the IDTC, only two years of eligible expenditures are eligible.

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