

TAX GUIDE

FOR THE INDUSTRY OF THE

VIDEO GAMES

IN THE
CANARY ISLANDS



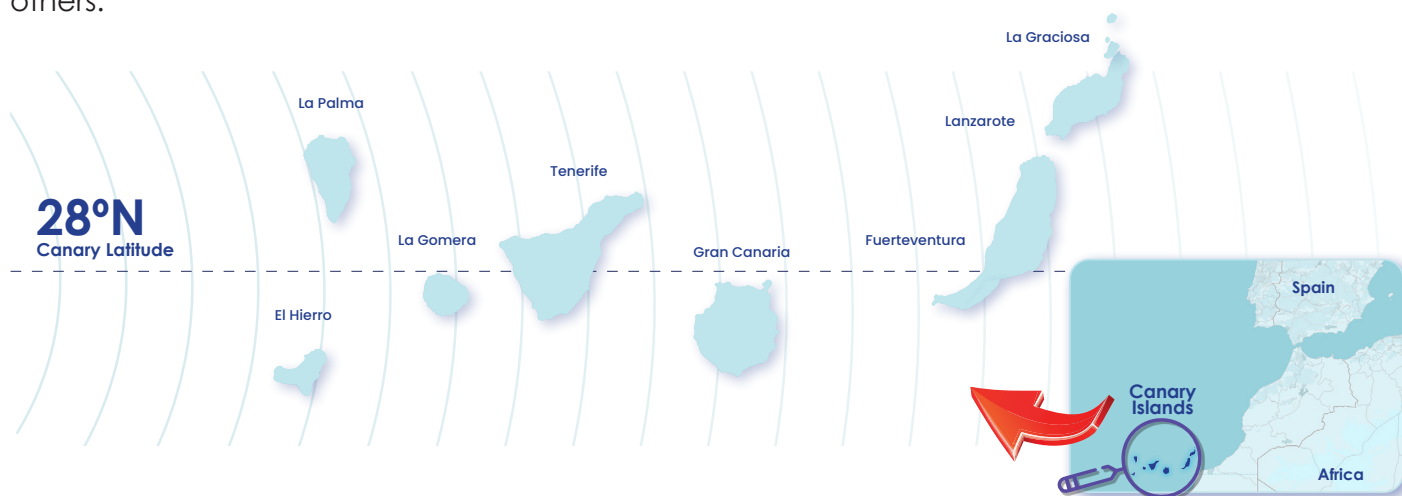
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1 Introduction

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:

- Deduction for investment in the development of videogames in the Canary Islands: 45%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% deduction for investment in fixed assets.
- 10-15% deduction on promotion and advertising expenses.

According to the REF of the Canary Islands, for the specific Technological Innovation activities incentives in the Corporate Tax Act⁴, the amount of deductions 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 15/2014 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 "Deduction 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 its wording according to 15/2014 Act, of December 19th.

⁴ Article 35 of the 27/2014 Corporate Income Tax Act. "Deduction for Research and Development and Technological Innovation activities".

2 Deduction for investment in Technological Innovation and Videogames Development

Video game development studios incorporated in Spain will be entitled to apply this deduction on eligible expenses. To benefit from the 45% deduction exclusive to the Canary Islands, the expenditure has to be done by a Canary Islands studio.

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 activities⁵.



		Spain	Canary Islands Special Case
INCENTIVE	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 deductions ***	18 años	18 años

* A 30.6% increase in the deduction ($45\% + 30.6\% = 75.6\%$) 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 deduction 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 deduction corresponding to the expense for the year exceeds, by itself, 10% of the positive adjusted full quota.

*** If it generates more tax deduction than the one that can be applied in the Corporate Income Tax, it is possible to accumulate it and apply it during the following 18 years.

There is also the possibility of monetizing the tax deduction for Video Game Innovation/Tech Development.

The monetization of the Innovation 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)

R + D + I

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 Quer V1292-03

⁷ Binding Quer V0054-02

4 What kind of expenses can be deducted?

The basis of the deduction for the performance of technological innovation activities comprises:

- Technological diagnosis activities aimed at identifying, defining, and guiding advanced technological solutions, regardless of the results.
- Industrial design and production process engineering, which shall include the conception and elaboration of plans, drawings and supports intended to define the descriptive elements, technical specifications, and operating characteristics necessary for the manufacture, testing, installation and use of a product.
- Acquisition of advanced technology in the form of patents, licenses, know-how and designs. The base corresponding to this concept may not exceed 1 million euros.
- Obtention of the certificate of compliance with quality assurance standards of the ISO 9000 series, GMP or similar, not including those expenses corresponding to the implementation of such standards.

THESE EXPENSES ARE:

1. Personnel costs for project activities, raw materials, consumables, and services used directly in the project, transportation costs, tests, trials.
2. External consulting services, provided they are directly related to the project.

At the same time, the costs of sub-activity, general company structure and financial costs cannot be charged to technology projects.

Therefore, during the development of a video game, the activities, phases, and tasks that can be considered as tax deductible are detected:

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 deduction?

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

TO HAVE **ACCESS** TO THE
OFFERED IN THE
CANARY ISLANDS

45%

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

6 How is the deduction obtained?

There are two main ways to obtain the tax deduction:

A. Quantification of the deduction 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 Binding Tax Consultation or a Preliminary Valuation Agreement can be filed.

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

This is the most commonly method used by innovative companies. 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

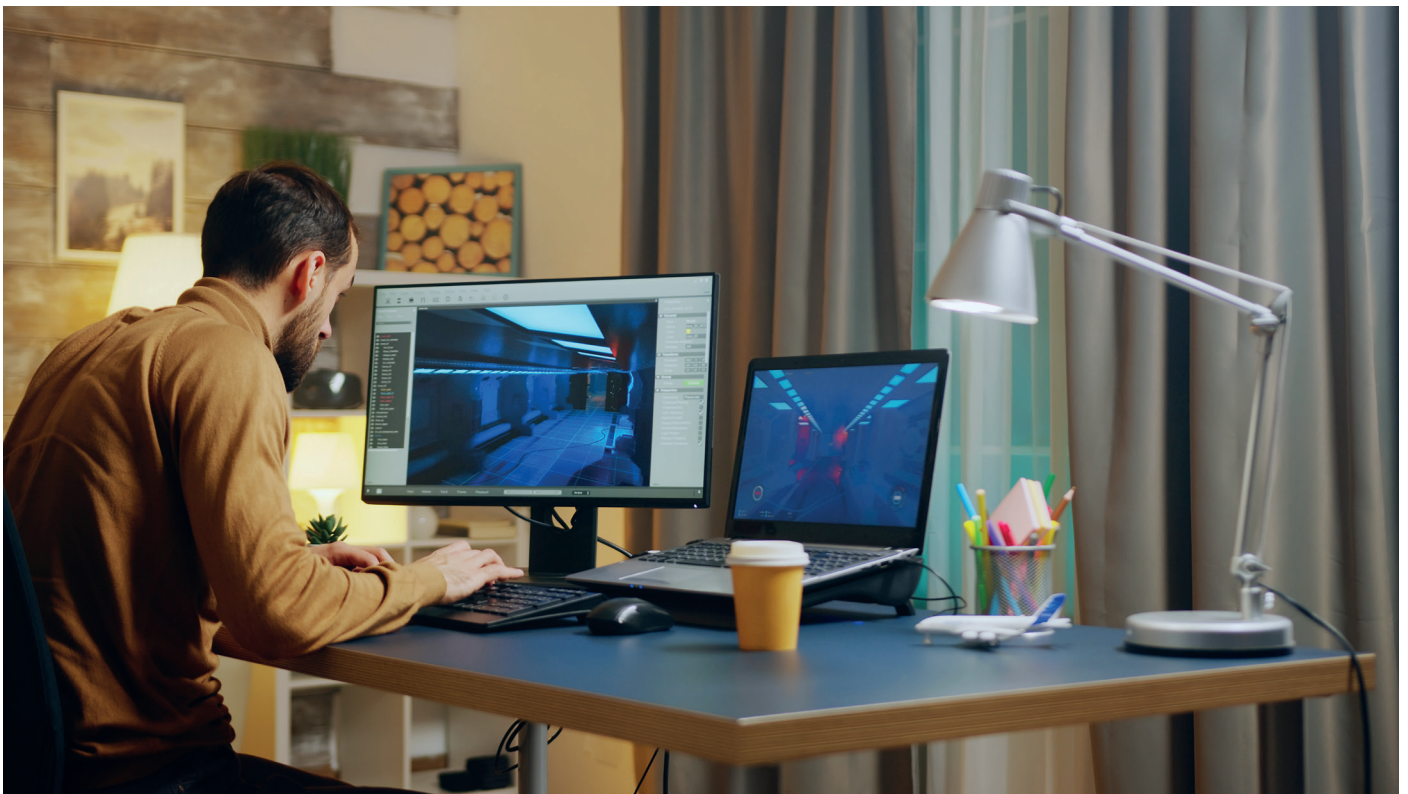
Article 35 of 27/2014 Act (former RDL 4/2004 – TR LIS) on Corporate Income Tax (in force on 01/01/2015). "Deduction for Research and Development and Technological Innovation activities".

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 deductions 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.

15/2014 Royal Decree-Act, of December 19th, amending the Economic and Fiscal Regime of the Canary Islands. Thirteenth additional provision. Deduction for technological innovation activities carried out in the Canary Islands.





Canary Islands Special Zone(ZEC)

A videogames development studio can be created as a ZEC entity and apply a reduced corporate income tax rate of 4%, instead of the general rate of 25%. ZEC entities can work in a wide range of activities in the audiovisual sector, such as:

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.
- Make an investment of at least €100,000/€50,000 (depending on whether the activity is carried out on the capital islands or not).
- Create at least 5 jobs/ 3 jobs (depending on whether the activity is carried out on the capital islands or not).
- Constitute the corporate purpose of authorized activities within the scope of the ZEC.

BENEFITS FOR ZEC ENTITIES:

- 4% Corporate Income Tax Rate.
- Exemption in the Tax on Patrimonial Transmissions and Documented Legal Acts.
- Exemption in the IGIC on imports, and exemption in operations between ZEC entities.
- Application of the International Double Taxation Agreements, and exemption at source of withholding tax for repatriation of capital applying the Parent-Subsidiary Directive.⁸
- Removal of the restriction on the application of the deduction for internal double taxation of dividends.

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

⁸ Therefore, dividends sent from the ZEC entity to the parent company outside of Spain would be exempt from the payment of withholding tax at source, applying the International Double Taxation Agreement at destination.



9 OTHER INCENTIVES IN THE CANARY ISLANDS

DEDUCTION FOR PROMOTION AND ADVERTISING EXPENSES

Deductions 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 deduction 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

Deduction 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.

DEDUCTIONS FOR INVESTMENT IN AUDIOVISUAL PRODUCTIONS⁹ (FILM, ANIMATION AND POST-PRODUCTION): 50%-45%.

Tax deduction 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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