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## Animation Outsourcing and the Ontario Computer Animation and Special Effects Tax Credit (OCASE)

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Tax credits represent one of the most confusing aspects of operating an animation production company; and, within the morass of jargon, rules and paperwork is one particular issue which must be understood by any animation professional thinking of going independent.

Among the potentially available credits is one familiar to every animation production company operating in Ontario: the Ontario Computer Animation and Special Effects (OCASE) tax credit. This credit represents a refund of 20% of eligible Ontario labour expenditures for eligible computer animation and special effects activities. In practical terms, labour expenditures may represent as much as 70% of the operating budget (excluding depreciation and interest and making certain assumptions regarding format, quality and, in the case of a television series, whether the production is the first or a subsequent season- all of which affects the size and salaries of the production team). In ballpark terms, then, the OCASE tax credit can represent a subsidy of as much as 14% of the entire operating budget. The OCASE tax credit is therefore essential to covering costs and turning a profit.

Activities that qualify as eligible labour expenditures cover the full pre-production and production range. Editorial, however, is excluded, as is post-production. It should also be noted that salaries and wages of individuals whose activities are not wholly devoted to eligible computer animation and special effects activities qualify only to the extent that they are so devoted. The problem arises when any of the foregoing employees decide to go independent,

incorporate a service studio and ask the production company to outsource.

The devil lies in the definition of "Ontario labour expenditure", which includes fees paid to a company only if the company is wholly owned by one individual and that individual provides "principally" all of the services personally. The OCASE tax credit differs from every other tax credit in this respect. If, therefore, one has employees or fellow shareholders, clients cannot pay the services company but must instead pay the individual. How, then, without incorporating and hiring employees, can one build a services studio beyond a one-person shop?

The solution is to discount fees to compensate the client for the loss of the tax credit. The service studio would then make up the shortfall by filing its own claim for the OCASE tax credit. It must be recognized, however, that this creates a cash-flow issue for the service studio since the OCASE claim cannot be filed until after the end of the taxation year in which the services are performed. Worse still, the queue at the Ontario Media Development Corporation (OMDC) is currently forty weeks. The OMDC's review typically then takes one week, after which time the certificate is mailed to the studio who must then submit it, together with supporting materials, to the Film Services Department of the Toronto Tax Services Office (TSO). The policy of the Toronto TSO is to review applications within sixty days, which, if all is in order, it then sends to the Tax Services Centre in Sudbury for payment. The service studio must



therefore be sufficiently capitalized to wait between one and two years for the payment of the OCASE tax credit.

This point illustrates how important it is to understand the OCASE tax credit and other available tax credits in advance of budgeting, financing and bidding for projects as well as the necessity of getting the right professional support.

### **About the Author**

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Patrick Westaway is Tax Counsel to Sorbara, Schumacher, McCann LLP, a full service law firm based in Waterloo, Ontario. Patrick advises on a broad range of Canadian

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### **Practice Groups:**

Corporate Tax Planning, Corporate and Commercial

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