DNS

Accounting Group

Film Tax Relief

Guide

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Film Tax Relief

The entertainment industry is on the rise worldwide. Every year we see new actors, directors and producers entering this industry trying to showcase their skills. You may chance to be a producer, planning to film in the UK, because London is an attractive destination for all content production. The wealth of world-class talent and resources are also underpinned by generous and user-friendly tax reliefs that can help you bring your project to the capital. Let DNS Accountants guide your way with all the information that you need.

What is UK Film Tax Relief?

Film tax relief is part of a relief scheme provided by the British government for creative industries. The relief is aimed at helping to bring down the production cost thereby encouraging companies to make films, TV shows or video games etc. in the UK.

The following conditions apply to gain UK film tax relief:

- The film needs to be certified British. It must either pass the cultural test or qualify as an official co-production;
- The film must be intended for theatrical release;
- The film, whether qualifying under the cultural test or a co-production film, must meet the minimum UK qualifying production spend requirement of 10%;
- The Film Production Company (FPC) must be responsible for all the film making activity, from pre-production through to delivery, within the scope of UK corporation tax; and that FPC needs to be registered with Companies House and set up before principal photography begins.

If the conditions are met then the FPC can claim an additional deduction in computing their taxable profits and, if this results in a loss, may surrender that loss for a payable tax credit.

British Certification:

In order for the FPC to claim tax relief, the film needs to qualify as British, by meeting the requirements of one of the following:

- The Cultural Test
- One of the UK's International bilateral co-production treaties
- The European Convention on Cinematographic Co-production

If qualifying, then the FPC may apply to the British Film Institute (BFI) for certification as British.

The Cultural Test:

The Cultural Test is defined in law with points awarded based on British content. It is made up of four sections:

A) Cultural content
B) Cultural contribution
C) Cultural hubs
D) Cultural practitioners

Each section has a number of questions, with points awarded to each answer. A film needs to score at least 18 out of a possible 35 points but is then subject to the 'golden points rule'.

Intention for Theatrical Release:

One of the qualifying conditions is that there must be an intention for theatrical release.

If there is any doubt about the intention, the following factors would count in favour of the film being intended for theatrical release:

- a finance plan written on the basis that the film will be released theatrically;
- being a normal full-length or short feature film of a type commonly shown at cinemas;
- production in a format suitable for theatrical showing at a commercial cinema;
- payment to actors and other participants on terms in line with those prevailing for cinema films (rather than, for example, television work), and;
- the relevant person can demonstrate, at the end of the relevant accounting period, the intention to seek a contract to present the film in the cinema.

A factor which could count against an intention for theatrical release is where there are no commercial cinemas that show that particular type of film.

A film may be made for many purposes and HMRC expect a significant proportion of the expected earnings of the film to be from its exhibition otherwise it may not be regarded as truly being intended for theatrical release. The phrase significant proportion is not statutorily defined; its level will depend on the facts in each case, however HMRC guidance advises they may accept 5% of total estimated income.

What constitutes UK Expenditure?

To qualify for Film Tax Relief the film must have at least 10% of its core expenditure on UK activities.

The amount of relief to which a film production company is entitled is also limited by the amount of core expenditure which is also UK expenditure.

UK expenditure is defined as:

'...expenditure on goods and services which are used or consumed in the United Kingdom.'

Please note this is independent of the supplier, or the location of the purchaser. The goods or services need to be identified, and the place where they are used or consumed.

Film Production Company (FPC):

The company undertaking production of the film, is generally termed the Film Production Company (FPC). To claim Film Tax Relief there are conditions on that FPC.

- The FPC responsible for the film must be within the scope of UK corporation tax.
- It must make the whole film including the arrangements for pre-production, principal photography, post-production & delivery of the completed film.
- It must be actively involved in production planning and decision making.
- It must directly contract for rights, goods and services relating to the film.
- It is best to incorporate sooner rather than later so costs can be included towards the Tax Relief claim, but must be incorporated before filming starts.
- It can be a UK 'off-the-shelf' company set up on behalf of an international parent company.
- Work can be sub-contracted to others, as long as this is reflected in the FPC's accounts.
- Loan-out companies can be used as long as this is reflected in the FPC's accounts.

FPC conditions are different for co-productions

How much can you Claim?

There are two parts to the relief.

Firstly, an extra deduction when calculating profits or losses of the film subject to UK corporation tax. Secondly, if this results in losses, then an option to surrender losses in return for a cash rebate

Extra Deduction:

The extra deduction available to the FPC in respect of a film, is the lower of either:

- 80% of the total core expenditure incurred by the FPC; or
- the actual UK core expenditure incurred.

For example, if £100 is incurred on core expenditure in the UK in producing a film, then the deduction for tax purposes could be £180 rather than £100.

Cash Rebate:

If the extra deduction has led to losses for the FPC, then some or all of those losses may be available for surrender, in return for a 25% cash rebate

Losses available for surrender are the lesser of

- the total available loss of the FPC after the extra deduction and including losses brought forward; and
- the extra deduction itself, less any amount surrendered in previous periods

A FPC may choose how much loss to surrender, but this cannot exceed the total loss available for surrender.

Losses surrendered for a cash rebate are not available for any other use e.g. carry forward.

To continue the above example,

If the extra deduction creates a loss of £60, then this may be surrendered in return for a cash credit of £15

But if total loss is £100 then losses for surrender are limited to £80, being the extra deduction and hence the tax credit is limited to £20

Per Film:

All FPCs are subject to special rules for taxation, regardless of whether they are eligible to claim Film Tax Relief. These special rules treat each film as a separate trade, and the treatment of the losses can be significantly different, from if it were taxed as one trade.

A FPC can alternatively elect to be subject to the normal basis of taxation, including offset of losses i.e. not be treated as a FPC, not treat each film as a separate trade and not be eligible for Film Tax Relief.

Calculating Core Expenditure

The additional deduction is based on the amount of core expenditure, and both total and UK core expenditure must be declared when making the claim. However, before calculating the additional deduction it is necessary to determine:

- the extent to which expenditure is core expenditure; and, if it is, then
- the extent to which it relates to services or goods 'used or consumed in the UK'

A film has various stages of production. Core expenditure is limited to expenditure incurred in:

- pre-production
- principal photography (including animation) and
- post-production

But excludes any costs incurred on

- development,
- distribution or
- other non-production activities.

Some expenditure may cover several stages of production, and hence the respective cost will need to be apportioned across the relevant stages, on a fair and reasonable basis.

For example:

- the screenplay will normally be written during development. But may continue to be reworked throughout the production; it will normally be used in development (to investigate funding etc.), pre-production (since the production is planned around it), principal photography (when the actual filming takes place) and post-production (to assemble to final product).

- a production designer might similarly be involved in development, pre-production and/or principal photography.

- when negotiating rights, an option to purchase would be development, the actual purchase of book rights itself would be a production cost but the right to character exploitation and similar commercialization rights would be a distribution or other non-production cost.

The most crucial distinction is between development (which does not attract Film Tax Relief) and pre-production (which does).

Essentially development costs are those incurred speculatively, before a decision is made on whether to make the film. But some pre-production costs may still be incurred before development is complete.

Once core expenditure has been identified and calculated, then core expenditure spent on UK activities needs to be identified.

Note: -There is no obligation to carry out all production activity in the UK; it is possible to qualify for UK Film Tax Relief under co-production rules, by carrying out elements of the production process in the UK, e.g. VFX/post or principal photography, as long as the minimum expenditure requirement is met (10%) and all other qualifying criteria are satisfied.

What expenditure is ineligible for Film Tax Relief?

Film Tax Relief is given for expenditure of a kind that would normally be taken into account in calculating the profit/loss of the film production, and specifically the FPC UK taxable profit/loss and that films separate trade.

But some such costs are for non-production activities and hence not eligible for film tax relief.

It is not for us to try to list every possible non-qualifying cost, but here are some typical expenses incurred by a FPC which would not qualify for film relief:

- Publicity and promotion
- Entertaining
- Audit fees
- Finance costs - bank interest and charges (see below)
- Development costs – the decision to make the film
- Distribution costs
- Completion bond and other forms of insurance (insurance more directly concerned with the film-making activity itself, may qualify)
- Character commercialization

While interest itself is regarded as part of the costs of financing a film, it is not incurred on production activities, so ineligible for relief. However, charges incurred by banks for facilities that are needed by the FPC to engage in film-making activities (e.g. charges associated with the maintenance of a current account from which suppliers, cast and crew can be paid) are classed as part of the costs of film-making.

Co-productions

A film may be a co-production between two or more companies, but only one can qualify as the FPC for a specific film, for the purposes of UK Film Tax relief.

Usually, the company that is most directly engaged in making the film will be the one that qualifies as the FPC, that is in contributing most to the film creatively, artistically, and technically.

However, the partners of a co-production may be a UK company and overseas companies under one of the UK 's official film co-production agreements with Australia, Canada, China, France, India, Israel, Jamaica, Morocco, New Zealand, Occupied Palestinian Territories, and South Africa; or under the European Convention on Cinematographic co-production.

Under these agreements there must be a production company in each country, responsible for the elements of production in that country. The film is then treated as a National film so does not need to pass the cultural test and the separate companies are officially co-producers.

When assessing which company is the FPC for such a co-production, only the activities of UK co-producers are taken into account, i.e. where there is one co-producer in the UK and another overseas, the UK co-producer will be the FPC for the purposes of Film Tax Relief, even where the overseas co-producer is more actively engaged in the production of the film as a whole.

Each co-producer must contribute at least 10% - 30% of the finance of the film and creatively contribute in the same proportion – usually 20% but details differ so you will need to check the specific treaty.

For such a split budget film, costs such as goods, services, and personnel, are assigned where they are sourced, unlike the "used and consumed" test for designating UK core expenditure.

In considering valid expenditure, HMRC expects each co-producer to only incur expenditure for which they are responsible in respect of each film and may disregard costs incurred for other partners or films, so good record keeping is essential.

Please note that the UK production company needs to be set up and apply for co-production status at least 4 weeks in advance of filming, in order to get British certification.

Co-productions: minimum UK expenditure

One of the conditions to claim UK Film Tax relief is that 10% of core spend on the film must be UK expenditure.

The fact of being a co-production does not change this test i.e. the test is applied by reference to all core expenditure on the film, incurred by all co-producers together, not just the FPC or UK partners.

And UK core expenditure, for the 10% test, includes all UK core spend including that spent by overseas partners, as costs are allocated to production partners based on source of supply, but costs are designated UK spend based on the location that goods or services are "used or consumed".

Example
A film is made as a co-production, with a UK company and a Canadian company as co-production partners under the terms of the UK-Canada treaty.

Total core expenditure on the film is £12m, of which £2m is UK expenditure, £1m spent by the UK partner and £1m by the Canadian partner. As £2m total UK spend exceeds 10% of total spend, then, provided other tests are met, the UK FPC may claim UK Film Tax relief.

Other Important Considerations

- The FPC must be set up in advance of filming
- Co-production status must be obtained in advance of filming
- Good record keeping is essential
- Interim certificates may be obtained, during the production
- Interim claims can be made annually
- There is no cap on funds available for relief.
- Claims must be made within 2 years of the end of the tax year
- The Tax Relief has been supported and maintained by both leading UK political parties.
- The UK's exit from the European Union will not negatively impact Film Tax Relief.
- The UK has a range of national and regional filming incentives which can be combined with the Film Tax Relief.
- It is possible to combine UK Film Tax Relief with incentives from non-UK jurisdictions either under a Production Service Agreement or by qualifying as an official co-production.

How and when to Claim

UK Film Tax relief is a corporation tax relief so is claimed via your company's corporation tax return, for each accounting period (usually a year)

Each film is classed as a separate trade so totals and calculations are required for each film, for each accounting year.

To claim Film Tax Relief on your Company Tax Return, you need to calculate the amount of:

- Total c ore expenditure on the film
- UK core expenditure on the film
- Core expenditure paid for by the FPC
- UK core expenditure paid by the FPC
- Additional deduction due to your company
- Losses available for surrender
- Losses you wish to surrender
- Any payable credit your wish to claim

You also need to provide

- your certificate from BFI confirming that the film qualifies as British – if the film is still in development, then you can claim by providing an interim certificate.
- statements showing the amount of core expenditure, split by UK and non-UK expenditure
- a breakdown of expenditure by category

You may make, amend or withdraw your claim to film tax relief, up to one year after the company's filing date. HMRC may accept late claims, but only in special circumstances

The abandoning of a film mid-production does not affect entitlement to relief, if other conditions are still met.

Frequently Asked Questions

What counts as a film?

A film is defined as '...any record, however made, of a sequence of visual images that is capable of being used as a means of showing that sequence as a moving image' and covers films made for cinema, DVD, television or viewing over the internet.

A series of less than 26 separate films with viewing time under 26 hours may be treated as one film e.g. a TV series.

What is the cultural test?

The cultural test is one of the three ways a film may qualify as British, and is organised by the British Film Institute

What is theatrical release?

A film achieves theatrical release when exhibited to a paying public such as in a commercial cinema. Film tax relief is for films completed, intended and ready for such presentation.

What counts as UK qualifying production spend?

Qualifying production costs are just those on the core production, both pre and post-production costs as well as principal photography or animation. UK spend is that part of core production costs, of goods and services, used or consumed in the UK.

Who issues certificates and when?

The British Film Institute (BFI) judges if a FPC has a qualifying film and may then officially advise the Secretary of State in the Department for Digital, Culture, Media and Sport to issue either an interim certificate for an uncompleted work or a final certificate once production has ceased.

An interim certificate may be used to claim tax relief before the film is complete.

All correspondence in this matter is through the Certification Unit of the Institute.

Can I claim cash back?

Film tax relief is principally given by way of enhancing costs before the calculation of corporation tax. However, if that enhanced expenditure takes the results into losses, then the losses so created may be surrendered in return for a cash sum.

Film production companies can claim a payable cash rebate of up to 25% of the qualifying UK film production expenditure.

What is Film Tax Relief worth?

If £100 is spent in the UK on a British film then there is a possible extra deduction of £80, and with Corporation tax currently at 19%, this would result in a reduction in tax due of £15.20

Alternatively, if the film were loss making then losses matching that extra deduction could be surrendered for up to 25% i.e., £20 tax rebate.

Further Information

Contact us for further guidance on UK tax reliefs and how to qualify as a British production.

Contact the BFI to find out how to apply for certification as an official British production under the cultural test or as a co-production.

See BFI guidance at: https://www.bfi.org.uk/about-bfi/help-faq/tax-relief-certification

Apply for certification with BFI at https://www.bfi.org.uk/apply-british-certification-tax-relief

See HMRC guidance at https://www.gov.uk/hmrc-internal-manuals/film-production-company-manual

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