

TAXREP 51/05

THE REFORM OF FILM TAX INCENTIVES: PROMOTING THE SUSTAINABLE PRODUCTION OF CULTURALLY BRITISH FILMS

*Memorandum submitted in October 2005 by the Tax Faculty of the Institute of
Chartered Accountants in England and Wales in response to
a Consultation Document issued in July 2005 by HM Treasury*

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INTRODUCTION

1. We welcome the opportunity to comment on the Consultation Document **The reform of film tax incentives: promoting the sustainable production of culturally British films** www.hm-treasury.gov.uk/media/624/CA/filmcondocv1.pdf
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are in the Annex.

GENERAL COMMENTS

3. We believe that the proposals should be modified to reflect fact that film production may not always lie just with the producer. See our comments at paragraphs 8 and 9 below.
4. We believe there is some confusion about the real value of the tax credit and it would be helpful if the Government were to clarify what it believes the real value to be.
5. We think that these provisions may be of specific benefit for low budget British films that may not make a profit. We think that there are anomalies in the application of the provisions which effectively provide for clawback when a film makes profit.
6. There is little as currently drafted in the provisions which will make the UK attractive for overseas film producers or joint venture producers because of the definition of producer, the requirement for capitalisation of the rights and ownership of the rights.
7. As currently drafted we do not think there is sufficient certainty in relation to the definition of expenditure.

SPECIFIC REQUESTS FOR COMMENT

- *Does the proposed definition of a producer provide an effective means of ensuring that the tax relief is available to the appropriate person? (paragraph 5.5)*
8. We believe that at present it does not. Under the currently proposed definition the producer is required to incur all the production expenditure and own all rights to the master version.
 9. We believe the definition should be amended to reflect the fact that the producer is essentially a project manager and to allow the flexibility to accommodate co-production arrangements.
- *What would be an appropriate level of minimum UK expenditure to achieve the objective of maintaining a critical mass of infrastructure and viable*

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capacity across relevant sub-sectors involved at all stages of the production of a film within the UK? (paragraph 5.7)

10. As the proposed tax benefit is only applicable to qualifying UK spend we are not sure there is a need to set a minimum level of UK expenditure. The consultative document indicates a level of 40 per cent. Any level seems arbitrary and will in any event be subject to EC scrutiny as part of the approval purpose. The level of UK expenditure is not in our view directly correlative to UK cultural identity.
 - *What items should be excluded or included in defining production expenditure for the purposes of the tax relief? (paragraph 5.11)*
11. We think that the definition of qualifying expenditure should be tied wholly to that required for UK GAAP. Inclusion of enhancement expenditure, financing costs etc may be a necessary concomitant of putting the commercial structure together, but we do accept the need to forestall abuse and would, therefore, prefer to see a categorisation which does allow inclusion of all appropriate costs where it is clear they are not abusive.
12. While we note the argument in the Consultation Document that ‘items that have commonly been included in expenditure as part of tax avoidance schemes’ should be excluded we believe that if a wider definition of producer is accepted then there may be other expenses which are necessarily incurred in bringing a film to the point of exhibition. The definition of qualifying ‘production expenditure’ should be reviewed in the light of any change to the definition of producer.
 - *Is the proposed test for determining what constitutes spending in the UK an effective one? (paragraph 5.13)*
13. There is very little detail in either the Consultation Document or the draft legislation as to how the test to determine what constitutes spending in the UK would operate. We think there is a need to provide rules to demarcate clearly what constitutes expenditure in the furtherance of UK cultural activity and expenditure in the UK.
14. If Company A, the film production company pays Company B, a UK company, a sum which represents the entire film budget for location work, and Company B pays for that work in Spain, would that be UK or Spanish expenditure. Moreover if the film related to the British Army during the Peninsular war with Irish actors, French director and Spanish technicians would the cultural argument be broken or supported? How would percentages be calculated?
 - *How should film losses be made available only against income from film exploitation? (paragraph 5.22)*
15. We welcome measures to enable film losses to be set against film income provided that the provisions overlay existing relief rules simply and are not made unintelligible by substantial anti abuse provisions.

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- *Would the proposal for reinstating losses previously surrendered for a payable credit enable film production companies to revisit their decisions in practice? (paragraph 5.24)*

16. We welcome the flexibility of this proposal but because of the time it may take to release and exploit a film the normal 12/24 month period in which to make and amend a return may not provide a sufficient period for the film company to reassess the merits of the earlier decision. We would recommend a longer period.

- *How should losses arising from the film reliefs be set against the profits from exploiting other films? (paragraph 5.25)*

17. We suggest that such losses should be set against the profits from exploiting other films by treating the production of films as a single composite trade. The Consultation Document seems to suggest that there would be a wide interpretation of what constitutes profits from films and, if this is the case, we welcome the enlightened attitude it displays. Whatever is enacted we think that if a wide interpretation is intended this could be indicated by ministerial statement during the passage of the bill.

- *Do you agree that films already in production when the new tax relief is introduced should not be subject to the proposed statutory definition of production expenditure? (paragraph 5.27)*

18. We believe the proposal that the new definition should not apply to production expenditure on films that commence principal photography before 1 April 2006 is a sensible one. However the requirement that such films should be completed before 1 January 2007 in order to continue to be treated under the old definition seems too onerous and we believe that time period should be extended.

- *Do you agree that Sections 40D and 41 of Finance (No. 2) Act 1992, together with their income tax equivalents in Sections 143 and 137 of ITTOIA 2005, should be repealed? (paragraph 5.29)*

19. We understand that other respondents to this Consultation exercise are of the view that the above reliefs are still of value. That there has not been a major use of the provisions does not mean that they will not provide useful reliefs within the new regime. We believe it would not be appropriate to repeal these sections at this stage and that a considered case should be made before action is taken.

IKY
21.10.05

WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.