

18 April 2022

Director
Industry Tax Policy Unit
Individuals and Indirect Tax Division
Treasury
Langton Crescent
PARKES ACT 2600

By email only: digitalgames@treasury.gov.au

Dear Director,

Digital Games Tax Offset

Thank you for the opportunity to provide feedback on the exposure draft legislation and explanatory statement for the Digital Games Tax Offset (**DGTO**).

The DGTO is a welcome initiative to strength the digital games industry in Australia, as is the Government's Digital Economy Strategy.

Some recommendations are set out below for your consideration.

1. Use the DGTO to send a strong message internationally about DAOs and blockchain-based gaming in Australia

Blockchain-based games are the new frontier of gaming, and decentralised autonomous organisations (**DAOs**) are the new frontier of global commerce.

With the investment in and proliferation of 'gaming guilds' around the world, virtual gaming as well as in-person events revolved around gaming could increasingly represent a fun and healthy gateway to learn digital skills, including digital finance, digital business and digital governance.

The vanguard of gaming is happening with DAOs and blockchain technology with the best talent naturally attracted to this work and aspiring digital creators also gravitating towards understanding and mastering the latest technology and approaches to new game experiences. Australia would be much better positioned to compete for the best digital and creative talent internationally if the exposure draft legislation is amended or examples/notes included that clarify that the tax offset is available to DAOs (to the extent that a DAO is treated as an Australian resident company and subject to Australian corporate tax) and/or persons creatively involved with DAO-run blockchain-based games (to the extent a DAO is treated like a flow-through entity for tax purposes like a partnership or trust with Australian resident contributors that carry on their business in Australia).

Whether a DAO is treated like a company or like a trust or partnership, and as an Australian resident taxpayer, depends on its particular model of governance and level of decentralisation. This task of clarification is currently underway across the Australian Taxation Office, the Board of Taxation and Treasury following the Government's in-principle agreement with recommendations made in the Final Report of the Australia as a Technology and Financial Centre Senate Select Committee. However, the task of clarification should not prevent the exposure draft legislation and explanatory statement from referencing DAOs and blockchain-based games which would act as a strong and positive signal internationally that Australia is open and competing for the best gaming innovation and experiences.

Application to core contributors to a DAO

A core contributor to a DAO might create an artwork or series of artworks that are linked to non-fungible tokens (**NFTs**) that may represent in-game characters, and be paid a stipend from the DAO treasury (i.e. a digital wallet that holds the DAO's reserve of digital assets to fund operations and governance).

In a truly decentralised DAO it is possible for core contributors to sign a one-way covenant whereby the contributor retains ownership of their intellectual property and art works (**IP**), allows for use of the IP in-game and may restrain themselves from use of the IP in other games for a period of time. This

sort of arrangement, where the IP is held by the core contributor in an Australian company, appears to fit within the policy intent of the exposure draft legislation but for the disconnects of minimum expenditure, clear flow through of the tax attribute, and that each individual core contributor cannot necessarily complete the game on their own. To the extent the exposure draft legislation can be amended to take account of these such circumstances, the impact of the policy for Australia could be much greater.

(a) *Reduce or remove the minimum expenditure requirement*

Australian resident core contributors to a DAO who engage as independent contractors and have an Australian corporate structure from which to engage could possibly claim the DGTO via the corporate structure but the minimum expenditure stifles this. The exposure draft's requirement of at least \$500,000 of expenditure should be reduced or removed to support individuals engaging via a corporate structure who may not be able to pay themselves \$500,000 or more.

(b) *Allow the DGTO to be a flow through tax attribute*

In addition, the 'tax attribute' of the DGTO should flow through to the individual in a similar way that distribution of a franked dividend from a company would be treated. That is, where the company pays a dividend to the individual shareholder, the shareholder would only be exposed to top up tax to the extent the dividend income exceeds a 30% tax bracket.

(c) *Modify the requirements around completion to allow for completion of components contributed to a game*

The DGTO is only available once a digital game is completed. Due to the nature by which core contributors contribute components of a game, the current requirements in the exposure draft legislation inhibit business models that allow creators to own their own IP in respect of what they contribute to games.

The exposure draft legislation could be modified to require an approval or sign off from a direct report or the governance model of a DAO to approve the work component as complete to enable a core contributor to claim the DGTO.

2. Consider a reduced corporate tax rate to retain digital gaming headquarters and talent in Australia

The DGTO has been visibly designed to address some of the key shortcomings of the Research & Development Tax Incentive regime (**R&D regime**). However notably and positively, unlike the R&D regime there is no clawback of the DGTO in the event the intellectual property is transferred offshore or in the event the eligible business 'exits to a DAO' (i.e. transitions from a company structure with a centralised model of governance with shareholders and directors, to a DAO with a decentralised model of governance with governance token holders).

Accordingly, it would appear that the DGTO would likely only achieve a short to medium term boost in attracting or retaining digital and creative talent in Australia while the game is being developed. Once a game is completed and in-market, Australia's corporate tax rate, particularly without the benefit of reduction by the DGTO, is uncompetitive internationally and would make it difficult for the company to justify an ongoing presence in Australia when the majority of gaming revenue may be earned from larger foreign gaming markets such as the US, Europe and Asia.

To the extent the exposure draft legislation can include a reduced corporate tax rate for gaming revenue produced from digital games that are eligible for the DGTO, the continuity and intended policy impacts of attracting and retaining talent in Australia would be better served.

3. Encourage healthy and holistic gaming policy

The DGTO should be used to incentivise and encourage healthy and holistic gaming policy. Instead of prohibiting games that may constitute a gambling service (within the meaning of the Interactive Gambling Act 2001), or that are substantially comprised of gambling or gambling-like practices, the

legislation could require that such games undergo upfront and ongoing ethical and e-safety reviews to ensure that healthy gaming habits are being formed.

Gambling and gambling-like practices are already happening outside of games on secondary markets and through betting applications, and often without any requirements for 'healthy' and educated exposure to that activity. There is an important and pivotal opportunity for the DGTO to incentivise more holistic and healthy game design. If there were an appropriate avenue for critique and issue of certificates in the DGTO regime, it would be an ethical gaming certificate rather than a completion certificate.

4. Remove the requirement for certificates

Except for the comments made at recommendation 3 above, the requirement for certificates is overly burdensome. A more effective measure would be to require the business to post certain information prominently on their website, social media and in-game and to provide the Minister or agency with a copy of that material. Self-assessment is a feature of the Australian tax law and to depart from this would be antithetical to reasons for introducing the self-assessment basis of taxation.

5. Tax attribute driven M&A activity

The exposure draft legislation attempts to provide clarity about the entity entitled to claim the expenditure for the DGTO, however the wording could allow for and attract investment activity driven by the tax attributes as was the case before the tax loss integrity measures were introduced. It is unclear whether this is an intended or unintended consequence of the current drafting.

Without an integrity measure, income tax consolidated corporate groups may look to acquire entities 'pregnant' with the ability to claim the DGTO to offset their overall corporate tax liability.

6. Clarify what 'released to the general public' means

Games are released to the public in a variety of ways and testing may occur concurrently to the game being treated as 'released'. For example, games released to the general public on an 'early release' basis are complete enough to be played and a fee to be charged but with the view that gamers test the game and provide feedback. It would be helpful if further examples could be provided to explain what this phrase means in the context of a game needing to be 'completed' before the DGTO can be claimed.

~ ~ ~

Gaming and gamification represents an enjoyable onramp and opportunity to educate people about business, government and everyday life. Gaming and gamification is an untapped policy implementation resource. The DGTO could deliver much more in prosperity to Australians and Australian businesses than is anticipated in the explanatory statement, and the nature of all recommendations made seek to illustrate the holistic opportunity.

I thank Luke Higgins for assisting me in critiquing the exposure draft legislation and explanatory statement, from a legal and a gamer's perspective.

I welcome the opportunity to discuss the recommendations and look forward to seeing the exposure draft legislation progress.

Yours sincerely,

Joni Pirovich

Principal

Blockchain & Digital Assets – Services + Law