

Taxation: a summary of the main issues affecting film production in the UK

Introduction

1. We were told by several parties of the concern expressed by some in the industry that film production in the UK had been hindered by what was regarded as an unfavourable tax regime here compared with the tax regimes in other countries. A number of research papers, pamphlets and articles have been written on this subject during recent years, some in preparation for, or following up from, the Downing Street seminar in June 1990 (see paragraph 3.20). The effects of many of these taxation and other issues on film production in the UK are set out and considered in a series of booklets published by the BFI under the series title *UK Film Initiatives* (the first was published in 1991, and the sixth and most recent in 1993).

2. Two aspects of the UK tax regime have been highlighted as causing difficulties for the film industry here. The first concerns tax relief for expenditure on film production and for new investment in film production facilities, and the second concerns the treatment of income tax (and in particular, the effect of bilateral and other taxation agreements between different countries).

3. No two countries' tax regimes and tax rates are the same, and great care must be taken in comparing and assessing the particular effects of individual aspects of each regime in isolation from the whole of which they are part. In presenting the summary information in this appendix, we do not wish to imply that we have come to any conclusion about any detrimental effects the present UK tax regime may have on the making of films in the UK. Such an assessment would have to be based on a thorough understanding not only of the taxation issues, but also of the many other factors which may influence a production company's film-by-film decisions on where to make their films.

Tax relief on expenditure and investment

4. Until 1979 expenditure on the production of a film had been treated as a revenue expense for tax purposes, but an Inland Revenue statement that year confirmed that such expenditure could be treated as expenditure on plant. This statement created incentives for companies to invest in films and achieve tax savings or deferrals by means of a variety of transactions, some involving the sale and leaseback of films, others involving the 'gearing' of investments by way of non-recourse loans. It is thought that the availability of capital allowances attracted into the film production industry a substantial amount of investment from the industrial sector and provided a great stimulus to film production in the UK.

5. Significant changes in Corporation Tax were announced in 1983, particularly that the rate payable was to be reduced in stages from 50 to 35 per cent. It was also announced that Capital Allowances were to be reduced in stages from 100 per cent of expenditure in the first year to 25 per cent a year of the reducing balance. These changes, the implementation of which was completed by 1988, applied to all companies and were not specific to the film industry. The overall effect for nearly all companies, however, was to reduce the amount of tax payable. The effect on the film industry was a marked decrease in outside investment, which had principally been tax-driven.

6. In 1992 additional rules for the treatment of expenditure on British-made films were introduced. In outline, these allowed 100 per cent of pre-production costs (to a maximum of 20 per cent of a film's production costs) to be written off as incurred, and for the remainder of the production costs to be written off in three equal instalments once a film had been delivered. Commenting at the time, the Director of the BFI said that the new measures were a first step towards relieving the cash-flow problem for producers, but they did not solve the investment shortage problem. The Director felt that the industry wanted to get back to its position in 1979, and that while these new measures were helpful, the solution was to repeal section 68 of the Capital Allowances Act 1990 in its entirety.

7. In considering the impact of various taxation measures on film production in the UK, it should be borne in mind that the production of individual films is generally carried out by companies specially established for that purpose. Receipts will usually only cover the production budget, so that the production company will not record a profit; for an unsuccessful film it will show a loss. Royalties in the resulting films will be owned in companies separate from those which distributed and exhibited them, and their profits will be taxable. Thus, while increased Capital Allowances would be of no benefit to newly-established production companies, since they have no immediate tax liabilities against which allowances could be offset, they might be of some benefit to established companies which financed several productions and which could use the allowances to defer payments of Corporation Tax.

Withholding of income tax

8. The second taxation issue concerns the application of a base rate withholding tax assessment by the UK Government of foreign film stars. Since April 1987, payments to non-resident entertainers (broadly defined) have been subject to deductions of income tax at the basic rate (this provision excludes the directors of films, and others employed behind the scenes). All non-resident workers are subject to UK income tax on their UK earnings, and the withholding tax amounts essentially to a payment on account. This tax provision is a widely used anti-avoidance measure aimed at taxpayers who are unlikely to be resident in a country for more than a few weeks. It applies to a wide range of entertainers, including musicians, and sports people, and not just to film actors.

9. In most cases non-resident entertainers should be able to claim tax relief in their own countries for any UK taxes paid. But it may take them a year or more to do this, and in the meantime they are out of pocket. The effect is often that the film producer has to agree to indemnify the film stars against their UK tax liability, causing an increased production budget, and a nuisance which may be sufficient to switch the film's production to (say) the Irish Republic or to another European country.