REFORM OF FILM TAX INCENTIVES: BECTU RESPONSE TO H.M. TREASURY CONSULTATION

1. BECTU is the trade union for technical, craft and creative workers, other than actors, in the film industry. We welcome the opportunity to respond to the Treasury consultation on the reform of tax incentives and to the linked DCMS consultation on the cultural test for British films. Before addressing the specific questions in the Treasury consultation, we wish to raise some more general issues.

<u>‘CULTURALLY BRITISH’ AND INWARD INVESTMENT</u>

2. We support the ‘key underlying objectives for film tax incentives’ as set out in paragraph 2.17:

   - ‘Encouraging the production of film that might not otherwise be made;
   - Promoting sustainability in British film production; and
   - Maintaining a critical mass of UK infrastructure, creative and technical expertise, to facilitate the production of culturally British films’.

3. We recognise that the core aim giving rise to these objectives is ‘to promote the sustainable production of culturally British film’ (2.16) and that the emphasis on the promotion of culture flows from concerns about how our current tax regime stands in relation to the European Commission’s rules on state aid. We note the Treasury’s view that ‘without any mechanism for ensuring that only culturally British films can access tax relief, it is highly likely that the EC will consider the new relief incompatible with state aid rules’ (Treasury, ‘Film Tax Reform - FAQs’, 29.7.05).

4. While recognising the merit goods arguments for films which are culturally British in content (as set out in paragraph 34), we seek reassurance that the emphasis on ‘culturally British’ film production will not be interpreted in a manner that will disrupt or discourage the vital flow of inward investment for large-budget productions - typically with American funding - which has historically made an essential contribution to the viability of the British film production sector. Sustaining our industrial infrastructure and skilled labour force will depend on attracting a continuing flow of inward investment and not

solely on producing films which are culturally British in content. The broader economic benefits of sustaining a sector which encompasses significant inward investment as well as indigenous production are well set out in 'The Economic Contribution of the UK Film Industry' (Oxford Economic Forecasting, September 2005).

5. We therefore hope that the emphasis on 'culturally British' production will give as much emphasis to sustaining our industrial base (regardless of the specific content of the films produced) as to promoting culturally British content. We seek a clear and explicit assurance that this will be the case.

THE LEVEL OF BENEFIT

6. We note with concern the widespread view in the industry that the effective level of benefit, especially for inward investment productions is too low. We believe that an effective benefit of possibly only 5-8% of budget may be regarded as inferior even to recent Section 42 benefits and simply too low to attract such productions to the UK. Therefore, in common with many others in the industry, we advocate a raising of the enhancement for higher-budget films from 25% to 50%.

COPRODUCTIONS

7. We acknowledge the concern that by applying the tax incentive only to UK expenditure rather than all expenditure there could be a disincentive to coproductions. However, we also acknowledge that the current coproduction regime has fostered a number of productions with minimal UK involvement. We therefore favour a system in which there is a positive incentive for UK production expenditure.

DISTRIBUTION

8. We accept that the focus of the proposed reform is on tax incentives for film production. However, we continue to believe that we face the structural problem of being a fragmented, production-led industry seeking to compete in a world market dominated by the distribution-led, integrated US film industry. We have long advocated measures to encourage the development of UK-oriented distributors - including tax breaks for distributors conditional on the distribution and marketing of British films.

9. We believe additional measures to support distribution would be fully compatible with the production-led emphasis of the current consultation. We note that 'a key objective of Government policy on film is to encourage stronger links between the distribution and production sectors' (2.7). We hope that continuing efforts will be made to develop policy instruments supportive of the distribution of British films

QUESTIONS FOR CONSULTATION

10. We now seek to address the specific questions raised in the consultation. We focus only on issues of relevance to our areas of interest. In the face of a range of initial reactions to the proposals, our underlying approach is to support any measures which provide increased incentives for British film production across the board - encompassing productions relying on inward investment; productions which are culturally -British in content; and coproductions. We seek reassurance that the proposed incentives will aim to promote production in all categories.

Does the proposed definition of a producer provide an effective means of ensuring that the tax relief is available to the appropriate person?

11. We strongly support the proposal that ‘the relief can only be accessed by genuine film producers, and not third party intermediaries and financiers’. We believe that relief should be targeted directly at the industry rather than the industry benefiting only as a by-product of investors’ search for mechanisms of tax avoidance.

12. However, on the specific definition of producer referred to in 5.5, we believe that this should be reviewed to ensure it encompasses producers of inward investment films (specifically including Hollywood studios), as well as UK coproducers.

What would be an appropriate level of UK expenditure (to qualify for tax relief)?

13. We note the proposal that ‘the minimum proportion of production expenditure in the UK will be set at a suitable level but no higher than 40% (5.7); and that this suggested level is justified as ‘allowing flexibility for producers’ (Treasury, ‘Film Tax Reform - FAQs’, 29/7/05).

14. We note that the prescribed minimum level is, at no greater than 40%, significantly lower than the current required level of 70% of production expenditure. We further note, however, that the proposed relief is limited solely to UK expenditure rather than, as currently, covering all expenditure. We acknowledge the strong underlying constraints in this area set by the EC rules on state aid.

15. However, in acknowledging EC state aid constraints, we do not in any way accept the arguments for setting only minimal levels of required UK expenditure or even for removing any such threshold at all. We believe there is a real danger that setting the UK expenditure level too low will encourage the growth of cherrypicking by producers who may deliberately limit their UK production involvement to, for example, visual effects (in which the UK has a world-class reputation). We strongly believe this could undermine the need to support a critical mass of UK production skills and facilities across the board (without

which, in the medium term, even specialist areas of excellence will decline). We therefore believe the minimum UK expenditure level should be set as high as possible within state aid rules.

What items should be excluded or included in defining production expenditure for the purposes of the tax relief?

16. We support the proposed focus on genuine production-related expenditure and we therefore support the specific proposition that 'items that have commonly been included in expenditure as part of tax avoidance schemes, such as interest and financing costs, deferments, participations and reinvestments, are excluded from the new tax relief' (5.11).

Treatment of film losses (paragraphs 5.22-25)

17. We support in principle any proposed incentives which are specifically geared to encourage the sustained production of a range of films rather than a one-off investment in a specific film. We recognise that the enhanced deduction proposals - by linking additional tax incentives to future film income beyond the specific current production - are aimed to encourage producers 'to adopt a slate approach towards the production of British films, instead of simply encouraging film production on a film-by-film basis' (2.21). We further recognise that this contrasts with the previous sale and leaseback structures under which 'there is nothing to discourage indigenous film-makers or inward investors from accessing tax relief purely on an individual project basis' (3.29).

18. We therefore support in principle the approach to film losses under which they could be set against relief on future film income generally rather than against income from the same film (5.22); and they could potentially be pooled with other film makers for purposes of tax relief (5.25). We are not able to comment, however, on the detailed accounting implications of these proposals.

Transitional arrangements (5.27)

19. We recognise the importance of transitional arrangements which do not disrupt or discourage current or planned productions. We further recognise the importance of certainty about future tax relief for the industry to be able to plan future production.

20. We acknowledge that the transitional arrangements outlined in paragraphs 5.26-5.27 are intended to achieve these aims but we also note the concerns that these do not take adequate account of the long lead-times required for project financing. We therefore believe consideration should be given to longer transition periods.

CONCLUSION

21. Our comments set out above are from the perspective of a trade union rather than a film financier and we have, therefore, not been able to engage in any detailed analysis of the accounting implications of the proposals.

22. We are in general supportive of the aims underlying the reform of film tax incentives as well as a number of the specific proposals - on tying relief to producers rather than investors; on focussing on genuine production-related expenditure; and on encouraging a slate approach to production.

23. However, we have a number of specific concerns:
    - We seek reassurance that the ‘culturally-British’ emphasis of the reforms will not be to the detriment of productions reliant on inward investment - which are industrially British if not always specifically British in content.
    - We believe the level of benefit needs to be set higher in order to continue to attract inward investment and we recommend a 50% enhancement for higher budget films.
    - We argue for a definition of producer which can encompass producers of inward investment films (specifically including Hollywood studios).
    - We believe the minimum UK expenditure level should be set as high as is compatible with state aid rules, in order to provide support for the industry across the board rather than for cherrypicking in specialist areas.

24. In the light of these concerns, we believe that any new film tax regime should be subject to review within 12-18 months of implementation. Furthermore, we continue to believe that a range of other policies - beyond those on film tax incentives - will be necessary to build a sustainable and prosperous film production sector in the UK. Such policies will need to focus on distribution as well as production and may need to encompass consideration of a reformed Eady-levy on box office revenue.

25. We look forward to the further progress of the consultation.