NorthBridge Consultants

Quarterly Newsletter
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Get in the GAME

CANADA'S DIGITAL MEDIA INDUSTRY

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Mahrie connects digital media companies with tailored and innovative funding options. Read Mahrie's take on digital media and industry news on the NorthBridge Canadian Business Blog.

Written by:
Mahrie Boyle, Technical Writer and OIDMTC Specialist.

Binary is taking over. During the 2012 first quarter, eBooks assumed the lead in sales over hardcovers in the U.S., and smartphone infiltration in Canada is expected to reach the 50-percent point this year. As the digital media industry hits majority milestones, Canada leads the world in online engagement, with the average Canadian spending about 45 hours per month connected – and now the icon of Canadiana, Tim Horton's, is introducing free WiFi access in stores across Canada.

Digital Media Defined

Digital media can be a vague term. The Ontario Media Development Corporation (OMDC) divides the industry into two sectors: the content creators producing interactive content, and the content enablers delivering the platforms and technologies which support and distribute the content. With significant economic impact (approximately $4 billion in annual revenue), the creative convergence of content and technology is integrating into daily life with immeasurable ease and speed, and the growth of the industry needs to support that transition.

The Game Advantage

Canada is home to some of the world's largest video game studios – with Ubisoft in Montreal and EA Canada in Vancouver. The video game industry is intensely R&D-heavy, with original Intellectual Property (IPs) prioritized. Video game-based tax credits are considered to be a major factor in the competitiveness of Canada's video game industry, with other global jurisdictions looking at Canada and its provinces as a potential growth model.

The Ontario Interactive Digital Media Tax Credit (OIDMTC) offers two heightened incentives for game companies with large development expenditures, which relaxes some of the eligibility criteria. Gameplan PEI is an economic development strategy, not connected to taxes, fostering the province's video game sector through rebates on eligible labour. Industry feedback, however, identifies government support as a risk to the industry, with the perception that existing infrastructure favours large scale developers and publishers and that the industry depends too heavily on these incentive programs.

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Financing Options

Funding and capital are cited as the major obstacles facing the digital media industry, largely comprised of small- and medium-sized enterprises (SMEs) – but there are numerous public support measures which can help companies get in the game.

Two major digital media-specific funds support the industry in Canada: the Canada Media Fund (CMF) and the Bell Broadcast and New Media Fund (Bell Fund). CMF delivers funding to interactive digital media (IDM) through its Experimental Stream wherein innovative IDM and software applications are funded up to 75% in Development, Production, or Marketing and Promotion phases through a selective process. In an effort to expand multi-screen engagement, the Bell Fund offers grants to independent Canadian producers developing and producing digital media content associated to a television production. Funds are meant to realize project goals, yet the competitive process is laborious.

Tools for the Job

There is a gap in funding for companies developing sleek digital media products with significant interactivity which are essentially tools for specific objectives or increased efficiency in a business atmosphere. Digital media funds and tax incentives are focused on products which encompass both technology and, often more importantly, full content. In the case of a tool or platform, the user is inputting and manipulating the content, which can be problematic in fulfilling IDM funding criteria.

Digital media companies should also consider more general R&D-based contribution programs as well, such as the National Research Council – Industrial Research Assistance Program (NRC-IRAP), a program the government pledged to enhance in the 2012 federal budget.

Other Cash Flow Resources

Leveraging tax credits can also increase cash flow, and unlike funds, tax credits are not competitive. IDM tax credits are offered by six provinces (see chart below) – and because IDM combines content with technology, the Scientific Research and Experimental Development (SR&ED) program is also relevant for back-end development efforts.

Federal	Benefit
Bell Media Fund Fund encouraging new media projects associated with television productions.	Up to 75% of production or development
Canada Media Fund (CMF) $375 million in funding annually to support the Canadian television and digital media industries.	Up to 75% of total project costs
Provincial	**Benefit**
British Columbia Interactive Digital Media Tax Credit Refundable tax credit based on eligible labour.	17.5%
Manitoba Interactive Digital Media Tax Credit Refundable tax credit based on eligible labour.	40%
Ontario Interactive Digital Media Tax Credit (OIDMTC) Refundable tax credit based on labour, marketing and distribution expenditures.	Up to 40%
OMDC Interactive Digital Media (IDM) Fund Non-refundable contribution of up to $150,000 to create a market-ready interactive digital media content product in Ontario.	Up to 50%
Quebec Production of Multimedia Titles Refundable tax credit based on eligible labour.	Up to 37.5%
Nova Scotia Digital Media Tax Credit Refundable tax credit based on costs directly related to the development of interactive digital media.	50% of labour or 25% of total expenditure
Prince Edward Island Video Game Labour Rebate Rebate on direct payroll costs, payable on a quarterly basis for positive cashflow; the program is not associated with taxes.	30%

Any costs incurred cannot be claimed simultaneously for multiple tax credits, but it can be advantageous to split costs between the programs. IDM tax credits have a wider scope of eligible development costs while SR&ED provides annual opportunity for cash flow.

The problem with IDM and SR&ED tax credits is that there can be long turn-around times, and the payout comes after the development costs are incurred. NorthBridge works with North Innovation Fund (NIF) to offer accrual debt financing for SR&ED-based returns. SR&ED-based funding is a non-dilutive solution for companies seeking up-front financing.

NorthBridge held a free webinar on the OIDMTC program on July 18 with great success – and is excited to grow with this innovative industry. To request a copy of the webinar, or to talk about funding solutions for your digital media company, contact me at: mahrie@northbridgeconsultants.com or 01101101 01100001 01101000 01110010 01101001 01100101 01000000 01101110 01101111 01110010 01110100 01101000 01100010 01110010 01101001 01100100 01100111 01100101 01100011 01101111 01101110 01110011 01110101 01101100 01110100 01100001 01101110 01110100 01110011 00101110 01100011 01101111 01101101 00100000 if you speak binary!

New Fiscal Year's Resolutions

Written by:
Ela Malkovsky, Technical Writer and Editor-in-Chief.

If you had found yourself frantically sorting through piles of paperwork in the early hours of the morning, weeks or even days before your SR&ED claim was due, while making resolutions to be more prepared next year, then you are not alone. Too often, grand and sincere ambitions to keep track of R&D projects at the beginning of the fiscal year wind down to a bare whimper as the year progresses and urgent business demands compile. So how do you maintain live tracking of your R&D projects when it gets harder and harder to find the time? The answer – keep it simple and work with what you know best.

The shortest path is the one you know best

If you have invested in complex R&D tracking systems in an attempt to make tracking more simple, only to find out that getting employees to input information is too challenging, it may be time to fold your hand and incorporate a more user-friendly tracking system. Every business has a unique and familiar culture or method of operation that employees rely on to effectively perform their duties, and while employees will eventually adapt to change, minimizing the scope of change will save a lot of time and frustration. Involving employees from the get-go provides an opportunity to map out the tentative projects in the pipe-line and is crucial for the development of a tracking system with minimal changes to the standard method of operation, thereby minimizing the scope of change for employees and motivating them to contribute to ongoing R&D efforts.

Ela Malkovsky B.A.
Technical Writer and Editor-in-Chief

Ela is dedicated to supporting the advancement of Canadian companies by identifying and leveraging innovative research and technology based funding options.

Time and time again

One of the main CRA complaints is related to unsubstantiated claims, so a reviewer will be focused on ensuring that the information and costs contained in the claim are well supported. Since the majority of the SR&ED credit is labour based, the ability to support the hours being claimed with records of resources allocated to R&D projects is crucial. This can be as simple as taking a bit of time every week to document the hours of the employees and flagging the R&D hours. Even when time constraints prevent more thorough tracking, developing a weekly R&D hours monitoring habit will provide one of the largest returns on time invested.

A picture is worth a thousand words

While continuously making R&D notes may seem challenging, taking a quick picture, video or voice recording takes a fraction of the time, but provides critical details that can help trigger memories at the end of the year for the technical portion of your claim and supplies chronological proof of labour. It is important to keep in mind that recorded documentation only provides pieces of the R&D puzzle and that more detailed information is still needed to explain how the pieces fit together, including any challenges encountered and how they were overcome.

The simplicity of ongoing claim preparation therefore, comes down to habit. Minimizing the complexity or difficulty with which R&D tracking is conducted makes it easier to develop a habit of it, ensuring that tracking does not become neglected and hopefully minimizing fiscal year end madness.

News – NorthBridge Holds EMC Manufacturing Seminars

In June, NorthBridge paired up with Excellence in Manufacturing Consortium (EMC) Canada to host a series of seminars in Atlantic Canada. The information sessions focused on how to best prepare for a SR&ED review and create a "culture of SR&ED" within your company to maximize success with the program.

The sessions compared the diverse experiences companies encounter throughout the SR&ED process, and touched on recurring challenges the program presents for many companies, from understanding the program guidelines and recent changes to educating staff of the program's value.

To get more information about manufacturing and SR&ED visit: www.northbridgeconsultants.com or www.emccanada.org

Federal Budget
SR&ED Changes:
Dollars and Cents

James Ro

Vice President of NorthBridge Consultants

James has over 10 years of experience in a wide range of business areas, including SR&ED, management, debt and equity financing, mergers, acquisitions and divestitures.

Written by:
James Ro, Vice President of NorthBridge Consultants.

The 2012 Federal Budget was released this past March and included some relatively significant changes to the SR&ED program in Canada. What was interesting in the Jenkins Report (released Oct 2011) was that its recommendations were focused on changes that would impact small- and medium-sized enterprises (SMEs), whereas the Federal Budget ended up favouring SMEs (see details below).

This didn't come as much of a surprise as the majority Conservative government had a mandate to reduce the deficit and, according to the Jenkins Report, large enterprises represented approximately 60% of the SR&ED tax credits granted but only approximately 10% of the total number of claimants in 2007. As a result, the government met their political agenda by reducing government spending and by focusing on the "bigger" dollars, but at the same time, they did not upset the approximate 20,000 SME claimants in a meaningful way – i.e., remained popular with the voting masses.

You can do a Google search and find a lot of literature summarizing the 2012 Federal Budget changes, but are claimants clear on what the changes mean to their bottom line in terms of dollars and cents? I have attempted to provide generic numerical examples of the SR&ED program changes in the tables on the right to demonstrate the dollar impact on claims for both SMEs (referred to as CCPCs) and large or foreign enterprises (referred to as Non-CCPCs). In summary:

1. For both CCPCs and Non-CCPCs, the proxy will be reduced from 65% to 55% of salary base.
2. For both CCPCs and Non-CCPCs, subcontractor costs will be reduced from 100% to 80% of eligible subcontract expenses.
3. For both CCPCs and Non-CCPCs, SR&ED capital equipment will no longer be eligible (this will not impact many SME claimants, as capital is not a common expenditure for smaller companies).
4. For CCPCs, the general ITC rate will remain unchanged.
5. For Non-CCPCs, the general ITC rate will be reduced from 20% to 15%.

In the example below, the Non-CCPC can expect to see almost a 40% reduction in their Federal ITC; whereas the CCPC can expect their Federal ITC to decrease only by approximately 7%.

CCPC - Illustrative Calculation of Total SR&ED Expenditures

	Current	Projected	Variance %
Labour/Wages(T4)	600,000	600,000	
Proxy - % of T4 Labour	65%	55%	
Proxy Amount	390,000	330,000	-15%
Materials	100,000	100,000	
Subcontractor - %	100%	80%	
Subcontractor - $	100,000	80,000	-20%
SR&ED Capital Equip - %	100%	0%	
R&D Capital Equipment	-	-	0%
Total Expenditures	**1,190,000**	**1,110,000**	**-7%**
General ITC Rate	35%	35%	
Assumed Federal Tax Credit	**416,500**	**388,500**	**-7%**

Non-CCPC - Illustrative Calculation of Total SR&ED Expenditures

	Current	Projected	Variance %
Labour/Wages(T4)	600,000	600,000	
Proxy - % of T4 Labour	65%	55%	
Proxy Amount	390,000	330,000	-15%
Materials	100,000	100,000	
Subcontractor - %	100%	80%	
Subcontractor - $	100,000	80,000	-20%
SR&ED Capital Equip - %	100%	0%	
R&D Capital Equipment	150,000	-	-100%
Total Expenditures	**1,340,000**	**1,110,000**	**-17%**
General ITC Rate	20%	15%	
Assumed Federal Tax Credit	**268,000**	**166,500**	**-38%**

While much more extensive reductions were discussed, only a portion of these were implemented. Overall, when you combine the revised SR&ED program with other government programs and corporate tax incentives, Canada continues to provide generous, broad-based incentive programs to support R&D and innovation.

If you would like to know more about how the changes to the SR&ED program will affect your claim, please feel free to contact me at (519)623-2486 ext. 227.