

British Columbia Digital Animation or Visual Effects Tax Credit

Income Tax Act

Bill 7, *Income Tax Amendment Act, 2003* amended the *Income Tax Act* (Act) to provide the legislative framework for the Digital Animation or Visual Effects (DAVE) tax credit described in this bulletin. Bill 7 received royal assent March 12, 2003.

The DAVE tax credit program provides refundable tax credits on a corporation's **digital animation or visual effects activities** that qualify for either the basic Film and Television tax credit or the Production Services tax credit. These credits are claimed when filing the T2 Corporation Income Tax Return, and are refundable to the extent they exceed the corporation's income tax payable.

The information in this bulletin is provided for your convenience and guidance and is not a replacement for the legislation. The *Income Tax Act* and Regulations can be found on the web at www.gov.bc.ca/sbr

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DEFINITIONS

The following terms defined in section 79 of the Act, and explained in **Bulletins CIT 009**, *Film and Television Tax Credit*, or **CIT 010**, *Production Services Tax Credit*, apply for the purposes of these credits:

- accredited production;
- accredited production corporation;
- accredited qualified BC labour expenditure;
- assistance;
- BC labour expenditure;
- certifying authority; and
- eligible production corporation.

The term **principal photography** is defined in the Film and Television Tax Credit Regulation and explained in **Bulletin CIT 009**, *Film and Television Tax Credit*.

The definition of **accredited production** in section 79 of the Act was amended with the introduction of the DAVE tax credit. Accredited production is expanded to include any production, regardless of total expenditures, that is an episode or a pilot for an episode, with a running time of less than 30 minutes, all, or substantially all, of which consists of prescribed digital animation or visual effects. The remaining portions of the definition of accredited

production remain the same and are explained in [Bulletin CIT 010](#), *Production Services Tax Credit*.

ELIGIBILITY REQUIREMENTS

A corporation is eligible for the DAVE tax credit for a taxation year if it meets the following requirements:

- the production is eligible for, and the corporation has claimed the basic Film and Television tax credit; **or** the production is eligible for, and the corporation has claimed the Production Services tax credit;
- **principal photography** of the production begins after March 31, 2003;
- the production consists of DAVE activities as discussed below;
- the DAVE activities are created primarily with digital technology; and
- the DAVE expenditure is a **BC labour expenditure** incurred after December 31, 2002.

DAVE TERMS

Industry Terms

Certain terms used in the DAVE legislation and related Film and Television Tax Credit Regulation are intended to have their common meaning or usual meaning in the digital animation industry and visual effects industry.

Animation is commonly used to refer to an animated sequence or production which is a series of 2D or 3D images rendered in sequence to create artificial moving images. Animation may be contrasted to a live action sequence or production which records live subjects in motion.

Digital animation is animation created primarily with the use of digital technology including computer animation hardware and software.

Visual effect is commonly used in connection with live action productions or sequences to refer to a special effect which is usually inserted into the production after filming to create a visual impression which would be impossible, impractical or unsafe to achieve during shooting using physical effects. The effect may be created by digitally augmenting and manipulating visual imagery originating on film, tape and/or 2D or 3D digital elements generated in the computer and

compositing the modified imagery back onto film or tape.

DAVE Activities

Activities undertaken to produce DAVE activities include, but are not limited to:

- designing – digitally creating a graphic representation, especially a detailed plan for construction or manufacture;
- modeling – for the purposes of painting, drawing, and photography, giving a three-dimensional appearance to an object (for example by shading or highlighting or representing something, usually on a smaller scale);
- rendering – converting a high-level object-based description into a graphical image for display;
- lighting – in animation, creating the illusion of reflection, lights or shadows in the image to enhance the mood and emotion of a scene;
- painting – in animation, the act of filling in the colours to add life and texture to the image;
- animating – creating animation as defined under industry terms;
- compositing – combining or layering computer graphic elements resulting in a completed composition or scene; and
- visual effects photography.

Visual effects photography includes, but is not limited to:

- blue or green screen photography;
- element photography;
- plate photography;
- motion control photography;
- miniature photography;
- motion capture sessions;
- texture photography; and
- digital scanning and/or surveying of actors, set pieces or entire sets.

Excluded Activities

The following activities are specifically excluded by regulation and do not qualify for the DAVE tax credit:

- audio effects – include sound effects added during post-production by the sound crew. However, voice-overs, the narration or non-synchronous dialogue that takes place over the action onscreen, are not excluded activities;

- in camera effects – include an effect that is achieved using single or multiple passes of film through a camera;
- credit rolls – a sequence of text credits that roll up the screen at the end of the production. However, title sequences, in which the title of the movie is displayed on screen and which appear at the beginning of a production or in another manner, are not excluded activities;
- subtitles – words which are superimposed over a film which mirror the dialogue that is heard at the time;
- animation or visual effects all or substantially all of which are created by editing activities; or
- animation or visual effects created for use in promotional material for the production.

In addition, labour expenditures that are not eligible for the basic Film and Television tax credit or the Production Services tax credit, such as audit fees and marketing expenses, are not eligible for the DAVE tax credit.

Primarily with Digital Technology

To qualify for the DAVE tax credit, the effect must be created primarily with digital technology. An effect is created primarily with digital technology if more than 50% of the effect is created with digital technology.

To determine if more than 50% of the effect is created with digital technology you may use:

- cost method – divide the labour expenditure for digital work by the total labour expenditure (mechanical and digital) of creating the effect;
- hour method – divide the hours spent on digital work by the total work hours (mechanical and digital) spent on the effect; or
- other method – that can be substantiated and that reflects the total effort expended to create the effect.

The method used must be reasonable, clearly documented and applied consistently to the production. If the effect is created primarily with digital technology, then the total labour expenditure directly attributable to creating that effect is included in determining the DAVE tax credit.

For example, a company creates a visual effect and pays \$15,000 in labour expenditures that are directly attributable to creating that effect, and those expenditures are allocated as follows:

- \$10,000 to digital visual effects employees; and
- \$5,000 to mechanical special effects employees.

The percentage of the labour expenditure for digital work is 67% of the total labour expenditure (\$10,000 divided by \$15,000). As the percentage is greater than 50%, the effect is created primarily with digital technology. Therefore, the full \$15,000 of labour expenditure is included in computing the DAVE tax credit.

Directly Attributable

Labour expenditures must be directly attributable to DAVE activities to be included in computing the credit. A labour expenditure is directly attributable if the salary or wages can be traced back to that activity.

The expenditure must relate to time spent on the DAVE activities or to time spent in direct support of those activities. There must be a direct link between the labour expenditure and the specific DAVE activity. You may determine the link for any given employee or sub-contractor by reviewing contracts, production sheets, or other detailed documentation.

If the duties performed by an individual include activities, some of which are not directly attributable to the effect, you may allocate only a portion of that individual's salary or wages to the effect. For example, if an individual works 70% of the time on non-DAVE activities, then only 30% of the individual's salary or wages would be considered directly attributable to DAVE activities. The allocation method used must be reasonable, clearly documented and applied consistently.

Labour expenditures that are directly attributable to DAVE activities include the salary or wages of individuals who create the effect and personnel that support those individuals performing that DAVE activity. Positions and job activities that may qualify include, but are not limited to, the salary or wages paid to:

- computer animation and visual effects staff directly engaged in the work;
- supervisors who are involved directly with the activities;
- evaluation, recruitment and hiring of those directly engaged in the work; and
- work performed by administrative staff in support of those directly engaged in the work.

THE DAVE TAX CREDITS

There are two DAVE tax credits:

- the DAVE tax credit under the basic Film and Television tax credit program; and
- the DAVE Production Services tax credit under the Production Services tax credit program.

Digital Animation or Visual Effects Tax Credit

The DAVE tax credit is calculated as 15% of:

$$\text{ALE} - (\text{TA} + \text{PA} + \text{ARE})$$

- ALE means the total of the corporation's **BC labour expenditure** incurred after December 31, 2002 for the current and preceding taxation years directly attributable to DAVE activities.
- TA means the total **assistance** that can reasonably be considered to be in respect of the corporation's ALE that the claimant has received or is entitled to receive, has not been repaid under a legal obligation to do so, and has not otherwise reduced the corporation's ALE.
- PA means all amounts determined under this formula in a previous year.
- ARE means the total of amounts included in ALE for which the corporation has received or will receive a reimbursement.

Digital Animation or Visual Effects Production Services Tax Credit

The DAVE Production Services tax credit is 15% of the **accredited qualified BC labour expenditure** for the taxation year directly attributable to DAVE activities.

Assistance

If you receive assistance related generally to the production, such as grants from a film or television fund, you must determine a reasonable portion of the assistance to be deducted from your DAVE labour expenditures. A reasonable portion can be determined by:

- dividing the corporation's cost of DAVE activities for the production by the total cost of the production; and then
- multiplying the result by the value of the assistance.

Assistance received in respect of DAVE activities

would generally be considered to have been received in respect of DAVE labour expenditures.

APPLYING FOR THE DAVE TAX CREDIT

A corporation's eligibility for the DAVE tax credit is determined by the **certifying authority**, the Minister of Tourism, Sport and the Arts.

A corporation applying to the **certifying authority** for a DAVE tax credit must:

- complete an application form;
- provide all information required to support the application; and
- pay an application fee.

British Columbia Film provides detailed information with respect to the application for a DAVE tax credit.

If more than one corporation is eligible to claim the DAVE tax credit in respect of the same production, one corporation may be designated as agent to apply for the certificate. Once the certificate is received, the agent is responsible for distributing copies of the certificate to the other eligible corporations.

If the **certifying authority** refuses to issue a certificate, or a certificate which has been issued is revoked by the **certifying authority** or the Canada Revenue Agency (CRA), notice with reasons for the refusal or revocation must be given to the corporation. Any such decision may be reconsidered.

Decisions may be appealed to the Supreme Court of British Columbia, in accordance with section 92 of the Act. Appeals must be filed within 120 days of the issuance of the notice of refusal or revocation.

CLAIMING THE DAVE TAX CREDIT

To claim the DAVE tax credit under the basic Film and Television tax credit program, an **eligible production corporation** must complete the *British Columbia Film and Television Tax Credit* form (**Form T1196**). To process the tax credit claim, CRA must receive:

- a completed Form T1196;
- the eligibility certificate issued by British Columbia Film; and
- the corporation's T2 Corporate Income Tax Return.

For the taxation year in which the production is completed, the completion certificate issued by British Columbia Film also must be submitted to the CRA.

To claim the DAVE Production Services tax credit under the Production Services tax credit program, an **accredited production corporation** must complete the *British Columbia Production Services Tax Credit* form (**Form T1197**). To process the tax credit claim, the CRA must receive:

- a completed Form T1197;
- the accreditation certificate issued by British Columbia Film; and
- the corporation's T2 Corporate Income Tax Return.

A corporation is not entitled to a DAVE tax credit unless it applies for the credit within three years of the end of the taxation year. For priority processing, please ensure the film tax credit claim forms are stapled to the front of the T2 Corporate Income Tax Return.

ROLE OF THE CRA AND THE MINISTRY OF SMALL BUSINESS AND REVENUE

The Ministry of Small Business and Revenue contracts with the Canada Revenue Agency (CRA) to review and audit the DAVE tax credit claims and issue refund cheques where appropriate. If a corporation disagrees with the amount of credit assessed by the CRA, a Notice of Objection should be filed with the CRA within 90 days of the date of the Notice of Assessment.

NEED MORE INFO?

This bulletin is provided for convenience and guidance.

For further information , please contact:

**Canada Revenue Agency
Vancouver Tax Services Office
1166 W. Pender St.
Vancouver BC V6E 3H8**

**Telephone: 604 666-7911
Website: <http://www.cra-arc.gc.ca/>**

**Ministry of Small Business and Revenue
Income Taxation Branch
PO Box 9444 Stn Prov Govt
Victoria BC V8W 9W8**

**Telephone: 250 387-3332
Fax: 250 356-9243**

**E-mail questions to:
ITBTaxQuestions@gov.bc.ca**

**Information is also on the web at
www.gov.bc.ca/sbr While there, you can
subscribe to our free electronic update
service.**

**For further information concerning
eligibility, applications and certificates,
please contact:**

**British Columbia Film
2225 West Broadway
Vancouver BC V6K 2E4**

**Telephone: 604 736-7997
Fax: 604 736-7290**

Website address: <http://www.bcfilm.bc.ca/>