NOVA SCOTIA
DIGITAL MEDIA TAX CREDIT
GUIDELINES

Nova Scotia Department of Finance and Treasury Board
Taxation and Federal Fiscal Relations Division

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DMTC Website

Table of Contents

Nova Scotia Digital Media Tax Credit Guidelines

What is it?

The Nova Scotia Digital Media Tax Credit (DMTC) is a refundable tax credit claimed by eligible corporations for expenditures incurred[1] and paid in Nova Scotia, which are directly attributable to the development of an eligible interactive digital media product.

The DMTC is administered by the Nova Scotia Department of Finance and Treasury Board, Taxation and Federal Fiscal Relations Division.

Where there is a conflict between the information contained in these Guidelines and the Legislation and Regulations, the Legislation and Regulations governing the DMTC will take precedence over the guidelines, application forms, advance ruling or any other published information. The legislative authority for the credit is contained in Section 47A of the *Income Tax Act* (Nova Scotia) and the *Digital Media Tax Credit Regulations*.

Who is eligible?

In order to be eligible for a DMTC, a corporation developing an interactive digital media product must be an "eligible corporation"[2]. An "eligible corporation" is a corporation that satisfies all of the following requirements:

1. It is a taxable Canadian corporation. A "Canadian corporation," as defined in subsection 89(1) of the *Income Tax Act* (Canada), is one which was incorporated in Canada (either federally or in one of the provinces).
2. The corporation must have a "permanent establishment" in Nova Scotia. This normally refers to a fixed place of business in the Province, assets in the Province to develop the product, and personnel in the Province who can contract on behalf of the corporation.
3. The corporation must not be a prescribed labour-sponsored venture capital corporation under the *Income Tax Act* (Canada).

The corporation may be controlled by foreign or Canadian owners. There is no restriction on the size of the corporation (e.g., market capitalization, number of employees, etc.).

Normally an eligible corporation has a "permanent establishment" in the Province if it has a fixed location where the corporation conducts its business. This will be determined in accordance with Regulations 400(2) of the *Income Tax Act* (Canada) and associated Interpretation Bulletin[3]. The Department of Finance and Treasury Board will evaluate "permanent establishment" based on the facts of the situation.

Applicants must demonstrate that they own the property rights of the product in order to claim the DMTC. In cases where a corporation developed an eligible product but does not own the

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[1] "Incurred" is interpreted to be the sooner of the time the consideration for a supply is due or the time the consideration is paid. Section 168(1) and Section 152(1) of the *Excise Tax Act* and GST Memoranda G330-6-1 will be applied as if they apply to supplies of exempt and zero-rated goods as well as taxable goods.

[2] "Eligible Corporation" is defined in Section 4 of the *Digital Media Tax Credit Regulations.*

[3] See Interpretation Bulletin IT-177R2.

property rights it may still claim the credit if it has been authorized by the product owner. This is normally done through the Certificate of Election form.

How much is the tax credit?

The DMTC is calculated as the lesser of 50 percent of "qualifying expenditures"[4] or 25 percent of "total expenditures"[5]. If the credit is calculated using "total expenditures" it will be reduced by the total amount of "government assistance"[6] received by the applicant for the eligible product. An additional bonus of 10 percent on "qualifying expenditures" or 5 percent on "total expenditures" is available for development of eligible products within an "eligible geographic area of the Province"[7].

There are no annual or per product limits to the total amount of tax credit received by an eligible corporation, nor any restrictions regarding the number of applications by an eligible corporation.

The following table displays the value of the tax credit available:

	Base Tax Credit Rates	Regional Bonus Rates	Total Tax Credit
Qualifying Expenditures	50%	10%	*(A)* 60%
Total Expenditures	25%	5%	*(B)* 30%
Tax Credit			Lesser of *(A)* and *(B)*

The DMTC is calculated as the lesser of (A) and (B).

What types of products are eligible?

To be eligible for the DMTC a product must be an "interactive digital media product"[8] whose primary purpose is to educate, inform or entertain the user. The product must be a combination of application and data files, all in a digital format, and achieve its primary purpose by presenting information, in appreciable quantities, in at least two of: (a) text, (b) sound or (c) images.

The eligible product must be interactive, that is, the user must be able to interact with the digital files, become a participant and not simply be a reader or spectator. Products that only allow the

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[4] "Qualifying expenditures" is defined in Section 6 of the *Digital Media Tax Credit Regulations*. Please note that "eligible salaries" will form part of "total expenditures".
[5] "Total expenditures" is defined in Section 7 of the *Digital Media Tax Credit Regulations*.
[6] "Government assistance" is defined in Section 2 of the *Digital Media Tax Credit Regulations*. Canada Revenue Agency publication IT-273R2 will be used to determine what the value of government assistance is for the purposes of the DMTC.
[7] "Eligible geographic area" is defined in Section 11 of the *Digital Media Tax Credit Regulations*.
[8] "Interactive digital media product" is defined in Section 2 of the *Digital Media Tax Credit Regulations*.

user to read, choose, access linear content (slide show, video, audio, general website) but do not allow the user to interact with the content are not considered interactive.

Interactivity is the interaction between the user and a product. Types of interaction can range from menus, cursors to verbal exchanges with a product.

The interactivity of a product is assessed by three characteristics:

- Feedback

Feedback is a tailored response given to the user based on user's specific input. For example, educational software can provide the user customized responses in a test, point out weakness, or suggest that user review a particular chapter. If every user would see the same evaluation following the test regardless users' specific input, that would not be considered an interactive experience.

- Control

The user can influence or affect how the program proceeds. Types of control include making choices, implementing strategy, moving objects, using logical reasoning, or modifying or creating an image. For example, the user of a video game can control his/her actions and influence how he/she advances through the game.

- Adaptation

The product is able to adapt to the user's skill level, preferences, decisions, actions, reactions or other input, which creates a highly personalized experience for each user. For example, in a driving simulation game, the product can assess areas of weakness for each driver and modify the simulation that the driver receives. As a result, the product provides highly adapted experience to each user.

These characteristics serve an important guide in the evaluation of a product and are required to present in a product in order for the product to be considered interactive. Types of interactive digital media products that may be eligible for the tax credit include, but are not restricted to, video games, educational, and informational products. There is no restriction on how the eligible product is distributed, for example, on a Read Only Medium (ROM) or through a website.

Applicants are encouraged to submit a Part A application to the Department of Finance and Treasury Board for a preliminary ruling before submitting a Part B application.

What types of products are not eligible?

A combination of application files and data files developed primarily for use as an operating system or application software (e.g., word processing, spreadsheets, database, etc.) is not eligible for the tax credit. Products used primarily for interpersonal communications – such as cell phone and email software – are also not eligible for the tax credit. For the purposes of interpreting the word "primarily", the Department of Finance and Treasury Board uses "greater than 50 percent" to mean "primarily". The Department will determine what products exceed the 50 percent threshold.

A product used primarily to present, promote, or sell the goods or services of a corporation or an organization is not eligible for the tax credit. Generally, this will include products that display, advertise or inform a user about the goods and services of a corporation or organization, or where they can be purchased, provide the user with the ability to purchase goods and services of a corporation or organization by using the product, or contain links to websites where the user can purchase goods and services of a corporation or organization.

A tax credit will not be provided for products for which public financial support would, in the opinion of the Minister of Finance and Treasury Board, be contrary to public policy. For greater clarification, this includes products that are pornographic in nature, have the undue exploitation of sex as their dominant characteristic, or are capable of inciting hatred against an identifiable group, including a section of the public distinguished by colour, race, religion, sex, sexual orientation or ethnic origin.

Each applicant will be required to submit a completed copy of their product or a video of playing the product to the Department where it will be reviewed, to ensure compliance with the Act and Regulations. Product demonstrations, which cannot be recorded, are no longer permitted to replace the above requirements.

What expenditures are eligible?

The DMTC is calculated as a percentage of "qualifying expenditures" (50%) or "total expenditures" (25%), whichever is less. These two terms are further explained below.

Qualifying Expenditures

The DMTC is equal to the sum of: 50 percent of "qualifying expenditures" incurred outside the eligible geographic area of the Province, and 60 percent of "qualifying expenditures" incurred in an eligible geographic area of the Province. A qualifying expenditure is defined as the sum of the following:

1. Eligible salaries[9];
2. 65 percent of eligible remuneration[10];
3. Marketing and distribution expenditures[11] to a maximum of $100,000 per eligible product.

In order for a "qualifying expenditure" to be reasonable in the circumstances, the dollar value of the labour expense must conform to industry standards, and the type of labour expense must be generally recognized as being essential to the development and production of the interactive digital media product. If the amount is unreasonable, only the amount in excess of what is reasonable is not eligible for the credit.

"Eligible salaries" are salaries and wages paid to employees of the eligible corporation. Dividends are not considered salaries and wages. Employees must have been residents of Nova Scotia on the last day of the calendar year prior to the year in which the salary or wage was earned. That is, they must have been liable for personal income tax in Nova Scotia by virtue of being resident in Nova Scotia. There are no "deeming" provisions for non-residents of Nova

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[9] "Eligible salaries" is defined in Section 9 of the *Digital Media Tax Credit Regulations*.
[10] "Eligible remuneration" is defined in Section 10 of the *Digital Media Tax Credit Regulations*.
[11] "Eligible marketing and distribution expenditures" is defined in Section 8 of the *Digital Media Tax Credit Regulations.*

Scotia. A corporation applying for the DMTC will be required to file a Declaration of Residency completed by each employee for whom eligible salaries are being claimed.

The eligible employee must normally report to a permanent establishment of the eligible corporation in Nova Scotia. In addition, salaries and wages must be reasonable in the circumstances, included in the cost of the eligible product, and directly attributable to the production of the eligible product.

Salaries and wages incurred in the eligible corporation's taxation year must be paid in that taxation year or within 60 days of the end of the taxation year. If not, they may be claimed in the subsequent taxation year as long as they are paid in the subsequent taxation year or within 60 days of the end of the subsequent taxation year. No claim for salaries and wages is allowable if they are not paid within these time limits.

Salaries and wages that may be claimed for a Scientific Research and Experimental Development Tax Credit or a Film Industry Tax Credit (Sections 41 and 47 of the *Income Tax Act*) are not eligible for the DMTC[12].

"Eligible remuneration" is the labour component of third party expenditures incurred by an eligible corporation and paid to arm's length entities or individuals. The eligible remuneration must be reasonable in the circumstances, included in the cost of the eligible product, and directly attributable to the production of the eligible product. In addition, the eligible remuneration must be paid for services rendered at a permanent establishment in Nova Scotia. Payments for services performed outside Nova Scotia or to an entity or individual that does not have a permanent establishment in Nova Scotia will not qualify as eligible remuneration.

Eligible remuneration incurred in the eligible corporation's taxation year must be paid in that taxation year or within 60 days of the end of the taxation year. If not, it may be claimed in the subsequent taxation year as long as it is paid in the subsequent taxation year or within 60 days of the end of the subsequent taxation year. No claim for eligible remuneration is allowable if it is not paid within these time limits.

Invoices from arm's length entities or individuals must be accompanied by a breakdown of the labour (services) component performed in the Province. Invoices which do not provide this breakdown, or where the breakdown is not supported by a Statement of Eligible Remuneration, will not be included in calculating the amount of eligible remuneration.

Expenditures that qualify as eligible remuneration and that may be claimed for a Scientific Research and Experimental Development Tax Credit or a Film Industry Tax Credit (Sections 41 and 47 of the *Income Tax Act*) are not eligible for the DMTC[13].

"Marketing and distribution expenditures" are expenses incurred by an eligible corporation that are directly attributable to advertising, promoting or distributing the interactive digital media product. Marketing and distribution expenditures may be incurred and paid to individuals and entities that do not have a permanent establishment in Nova Scotia and for goods and services provided outside Nova Scotia.

Examples of expenditures that would fall within the definition of marketing and distribution are as follows:

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[12] Subsection 9(2) of the *Digital Media Tax Credit Regulations*.
[13] Subsection 10(2) of the *Digital Media Tax Credit Regulations*.

- Expenses associated with attending trade shows where the eligible product is being promoted;
- Advertising costs (including design) for promoting the eligible product in print and other forms of media;
- Market research and focus group testing;
- Development of a visual identity for the eligible product (e.g., branding, logos, promotional products, etc.);
- Product displays, demonstrations and in-store promotions;
- Provision of samples of the eligible product;
- Direct mail and telemarketing expenses;
- News releases and media kits;
- Salaries related to the marketing and distributing of the product.

Marketing and distribution expenditures are capped at $100,000 per eligible product[14].

The marketing and distribution expenditures can be incurred from 24 months before the eligible product is completed to 12 months after the eligible product is completed. The expenditure must be paid in the taxation year in which it is incurred or no later than 60 days after the end of the taxation year.

Expenditures for food, beverages and entertainment related to the marketing and distribution of the eligible product are included at the rate of 50 percent of the expenditure.

The expenditure cannot be directly related to processing an order for an eligible product from a consumer or shipping an eligible product to a consumer.

Total Expenditures

The DMTC is equal to the sum of: 25 percent of "total expenditures" incurred outside an eligible geographic area of the Province, plus 30 percent of "total expenditures" incurred inside an eligible geographic area of the Province. Total expenditures are defined as the sum of all salaries and wages paid to Nova Scotians, eligible remuneration, all "Outlays, Expenses, Losses or Replacement of Capital"[15] expenses paid in Nova Scotia, marketing and distribution expenditures to a maximum of $100,000, less the value of government assistance. HST is not included in the calculation.

The value of government assistance[16] (grants, forgivable loans, financing, payroll rebates etc.) will be deducted before applying the applicable credit percentage to total expenditures. The DMTC is not considered government assistance for the purposes of this credit. Conditionally forgivable loans will be considered government assistance for the purposes of Section 2 of the *Digital Media Tax Credit Regulations*.

Expenditures that qualify as total expenditures and that may be claimed for a Scientific Research and Experimental Development Tax Credit or a Film Industry Tax Credit (Sections 41 and 47 of the *Income Tax Act*) are not eligible for the DMTC[17].

"Outlays, Expenses, Losses or Replacement of Capital" (OELR) is a catch all category that is intended to capture all costs that are directly related to the production of the eligible product,

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[14] Subsection 7(1) of the *Digital Media Tax Credit Regulations*.
[15] Subsection 7(1) of the *Digital Media Tax Credit Regulations*.
[16] Canada Revenue Agency publication IT-273R2 will be used to determine what the value of government assistance is for the purposes of the DMTC.
[17] Subsection 7(2) of the *Digital Media Tax Credit Regulations*.

that were incurred in Nova Scotia and don't fall within any of the other categories. This includes items such as rent, supplies, computers and software. Eligible OELR costs can be calculated one of two ways. The first method involves specifically identifying each eligible OELR expenditure. Each item must be supported by invoices, contracts, etc and listed in the application form. Alternatively, if an applicant chooses, the Department of Finance and Treasury Board will estimate eligible OELR expenses to be 65% of Eligible Salaries. Applicants are free to choose whichever method they prefer, however, once a choice is made it must be used in each application for the eligible product.

What is the Eligible Geographic Area of the Province?

Eligible corporations that develop and produce interactive digital media products in an "eligible geographic area of the Province" (EGA) are eligible for an increase of the DMTC rate by 10 percent of qualifying expenditures or by 5 percent of total expenditures provided that:

1. The "eligible corporation" has a "permanent establishment" in the EGA; and
2. No less than 50 percent of "eligible salaries" for the "eligible product" are paid to "eligible employees" who report to the permanent establishment in the EGA.

The EGA is defined as everywhere in Nova Scotia except for the area within thirty kilometers driving distance from Halifax City Hall in the Halifax Regional Municipality.

How does the application process work?

The Taxation and Federal Fiscal Relations Division (TFFRD) of the Department of Finance and Treasury Board is the principle administrator of the DMTC. The TFFRD is responsible for issuing tax certificates that eligible corporations may use to claim the DMTC with their annual income tax filings. The tax certificates contain information about the eligible corporation and the value of the DMTC by taxation year.

Corporations may apply for the DMTC either when the product is completed or at the end of each taxation year for which qualifying expenditures are incurred. Tax certificates which are issued before a product is completed may be subject to review, revision, and in some circumstances revocation if the product is not completed, or if the costs claimed in the application aren't supported by the affidavit or audit/review report submitted in the final application.

Applications must be submitted within thirty months of the end of taxation year that expenses for an eligible product were incurred, even if the product has not yet been completed.

Application for the DMTC can be made by submitting a completed signed and dated application as well as all the information listed below.

(a) <u>Application & Expenditure Report.</u> The first tab in this spreadsheet contains the application form. The entire spreadsheet should be completed in full and emailed to the TFFRD. A signed and dated paper copy also needs to be sent to the TFFRD. The expenditure report contains a breakdown of all the eligible company's expenses which is used to calculate the value of the DMTC.

(b) <u>Declaration of Residency Forms.</u> These are required for all employees listed in the expenditure report. Failure to submit these forms, or submission of an incomplete form, for any employee, will result in that individual's salary being ineligible for the purposes of the tax credit.

(c) Invoices. Invoices need to be provided for all third party work completed. Failure to provide them will result in these expenditures being ineligible for the calculation of Eligible Remuneration. Invoices must contain the following information in order to be used to verify expenses:

	Total Sale Under $30	Total Sale $30 to $149.99	Total Sale $150 or More
Business Name of Seller	X	X	X
Invoice date	X	X	X
Total amount paid or payable	X	X	X
Amount of GST/HST		X	X
Seller's Business Number		X	X
Buyer's Name			X
A Brief Description of the Goods or Services			X
Terms of Payment			X

(d) Statements of Eligible Remuneration. Statements of eligible remuneration should be provided for all invoices. Since these statements help the TFFRD determine how much of the invoice is eligible remuneration, failure to provide them may result in the TFFRD revising the submitted calculation.

(e) Affidavit, Review Engagement Report or Audit Report. These are statements detailing the qualifying expenditures and total expenditures of the "eligible product". Projects with budgets above $500,000 require an audited cost report; budgets in excess of $100,000 but equal to or less than $500,000 require a review engagement report; and budgets equal to or less than $100,000 require an affidavit certifying the final cost report. These affidavits must be notarized. Both the audit and review engagement reports must show how much was spent in Nova Scotia (before sales taxes), the value of salaries paid both inside and outside of the EGA, and the amount paid to arm's length businesses (before sales taxes). In addition, all of this must also be broken down by tax year in which it was incurred. These reports must be signed by a duly qualified officer of the applicant corporation. The audit or review engagement report must be completed by a qualified arm's length business. The Department of Finance and Treasury Board has the right to request an audited cost report on any project and the "eligible corporation" shall be obligated to provide the report at their cost. For products which were developed over multiple taxation years, the affidavit/report only needs to be included in the final application for the product.

(f) Articles of Incorporation and Memorandum of Association. If this is unchanged from the applicant's previous application, this does not need to be submitted again.

(g) Shareholders Registry. If this is unchanged from the applicant's previous application, this does not need to be submitted again.

(h) Corporate chart.

(i) Gantt Chart.

(j) Completed Digital Media Product. If the product is completed, a copy of the product or a video of playing the product needs to be included in the application. Products should be shelf-ready or exploitable. For websites provide a link to the site where the product can be accessed as well as any necessary login names and passwords.

(k) Chain of title documentation. Where the applicant corporation does not retain principle ownership of the “eligible product” the applicant corporation must provide a Certificate of Election form signed by the entity who owns the property rights.

(l) Exchange of Information Form. This form permits the TFFRD to exchange information related to the application for audit and verification purposes.

In some cases, the Department of Finance and Treasury Board may also require additional documentation or information in order to issue a credit. All documentation or information received from an applicant will be maintained in strictest confidence by the Department.

Frequently Asked Questions

1. What is a Part A Application?

Part A applications are optional. They are intended to give the eligible corporation an opportunity to receive an advanced ruling on whether the project is eligible for the credit. These applications will also allow Finance staff to provide an estimate as to the size of the credit, before the formal application is made. Advanced rulings are not required as part of the application process and do not constitute a guarantee of product eligibility, the issuance of a DMTC from the TFFRD, or the content of the certificate should it be issued from the TFFRD. These applications are only intended to give the applicant a preliminary indication as to whether the project is eligible. A final decision will not be reached until after the full Part B application has been made. Applicants will be evaluated for actual costs and actual product characteristics once the product is completed. A company is encouraged to apply for an advance ruling at any time after project plans are sufficiently detailed to determine product eligibility.

2. Does a product have to be completed before company applying for the credit?

No. Companies can apply at the end of every tax year for a product whether it's completed or not. Products must be completed within 36 months after beginning development. Please keep in mind that tax credits will be revoked if a product is not completed on time or if it doesn't qualify as an eligible product.

3. Is there an application fee?

No, there are no administration fees required for processing DMTC applications.

4. Revocation of certificates

The Minister of Finance and Treasury Board may, at any time after a tax credit certificate has been issued, revoke the tax credit certificate if the corporation has not completed the eligible product within 36 months of commencing development. The tax credit may also be revoked if, in the opinion of the Minister, the corporation has not complied with any provision of the *Income Tax Act* or the *Digital Media Tax Credit Regulations*, or the spirit and intent of the Act and regulations.

5. Recognition of Provincial Contribution

The following credit recognizing financial support from the Nova Scotia Government can be used for "eligible corporations" who wish to recognize the contribution to their production:

Produced with the assistance of the Nova Scotia Digital Media Tax Credit