

Tax Memo

Tax Incentives for Digital Media in Ontario

Through recent initiatives, Ontario has demonstrated its commitment to the development of digital media in the province. Measures include creation of the Emerging Technologies Fund and budget changes aimed at fostering a strong business environment for the Entertainment and Creative Cluster.

These come at a time when technology demands are forcing many companies in the sector to shift to digital media. This challenges the current business models of traditional companies and creates opportunities for emerging companies. Even in the current economic environment, digital media, especially video games, continues to show good growth.

Many provinces, including Ontario, have tax incentives to help companies develop digital media products. The 2009 Ontario budget enhanced the refundable Ontario Interactive Digital Media Tax Credit (OIDMTC) by increasing the rate to 40% for qualifying corporations that develop their own product, regardless of the corporation's size. In addition, qualifying corporations that develop eligible products under a fee-for-service arrangement qualify for a 35% refundable tax credit. The refundability aspect is particularly important in this economic environment, because the credit reduces the cost of development, so the company need not be taxable to enjoy the benefits.

In its 2008 Canadian Interactive Industry Profile, the Canadian Interactive Alliance estimates the number of interactive media companies in Canada at 2,960, collectively employing between 51,000 and 52,500 Canadians in various roles. The estimated revenue generated by these companies is \$4.7 billion annually, with \$3.8 billion of that coming from interactive digital media projects.

The OIDMTC program has been enhanced significantly by the provincial government in two out of three budgets since 2006. This *Tax Memo* provides a brief overview, including the chronology of the key changes.

Background

The OIDMTC program is jointly administered by the Canada Revenue Agency (CRA) and the Ontario Media Development Corporation (OMDC). The program provides refundable tax credits for:

- Ontario labour expenditures with respect to eligible and specified products; and
- eligible marketing and distribution expenditures incurred by qualifying corporations with respect to eligible products, to a maximum of \$100,000 per product.

Upon receipt of an application and a fee equal to 0.1% of eligible expenditures, the OMDC will review the taxpayer's application and issue a certificate of eligibility if the various criteria are met. The refundability of the tax credits is handled through Ontario's corporate tax system, which has been harmonized with the federal corporate income tax system, starting with taxation years ending after December 31, 2008.

Two types of products can be claimed under the OIDMTC: eligible products and specified products.

Eligible products are interactive products that:

- are developed in Ontario by a qualifying corporation;
- are in digital format;
- present information in at least two of text, sound and images;
- have the primary purpose of educating, entertaining or informing the user; and
- are not used primarily for interpersonal communication, to present or promote the qualifying corporation or to present, promote or sell its products and services.

Specified products are interactive digital media products developed:

- under a fee-for-service arrangement between the qualifying corporation and an arm's length purchaser; and
- for the purpose of sale or licence.

In its March 26, 2009 budget, Ontario extended the OIDMTC to digital media game developers that incur a minimum of \$1 million of eligible labour expenditures over a 36-month period for fee-for-service work done in respect of an eligible product. These claimants are no longer required to deal at arm's length with the purchaser and to develop all, or substantially all, of the eligible product in Ontario.

Tax Credit Rates

Tax credit rates for eligible and specified products are as follows:

Qualifying expenditures incurred:		Eligible products		Specified products (under fee-for-service)
After	Before	Qualifying corporation is:		
		Small	Other	
n/a	March 24, 2006	20%		n/a
March 23, 2006	March 26, 2008	30%		20%
March 25, 2008	March 27, 2009			25%
March 26, 2009	n/a	40%		35%

In general, a qualifying small corporation is a Canadian corporation that:

- develops an eligible product at a permanent establishment in Ontario; and
- during the preceding taxation year (on an associated company basis) had neither annual gross revenues above \$20 million nor total assets above \$10 million.

For eligible products, tax credits are based on Ontario labour expenditures and the first \$100,000 of eligible

marketing and distribution expenditures for each eligible product.

For specified products, tax credits are calculated with reference to salaries and wages of employees resident in Ontario. Residency is determined by where the employee resided on December 31 of the previous year.

Eligible Expenditures

Eligible Ontario labour expenditures include:

- **for eligible products and specified products:** salaries and wages directly attributable to the development of the product and actually paid to employees (100% included); and
- **for eligible products:** contract expenditures paid to arm's length contractors that are attributable to the salaries and wages of the contractor's employees, for services rendered at a permanent establishment in Ontario (100% included effective March 27, 2009, 50% until then).

Eligible marketing and distribution expenditures are expenditures that are directly attributable to advertising, promotion or distribution of the eligible product.

	Eligibility for products completed	
	Before March 26, 2008	After March 25, 2008
Period in which Ontario labour expenditures must be incurred¹	25 months ¹	37 months ¹
Marketing and distribution expenditures (eligible products)	Include expenditures incurred within the 12-month period following the release date, if the \$100,000 maximum has not been reached.	
Specified products (described above)	Limited to the salaries and wages of its Ontario-resident employees.	

1. Applies to both eligible products and specified products. Period terminates at the end of the month in which development of the product is completed.

Effective Use of the OIDMTC program

The increase in the rates of refundable tax credits makes the OIDMTC program extremely attractive and valuable to any company developing interactive digital media products.

The potential to reduce your after-tax cost of developing products or providing services should not be ignored. Every effort should be made to identify qualifying products and track associated costs to ensure that your tax credits are maximized. Claims can be submitted retroactively for all open Ontario tax years.

For More Information

If you would like more information or to discuss how your company can take advantage of its full OIDMTC entitlement, please contact your PricewaterhouseCoopers adviser or any of the following individuals.

Greater Toronto	Tracey Jennings	416 869 8737	tracey.l.jennings@ca.pwc.com
	Spence McDonnell	416 869 2328	spence.n.mcdonnell@ca.pwc.com
	Dean Morrison	905 949 7344	dean.morrison@ca.pwc.com
	Maureen Savoy	905 949 7370	maureen.m.savoy@ca.pwc.com
London	Kevin Robertson	519 640 7915	kevin.c.robertson@ca.pwc.com
Ottawa	Kent Smith	613 755 8742	kent.b.smith@ca.pwc.com
	Jennifer Smart	613 755 4360	jennifer.f.smart@ca.pwc.com
Waterloo	Jay McLean	519 570 5759	jay.mclean@ca.pwc.com
Windsor	Giancarlo DiMaio	519 985 8911	giancarlo.dimaio@ca.pwc.com

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