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By Email: digitalgames@treasury.gov.au

Dear Sir / Madam,

DGTO Exposure Draft: Deloitte feedback

Further to the publication of the Exposure Draft Legislation on the proposed Digital Games Tax Offset (DGTO), we are pleased to offer some comments.

Please see the attached Appendix for an outline of our comments and suggestions. We would be happy to discuss or elaborate on these further.

If you have any questions in relation to our comments, please call me on (07) 3308 7215.

Yours sincerely

Greg Pratt
Partner

Deloitte.

Appendix

Overall, the proposed DGTO legislation presents a potentially attractive benefit to both incumbent and inbound game publishers and developers. The 30% refundable offset appears to be a mid-level benefit when compared with other similar programs in Europe and North America, where the benefits can range from 20% to as high as 50% of eligible expenditure.

To the benefit of potential claimants, the design appears to be broadly worded such that it does not necessarily exclude some expenditure scenarios that our clients have raised as salient to game development and broader industry practices. However, concerns do remain around some aspects of the proposed legislation.

Our detailed comments and suggestions surrounding the drafting of the proposed Division 378 are as follows:

- Our industry contacts have raised concerns that the design of the tax offset will make it difficult for companies to use the future DGTO as leverage when they are taking a game to market, making a game less attractive for potential investors and publishers since the financial risks will not be reduced. One suggestion has been to replicate the use of a provisional certificate process which is a feature of the Producer Offset program. Such a process would provide early assurance to a future DGTO claimant on their eligibility for a claim and can allow them to borrow capital against the future receipt.

- As drafted, under proposed s 378-10, there is a lack of clarity around which income year a company should make a DGTO claim which may of course be intentional. By way of example, it appears that where there is a time lag between completion or porting of a game and the issuing of a certificate, the offset could either be claimed in the income year in which the game is completed or ported (assuming a certificate was obtained before the income tax return was due to be lodged), or the income year in which the certificate is actually obtained. Para 1.21 of the Explanatory Statement does not provide any further insight. For the purposes of clarity for companies which would like to make an earlier claim where the certificate has been obtained after the end of the income year, we suggest amending s 378-10 to reflect the legislator's intent or clarify the ambiguity in the Explanatory Statement.

- Special purpose vehicles are likely to be set up to develop a specific game - clarification would be welcomed on whether there would be any issues where a special purpose vehicle is being wound up while the certificate is being obtained and the DGTO claimed.

- For ongoing development certificates, proposed subparagraph 378-20(5)(c) requires that the $500,000 minimum expenditure is fully incurred within the income year. This would discriminate against companies which incurred the minimum expenditure but across two income years – for example between May and August. Could this requirement be amended such that the minimum expenditure must be incurred in the 12-month period immediately prior, whilst ensuring that a claim is made only once the expenditure threshold is reached?

- It appears that arcade games may be excluded from the requirements set out in proposed s 378-20(7)(b) – if this is the intent of the legislation, this should be clarified in or around para 1.28 of the Explanatory Statement.

- Para 1.76 of the Explanatory Statement appears to indicate that companies can double dip, with expenditure qualifying for state-based rebates not being precluded from being counted. We suggest that this also could be legislatively clarified in proposed s 378-35.

- It is welcomed that proposed s 378-30 is broadly drafted. However, we feel it could be beneficial to include the concept of gaming market research as a category in s 378-30(2)(a) and also address the wider issue of pre-development costs which can be significant in s 378-30(b) which currently includes

game research costs. At a minimum the inclusion or exclusion of pre-development costs here could be clarified in the Explanatory Statement.

- In the prototyping inclusion in s 378-30(2)(c), could it be clarified whether the costs incurred on the design of new hardware, such as consoles, can be included (bearing in mind the hardware exclusion in proposed s 378-30(3)(g))?

- Although we appreciate the intent and explanations of the terms 'wholly independent' and 'substantially attributable' in proposed s 378-30(3)(o) and s 378-35(2)(a), we note that these add yet further subjective new concepts into the Tax Act and are overly punitive. Could it be further explored whether there are existing terms in the Tax Act that are well understood which could serve the same purpose – for example, the use of a market value test if not at arm's length and a 'purpose' test which has been considered by the Courts in the context of R&D activities?

- Although we appreciate the reasoning behind the exclusion of subcontracting costs in s 378-30(3)(a), subcontracting may be a more significant industry practice in game development than thought, particularly in mid to large-scale development companies. As such, this exclusion may detract from the policy intent.

- Clarification would be welcomed on the extent of the exclusion in s 378-30(3)(s) in respect of acquiring or licensing software and whether this would extend to subscriptions to development tools and a game engine (used for the purpose of developing the specific game).

- There is a perception that the inclusions have been drafted very narrowly with overly punitive exclusions. In particular, the s378-30 (3)(c) and (h) exclusions for overheads and rent respectively are costs that must be incurred to be able to provide space and run game development activities. A start-up company set up for only one game would be proportionately out of pocket due to the set-up costs when compared with companies that already have space and hardware at their disposal. An expenditure cap for these sorts of costs would be welcomed.

- We welcome the provisions in proposed s 378-40 which will allow the inclusion of expenditure incurred by outgoing companies. However, the legislation as drafted does not accommodate the concept of the partial takeover of games. It would be beneficial to address this issue, or at least make clear in the Explanatory Statement that affected expenditures can be apportioned and traced to the parts of the games that are taken over.

- The proposed provisions in s 378-90 and s 378-95, appear to allow for an unlimited amendment period given there are no time limits on amending a certificate. This seems to be overly demanding in the context of other income tax provisions.

- With reference to paras 1.33-1.34 of the Explanatory Statement on loot boxes, clarification would be welcomed on the understanding of the term "real currency" and whether it also includes digital assets, i.e., cryptocurrency, or services-in-kind.

- There are drafting errors in proposed s 378-95(a)(i) and (ii) with the correct legislative cross-references being s 378-90 and s 378-65 respectively.

- There are also errors in Paras 1.119 and 1.120 of the Explanatory Statement (but not in the draft law itself) in respect of the application provision date being on or after 1 July 2022.