Tax reliefs for production of British films

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Tax law allows for the production costs of a film to be offset against taxable profits over the income generating life of that film. There are two special tax reliefs that allow for an accelerated deduction, for tax purposes, of eligible production or acquisition expenditure on a British film:

- under section 42 of the *Finance (No 2) Act 1992* ('section 42 relief') expenditure may be deducted over a minimum of three years, on a British film of any size
- under section 48 of the *Finance (No 2) Act 1997* ('section 48 relief') expenditure may be deducted immediately upon completion or acquisition of a British film, with total expenditure of £15 million or less.[1]

Initially section 48 relief was granted for a three year period only – from 2 July 1997 to 1 July 2000. In the 1998 and 2001 Budgets it was extended twice, up to 1 July 2005. In the 2004 Budget the Government proposed that rather than extend section 48 relief any further, it should be replaced by a new relief for production expenditure to go direct to the film-maker.[2] However, in Budget 2005 the Government announced that it would consult on replacing section 48 *and* section 42 relief, and detailed proposals were published in July 2005.[3] In the 2005 *Pre-Budget Report* it was confirmed that new tax incentives for British films would replace existing reliefs from 1 April 2006, subject to state aids clearance.[4] A delay in obtaining this guidance resulted in the new relief commencing on 1 January 2007; to take account of this delay section 42 relief was extended until 31 December 2006.[5] This note gives a short history to the development of these new tax incentives. Detailed guidance on tax reliefs for film investment is collated on HM Revenue & Customs site.[6]

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1 For these purposes, a film needs to be certified as a British film under Schedule 1 to the *Films Act 1985*.
2 HC 301 March 2004 para 3.115
3 HM Treasury, *Reform of film tax incentives: Promoting the sustainable production of culturally British films*, July 2005. Available at: http://www.hm-treasury.gov.uk/consultations_and_legislation/filmtax/consult_filmtax_index.cfm
4 Cm 6701 December 2005 para 5.96
5 under SI 2006/3399. *Pre-Budget Report* Cm 6984 December 2006 para 5.107
6 http://www.hmrc.gov.uk/films/index.htm

A. The introduction of 'section 48 relief'

A short history of the tax treatment of film investment, up to the introduction of "section 48 relief" in 1997, is given in HM Revenue & Customs' technical manual on business income:

> Expenditure on the production or acquisition of an original master version (that is a master negative, master tape or master disc) of a film or audio product is generally capital expenditure on the provision of an item of plant. In the absence of the special rules for relieving expenditure on the production or acquisition of films such expenditure would qualify for relief under the capital allowances code. The exception to this treatment is where the asset is produced or acquired as an item of trading stock.
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> In 1982 plant and machinery was subject to a 100% first year allowance. So all expenditure on the master versions of films and audio products could be written off immediately, which gave rise to substantial tax avoidance. To prevent this legislation was introduced in 1982 that deems the capital expenditure on the production or acquisition of the original master version of a film or audio product to be revenue expenditure, to be written off over the lifetime of the film by matching this expenditure against income from the film. As a corollary, any sum received from the sale or other exploitation of the master version is deemed to be an income receipt. To prevent a detrimental effect on the British film industry, transitional provisions, subsequently extended, were enacted to allow British films to remain subject to capital allowances and thereby to continue to benefit from the first year allowance, although producers could elect for the revenue matching treatment if they wished.
>
> However, by 1992 first year allowance for plant had disappeared and capital allowance treatment on the reducing balance basis was of little benefit to British film producers. Therefore, a new relief was introduced to ease the cash flow difficulties often faced by British film producers. This relief treated expenditure on the production or acquisition of British films as revenue expenditure but allowed that expenditure to be written off over three years rather than matched against income from the film [under section 42 of the *Finance (No.2) Act 1992*], although producers could opt instead for capital allowance treatment if they wished (F2A92/S40D). F2A92 also introduced legislation to give immediate relief for film development costs (preliminary expenditure on a film – F2A92/S41).[7]

In his July 1997 Budget the Chancellor Gordon Brown announced a new relief for investment in British film:

> Britain is increasingly leading the world in those industries which most obviously depend on the skills and talents of their workers - communications, design, architecture, fashion, music and film. Our national endowment fund for science technology and the arts will offer talented young artists and scientists, the finance to turn British ideas into successful business ventures. But despite the British film industry's outstanding record of creative and critical success, too many British films that could be made in Britain are being made abroad, or not at all.

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7 HM Revenue & Customs, *Business Income Manual*, 2006 para BIM56015 (Film and audio products: introduction: history and purpose of relief).

> The talents of British film makers can and should, wherever possible, be employed to the benefit of the British economy. So, after today, production and acquisition costs on British films with budgets of £15 million or less will qualify for 100 per cent write-off for tax purposes when the film is completed: a 3 year measure at a cost of £30 million, that will not only boost the number of British films but the British economy by boosting our exports.[8]

The announcement was warmly welcomed by the industry.[9] Details of the scheme were given in an Inland Revenue press notice issued at the time, from which the following text is taken:

> At present the costs of producing or acquiring a British qualifying film can be written off either as the film generates income or at a flat rate of 33 1/3 per cent per year starting when the film is completed. The Government has decided to improve the flat-rate relief for British qualifying films costing £15 million or less to make. In these cases, the new rules will allow 100 per cent write-off for production or most acquisition costs when the film is completed. The new rules will apply to production costs incurred after Budget day or acquisition expenditure on films completed and acquired after Budget day, including films begun before that date. The relief will be time limited to costs incurred during the three years from Budget day.
>
> Under the existing rules, most production or acquisition expenditure is either written-off over the income producing life of a film, or it is set off pound for pound against income as it arises. Alternatively makers of British qualifying films can claim relief at a flat rate of 33 1/3 per cent per year when the film is completed. The Advisory Committee on Film Finance, established in 1996 under the chairmanship of Sir Peter Middleton, was set up to identify any obstacles to attracting private sector investment into British film. The Committee recommended that a move to 100 per cent write-off would have an immediate impact on investment in the film industry at a time when the industry was well placed to make the most of it.
>
> A British qualifying film is one certified as such by the Department of National Heritage under the Films Act 1985. In order to be certified as a British qualifying film, a number of criteria must be met. These include using UK studios for a high proportion of the film; and ensuring that the film is made by a company registered, managed and controlled in the UK or another EU state. The Department of National Heritage can provide full details of the other criteria.
>
> The new measure will be available only in respect of the costs of production or acquisition of qualifying films. It will not apply to audio tapes and discs or to non-qualifying films. The new measure will bring forward the time at which relief is available, reducing the lag between expenditure being incurred and relief being received. It will be built into the existing legislation for British qualifying films which is found at section 42 of Finance(No2) Act 1992.[10]

It may be worth saying a word about acquisition costs in this context. These are defined in section 42 of the *Finance (No.2) Act 1992* as any expenditure of a revenue nature incurred by the person claiming tax relief on the acquisition of the master negative, tape or disc of a British film. The write-off allowance for acquisition costs is designed to attract finance from banks etc.

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[8] HC Deb 2 July 1997 cc 307-308

[9] For example, "Tax action greeted with joy by moviemakers", *Times*, 3 July 1997

[10] Inland Revenue press notice, *Tax relief for film production expenditure*, 2 July 1997

through sale-and-leaseback deals in which the film is bought from the producer and leased back to him over a period of time (typically 10-12 years).

In July 1996 the Advisory Committee on Film Finance, which had been set up by the Government under the chairmanship of Sir Peter Middleton, published a major report on how private investment into the British film industry might be encouraged. The report noted that sale and leaseback deals could be worth between 4% and 8% of the total production budget to the producer: "While this can be of considerable value for productions of £10 million or more, it is often not worth the time, trouble and expense of setting up the deal for lower-budget films." The Committee took the view that a 100% write-off would make sale-and-leaseback deals on smaller films much more attractive.[11]

The provision was debated at the Committee stage of the Finance Bill in July 1997, and approved without division;[12] following Royal Assent it formed section 48 of the *Finance (No.2) Act 1997*. Introducing the clause on this occasion the then Paymaster General, Geoffrey Robinson, said, "this is a defined and limited measure; it is to encourage films that meet the criteria to be made in British to contribute to our output in a sector that is growing very quickly."[13] Initially relief was to apply to expenditure incurred in the period from **2 July 1997 to 1 July 2000**. This has been extended twice: first, in the 1998 Budget, by a further two years to **1 July 2002**.[14] In the 2001 Budget the Paymaster General, Dawn Primarolo announced a further extension to **1 July 2005**:

> There is emerging evidence that film tax relief is encouraging long term structural change in the British film industry. There is growing confidence in the industry and, with the emergence of sustainable investment packages and record inward investment - over £500 million in 2000 - UK studios are busier than ever. A three-year extension of the tax relief will give the industry sufficient time to build on these encouraging developments.[15]

B. Avoidance provisions in 2002, 2004 and 2005

Since the introduction of section 48 relief the Government has brought forward provisions on three occasions to reduce the scope for tax avoidance in exploiting these rules. As HMRC's business income manual notes, to make full use of the reliefs available, film producers have often had to use quite complex planning structures – and this in turn has been associated with tax avoidance activity:

> The purpose of these reliefs is to encourage investment in qualifying British films with the aim of building a profitable and self sustaining industry. While the reliefs have contributed to a significant increase in the number of British films since 1997, the accelerated relief of expenditure is rarely accessed directly by the producer as the producer has no immediate income to set the relief against. Instead, the reliefs are usually accessed through third party financiers (banks or partnerships of wealthy

11 *The Advisory Committee on Film Finance (the 'Middleton report')*, July 1996 para 4.6
12 SC Deb (A) 23 July 1997 cc 485-507
13 *op.cit.* c 485
14 Inland Revenue press notice, 25 March 1998
15 Inland Revenue Budget Notice REV4, 7 March 2001

individuals) using tax deferral arrangements involving sale and lease back or production and licence schemes. These schemes allow financiers to use the reliefs to shelter other sources of income from tax while deferring taxable income from the film, thus creating a tax advantage. Unfortunately, this has been accompanied by a considerable amount of tax avoidance, where the reliefs have been used in ways that were not intended.[16]

The Treasury's consultation document on film tax reliefs gives more detail of how sale and leaseback arrangements work:

Film sale and leaseback financing structures were developed to enable filmmakers to utilise the tax relief immediately after the completion of a film by accessing the taxable capacity of third parties. A standard, or 'plain vanilla' sale and leaseback structure operates as follows:

Sale and Leaseback Model

• A production company sells a film as soon as it is completed to a third party, the purchase being funded partly by equity investment and partly by a bank loan. The third party then enters into a finance lease, usually for a period of 15 years, leasing back the rights to the original producer. The bulk of the sale proceeds that the film production company receives is put on deposit and is used, with the interest it generates, to cover the future lease payments whilst the remainder is set against the costs of producing the film.

• The sale and leaseback structure enables the third party - typically a partnership of high net worth individuals or a large corporate - to claim the benefit of the film tax reliefs against their own taxable income from other sources. Meanwhile, film-makers exchange the cash flow benefit offered by the film tax reliefs for an upfront payment which can be put towards the cost of making the film, the level of the payment being determined by the terms of the sale and leaseback agreement. In effect, the benefits provided by the film tax relief are shared between the film-makers and the third parties.[17]

It goes on to explain how these arrangements have been exploited for the purposes of tax avoidance:

Whilst the two film tax reliefs were not designed specifically to be used through sale and leaseback structures, it has proved difficult for film-makers to access the incentive effect of the current reliefs without them. It is in this context that the use of 'plain vanilla' structures within the industry has become common. … The most notable side effect of the industry adoption of sale and leaseback structures has been its link with increased levels of tax avoidance activity. The Government has been forced repeatedly to take action to protect the Exchequer from aggressive avoidance schemes over the life of the current film tax reliefs …[18]

The ability to transfer the benefit of film tax reliefs, through the sale and leaseback structure, has been the source of a major part of this avoidance activity since the

[16] HM Revenue & Customs, *Business Income Manual*, 2006 para BIM56015

[17] HM Treasury, *Reform of film tax incentives: Promoting the sustainable production of culturally British films*, July 2005 para 3.10

[18] [The paper gives a full list at para 3.13; pp 13-14]

attraction of sheltering other forms of economic activity increases the incentive for avoidance. Where a relief can be accessed to shelter higher marginal rates of tax, such as under the film tax partnerships that have used sale and leaseback structures, the incentive for the avoidance industry is even higher. Recent evidence indicates that, whereas tax avoidance activity had previously been directed at S48 for the most part because of its more generous rate of accelerated tax deduction, over the last two years S42 has also been the target for increasing tax avoidance of the sort that it has proved necessary to combat in the past, primarily in relation to S48.[19]

In the 2002 Budget a number of measures were announced, "to protect the tax base and to root out tax avoidance whilst facilitating business efficiency and promoting competitiveness" including:

Restriction of the tax reliefs for expenditure on the production of **'British qualifying films'**, subject to discussion with the industry on the details of the implementation. This will refocus the reliefs on the original intention of stimulating the production of films in the UK and to promote growth, employment, investment and opportunities in the British film industry. These changes will apply from 17 April 2002.[20]

At the time the Treasury Committee expressed its concern about the fact that the Government felt it had to change these rules:

We are concerned at the abuse of the film tax relief measures which were introduced by the Treasury in 1997 and 2001. We believe that the Treasury should investigate the reasons for this tax avoidance, publish estimates of the revenues lost as a consequence, and consider why loopholes were allowed to be exploited. We are concerned that the recent proliferation of tax reliefs, allowances, and credits will increase the scope for tax avoidance, and we urge the Treasury to carefully consider such issues before bringing forward additional tax reliefs of this kind.[21]

Further amendments were made to these provisions, following concerns about the impact on production companies that had been already committed to projects in anticipation of accessing tax relief.[22]

Two further measures were announced in Budget 2004:

As announced in the 2003 Pre-Budget Report, a charge to tax will be imposed where investors in film schemes attempt to avoid a charge to income tax on future income. The measures apply to disposals made on or after 10 December 2003.

As announced on 10 February 2004, partnership losses claimed against other income and gains by 'non-active' partners will be restricted to the amount actually contributed to the business; and disposals of future income streams by 'non-active' partners will be charged to income tax on disposal. The measures apply where losses arise on or after 10 February 2004.[23]

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19 *Reform of film tax incentives*, July 2005 paras 3.11-3.15

20 Inland Revenue/HM Customs & Excise Budget press notice REV/C&E 1, 17 April 2002. This change was also flagged in *Budget 2002* HC 592 April 2002 para 5.97.

21 Treasury Committee, *Second report: the 2002 Budget*, 1 May 2002 HC 780-I 2001-02 para 73

22 Inland Revenue press notice 52/02, 28 June 2002

23 HC 301 March 2004 p 201

These announcements had been made by means of a technical note issued alongside the Pre Budget Report,[24] and a press notice.[25]

A Ministerial statement was issued after the 2004 Budget stating that provisions would also be included in the Finance Bill to block avoidance schemes tailored to exploit the new rules concerning partnerships that had been announced in February:

> Legislation is to be included in the Finance Bill 2004 to prevent tax avoidance schemes which seek to work round the legislation announced on 10 February 2004. The new legislation will only apply to losses from a trade involving the exploitation of film, apart from a trade involving the production of a film or the acquisition of the master version of a film. It will not therefore affect partnerships which operate within the specific relief for qualifying films. For trading losses which arise in any of the first four years that a partner carries on a trade, relief for set-off against other income will be denied where a partner does not spend a significant amount of time in the partnership trade and is guaranteed to receive income from the partnership. The changes will have effect from today …[26]

Further to this statement the Revenue issued a short technical note,[27] with examples of how the proposed legislation would work in practice.[28] These provisions now form ss 119-25 of the *Finance Act 2004*. They were debated in Standing Committee on 25 May 2004.[29] The second provision relating to partnership losses – announced on March 26 – was added to the text of the Bill at the end of the Committee stage but was agreed to without debate.[30]

A third set of measures were confirmed in the *Pre Budget Report* in December 2004.[31] Full details were given in the 2005 Budget:

> As announced in the 2004 Pre-Budget Report, the measures counter tax avoidance schemes which seek to: obtain relief more than once on expenditure on any qualifying film; use film reliefs alongside arrangements to defer tax for more than 15 years; enable companies using 'exit' schemes intended to convert the deferral of tax into a permanent tax advantage; and enable partnerships to get loss relief for money not really at risk. A change is also being made to align some of the rules on relief for large budget films with the rules for small budget films …
>
> The provisions in F(No.2)A 92 allow expenditure on the production or acquisition of a qualifying British film, which would otherwise be on capital account, to be treated as a revenue expense and either matched against income from the same film of written off over three years. Section 48 F(No.2)A 97 allows production or acquisition expenditure on a low budget qualifying British film to be written off immediately it is completed or acquired. Partners of Film Partnerships which invest money in films can get relief for trading losses under section 380 ICTA 1988, or under section 381 ICTA 1988 for the

24 Inland Revenue, *Avoidance using exits from businesses that have accessed film tax reliefs,* December 2003
25 Inland Revenue press notice, *Tackling avoidance: income tax - manipulation of partnership losses*, 10 February 2004
26 HC Deb 26 March 2004 c 72WS; see also, Inland Revenue press notice, 26 March 2004
27 Inland Revenue, *Legislation to counteract partnership avoidance*, 26 March 2004
28 Inland Revenue, *Tackling avoidance: income tax – manipulation of partnership losses*, 26 March 2004
29 SC Deb (A) 25 May 2004 cc 364-388
30 SC Deb (A) 24 June 2004 cc 766-7
31 Cm 6408 December 2004 para 5.91

early years of a trade, or under section 72 Finance Act 1991 against their capital gains.

The provisions to counter multiple claims to relief will allow only one person to claim relief under section 42 or section 48 in respect of any one film, either for production expenditure or for acquisition expenditure, but not both.

The provisions to counter deferral beyond 15 years will, in cases where there is a guaranteed stream of income, restrict the relief in the proportion that 15 years bears to the length of the income stream.

The provisions to prevent groups of companies turning the tax deferral into a tax gain will require the companies to bring in the value of the film rights not yet brought into the tax charge as a trading receipt at the time of the exit event.

The provision to counter partnership abuse will prevent partners obtaining loss relief in excess of their capital contribution for which they are fully at risk, and also prevent such non-risk contributions from being counted when computing the exit charge under section 119 FA 2004 ('Exit charge for individuals benefited by film relief').

The measure aligning relief under section 42 with that under section 48 will ensure that the maximum amount of relief will be restricted to the amount incurred before the film was completed and payable within 4 months of completion.[32]

These provisions form ss 59-71 of the *Finance Act 2005*; the timing of the General Election meant that these, along with most of the provisions in the Act, were agreed to without debate.

In its report on the industry in September 2003, the Culture, Media and Sport Committee found that many witnesses were very critical of these developments:

The historical cycle of change in the tax regime was presented to us by the majority of witnesses as a huge disadvantage to the industry. Mr Elstein, Chairman of [the British Screen Advisory Council (BSAC)], stressed to the Committee that:

"What we actually need…if we were really going to try and solve this once and for all, is a permanent fiscal regime which we know is there forever, that is how you treat a film from a tax point of view. The end. Because that would allow long-term planning, long-term investment."

BSAC argued that it has only been since last year, 2002, that Section 48 has begun to have the impact it was designed to achieve because until then its exploitation was distorted by 'abuse' by television production. In these circumstances, the possibility that the mechanism might be lost within a year and a half was characterised as 'galling' and a cause of 'despair'. Many submissions to the inquiry emphasised the need for consistency within government policy in the sector:

"Predictability is very important to investors and it is something that has been emphasised by others and I also tried to emphasise in my own remarks. one of the worst things I can imagine is to create uncertainty about the

[32] Inland Revenue Budget Notice REV BN 16, *Countering film tax avoidance*, 16 March 2005

environment by de-stabilising some of the elements that have been very successful without knowing what will be coming along next. It takes time for industry to make the adjustments, whether it is our own member companies or other companies here. So long lead times are certainly critical if change there is to be and I think change has to be considered very carefully before implemented."

[The Producers Alliance for Cinema and Television (PACT)] also argued that the tax incentives, particularly Section 48 for smaller budget films, had just started to work and that to reduce, or alter them, significantly would be immensely harmful to the industry. The film industry did not want to continue in the 'boom and bust' seven-year cycle described by one witness.[33]

Estimates of the cost of both section 42 and section 48 relief were given in a written answer in December 2005:

Mr. Amess: To ask the Chancellor of the Exchequer what support the Government gave to the British film industry in (a) direct funding and (b) tax breaks in the last 10 years for which figures are available. [34248]

Dawn Primarolo: The tax costs of Sections 42 and 48 film tax relief are provided in the following table. These costs include substantial known avoidance that was closed down by anti-avoidance measures announced at the 2004 pre-Budget report.

			(£ million)
	Section 42 relief	*Section 48 relief*	*Total*
1997–98	5	5	10
1998–99	10	40	50
1999–2000	20	80	100
2000–01	25	90	115
2001–02	35	120	155
2002–03	60	145	205
2003–04	95	190	285
2004–05	170	350	520
2005–06	220	340	560

The Government has also provided £448 million in direct funding to the UK film industry in the last 10 years.

This figure includes:

- £252 million National Lottery funding provided by the Arts Council between 1995 and 2001;
- £19 million provided to the British Screen Finance Group between 1996 and 2000; and
- £177 million National Lottery funding provided by the UK Film Council between 2000 and 2005.[34]

[33] *Sixth report: the British film industry*, 18 September 2003 HC 667 2002-03 para 76-77
[34] HC Deb 7 December 2005 c 1323W

C. New tax relief for culturally British films

In Budget 2004 the Government announced that a new relief to replace section 48 relief would be introduced in 2005:

> The Government has discussed with the film industry and others extending support to the industry through the tax system beyond 2005, with the aim of simplifying and targeting support more effectively. Budget 2004 announces that Section 48 relief for low-budget British qualifying films, which is due to expire on 1 July 2005, will be replaced by a new relief for production expenditure. The relief will go direct to the film-maker and not to any third party. It will typically cover 20 per cent of the production costs of British films, compared with the 15 per cent typically provided by the current Section 48 relief.
>
> The Government is currently reviewing the treatment of co-productions with a view to creating a tighter definition of British Qualifying Status. The Government will also consider the scope for the new relief to increase the proportion of British films that get distribution. Full details of the new relief will be published in summer 2004, following further discussions with the industry and others.[35]

Further details of the new relief were published on 21 September 2004:

> Key features of the new relief include the following:
>
> - the money will be paid direct to film-makers, not through third parties, so it will be less open to abuse;
> - the relief will cover 20 per cent of production costs compared to the 15 per cent covered by the old Section 48 relief;
> - films with budgets of up to £20 million will be able to benefit, compared to a limit of £15 million under Section 48;
> - for the first time, the relief will include an added incentive for films to be profitable; the relief applies to all production expenditure, not just that spent in the UK; and
> - the maximum relief which can be claimed on a qualifying film will rise typically to £4 million compared to £2.25 million under Section 48.
>
> The new relief will come into effect from July next year, but details are being announced today so that the industry can plan the finances of films in development with confidence about what the tax arrangements will be when those films are completed…
>
> The new relief will be available to "qualifying British films" certified by the DCMS with total production expenditure not exceeding £20 million. The production company will be entitled to a deduction of 150% of total production expenditure which it can offset against income when computing its business profits. The company will be able to surrender losses, up to a limit of 100% of production expenditure, to the Inland Revenue for a cash payment equal to 20% of the amount of the loss surrendered. Transitional arrangements will apply to films in production on 2 July 2005 ...

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[35] HC 301 March 2004 para 3.115. The measure was also cited in the Chancellor's Budget speech (HC Deb 17 March 2004 cc 328-9), and a Budget press notice (HM Treasury Budget press notice PN4, *Encouraging enterprise, investment and productivity*, 17 March 2004 p 4)

> The Government's policy is to encourage stronger links between the distribution and production sectors in order to help build a sustainable British film industry. The Government has considered ways in which the new tax relief might be used in support of this objective, for example by making the relief conditional upon a distribution contract being in place. The Government has concluded that a tax measure is not practicable at the present time, but it intends to monitor the operation of the new relief closely and is prepared to reconsider the matter at some later time if and when wider changes in the distribution market suggest it may become feasible.[36]

However, in Budget 2005 the Government confirmed that the introduction of the new relief would be delayed:

> 3.51 Details of the new tax relief for low budget films were launched in an Inland Revenue Technical Note in September 2004. The Government is committed to the principles and terms of the proposed new relief but understands that the industry has concerns, in the short term, about its practical operation. The Government has therefore decided to extend the current relief for low budget films. This will enable the formal consultation on draft legislation to consider issues across the entire film sector and will ensure that tax reliefs for low and large budget film production are provided on a coherent and consistent basis. The transition from the current to the new film tax reliefs will then be effected next year, subject to state aids clearance. [37]

As a consequence legislation would be introduced the extend the life of section 48 relief for as long as necessary:

> Legislation in the 2005 Finance Act will extend the low budget tax relief from 2 July 2005 until 31 March 2006. It will also contain a power to substitute a later date. This allows for the timetable if necessary to obtain formal State Aid clearance. This extension will enable films to qualify for current tax relief where: the first day of principal photography is before 1 April 2006; and, the film is completed before 1 January 2007. Relief for acquisition will continue to be available for films which meet these conditions and which are acquired before 1 October 2007.[38]

The *Financial Times* reported that film makers generally welcomed the change.[39] Initially clause 82 of the *Finance Bill 2005* – which was published on 24 March – made this provision. The announcement of a General Election for 5 May meant a second, shortened version of the Bill, replacing the first, was presented to the House on 6 April, when it completed all of its stages in the Commons.[40] Given the very short timetable for Parliamentary scrutiny, it is not surprising that the extension of section 48 relief – which forms section 58 of the *Finance Act 2005* – was not debated.

In the *Pre-Budget Report* in December 2004 the Government had announced that, along with measures to close down a number of tax avoidance schemes, it would, "consult with the UK Film Council and the industry in an early review of the tax relief that is used by large

36 HM Treasury press notice 79/04, *Treasury announces new tax relief for British films*, 21 September 2004. Further details were published by the Inland Revenue at this time in a technical note.

37 *Budget 2005* HC 372 March 2005 p 57

38 Inland Revenue Budget Notice REV BN 15, *Extension of Low Budget Film Tax Relief*, 16 March 2005

39 "Film producers welcome extended relief rules", *Financial Times*, 17 March 2005

40 *Finance (No.2) Bill* [Bill 104 of 2004-05] was scrutinised in its entirety on the floor of the House (HC Deb 6 April 2005 cc 1432-1491) and received Royal Assent the next day (HC Deb 7 April 2005 c 1641).

budget British films, that will conclude at the end of January 2005."[41] In Budget 2005 it was confirmed that "the current structure of the relief [for larger films] is no longer effective for this purpose and [the Government] intends to replace it next year with a structure that is similar to the new tax relief model that has been proposed for low budget films. The Government will therefore conduct a formal consultation on draft legislation and retain the existing relief until an orderly transition to its replacement can be effected."[42]

On 29 July the Treasury published a consultation document, setting out a new relief to replace both section 48 and 42 relief; responses were invited by 21 October 2005. In parallel the Department for Culture, Media and Sport launched a consultation on a proposed objective cultural test for British film. The purposes of the new tax relief were set out in a press notice issued at the time:

> The proposed new relief aims to achieve the following:
>
> - direct and easier access to support for film producers ensuring better value for money for taxpayers;
> - better targeting of support towards culturally British films, including more generous levels of benefit for those British films in need of greater support;
> - greater flexibility for film-makers in light of the increasingly global nature of film-making - balanced with incentives that support the sustainability of UK infrastructure and human and technical resources, to ensure the ongoing production of culturally British films; and
> - ensuring that the cinematic successes of today can help support the successes of tomorrow by providing producers the most generous level of benefit where they are committed to medium-term investment in UK film production.[43]

The consultation document summarised the key features of the new relief:

> The proposed new relief is based on the tax credit model that was launched in September 2004 as a proposal for a new small budget film tax credit. This new relief reflects the desire for a single coherent regime applicable to all films following industry comments last year on the tax credit model and earlier this year on S42. Different levels of payable credits and enhancements are envisaged for different films. In summary, the proposed new relief would:
>
> - be provided directly to film-makers themselves
> - apply to films that are certified as culturally British films, under a new test that the Department for Culture, Media and Sport is consulting on from 29th July 2005;
> - be provided on qualifying UK production expenditure where a minimum UK spend threshold of up to 40% has been met, and subject to a maximum of 80% of the total qualifying production expenditure in order to comply with EU State aid rules;
> - allow a payable tax credit at a level of 30% for films that cost up to £20 million;
> - allow a payable credit at a level of 25% for other qualifying films;

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41 Cm 6408 December 2004 para 5.91

42 *Budget 2005* HC 372 March 2005 p 57

43 HM Treasury press notice 71/05, 28 July 2005

- provide an enhanced deduction of 50% for films that cost up to £20 million; and
- provide an enhanced deduction of 25% for other qualifying films.[44]

The department also published a series of FAQs on the consultation; a short selection of these – focusing on the purpose of the new relief – is reproduced below:

> 6. Why are there different rates for different films?
> One of the Government's objectives for film tax incentives is to provide support for culturally British films that might not otherwise be made, where clear commercial potential cannot be identified in advance. Such marginal film projects tend to have small production budgets. Small films therefore merit a higher level of support than large films where the sheer scale of the production budget means that only projects with clear advance commercial potential are made.
>
> 8. Why is the Government changing the current gateway to tax relief?
> Under the Films Act 1985, a film only needs to meet the requirement that 70% of the production expenditure be incurred within the UK to qualify for tax relief. There is no requirement that the film be culturally British in content or subject matter. Without any mechanism for ensuring that only culturally British films can access tax relief, it is highly likely that European Commission will consider the new relief incompatible with State aid rules.
>
> 12. Will we still be able to use sale and leaseback financing structures?
> Because the new relief can only be accessed directly by film makers, and not by intermediaries such as banks and partnerships, sale and leaseback structures are no longer necessary for tax purposes.
>
> 13. Will the reliefs be permanent?
> The Government is not setting a time limit on the new relief. We have stated an ongoing commitment to support the UK film industry. However, the relief has to reflect external factors such as EU guidelines on state aid. An application will be made to the European Commission for state aid approval and therefore the new relief will comply with their guidelines which require State aids to be time-limited.
>
> 17. Why are DCMS consulting on a new cultural test for films?
> Principally, because the European Commission requires that State support for film has a firm cultural basis. Requiring films to pass an objective cultural test, in the broadest sense of "cultural", is the easiest way to demonstrate this, and thus safeguard the relief. The test on which DCMS are consulting would allow for a film to qualify through a variety of routes - whether it has UK cultural content, whether it uses UK facilities and whether it uses the required personnel. We are asking people whether we have got the categories right, whether the points are allocated correctly to those categories, and how many points film-makers might be required to get. Overall, the test should provide predictability to producers and ensure that films which contribute to British film culture and infrastructure are supported.[45]

[44] HM Treasury, *Reform of film tax incentives: Promoting the sustainable production of culturally British films*, July 2005 p 19.

[45] Available at: http://www.hm-treasury.gov.uk/consultations_and_legislation/filmtax/consult_filmtax_faqs.cfm. Retrieved 16/03/2007.

On the last of these issues – the new cultural test for British films – the Department published a new test in April 2006, though this was revised, to comply with EU rules on state aid, in December, and was introduced alongside the new tax relief.[46]

The introduction of the new tax relief was confirmed in the 2005 *Pre-Budget Report*:

> The Government is committed to supporting the sustainable production of British films, and recognises the cultural and economic benefits that they bring. Following consultation, the Government today announces further details of the new tax incentives available for culturally British films. Films costing £20 million or less will be allowed an enhanced deduction of 100 per cent of qualifying production costs with a payable cash element of 25 per cent, while films costing more than £20 million will be allowed an enhanced deduction of 80 per cent with a payable cash element of 20 per cent. The Government also intends to allow losses to be utilised in ways that will support more sustainable investment in the British film industry. The new incentives will replace the existing reliefs from 1 April 2006, subject to state aids clearance, and will provide better-targeted and more effective support direct to film production companies.[47]

Details of the responses to the consultation document do not appear to have published; though the UK Film Council strongly supported the PBR announcement.[48] Alongside the PBR, HM Revenue & Customs published a technical note, giving details of the commencement rules for the new relief.[49] This note also gave details of two technical matters: first, how the relief would be targeted to film makers:

> The HM Treasury consultation document proposed that the relief would only be available to a film producer, defined as the company which incurs all the production expenditure on the film and owns all rights in it on completion. However, during consultation it became clear that this term is used in a number of different ways in the film industry and that its inclusion in the legislation for the tax relief could create confusion. In addition, it would, in some circumstances, have excluded companies at whom the relief was intended to be aimed. The Government therefore proposes that the new regime will apply instead to 'film production companies' (FPCs) rather than to film producers. A FPC will be defined as the company responsible for the principal photography and post-production stages of the film and for the completion of the finished film. This definition will include safeguards to ensure that the FPC has an active involvement in the process of film making in order to exclude any company whose participation is restricted to providing or arranging the finance for film production activity.[50]

Second, the note gave details of how acquisition expenditure – as opposed to production expenditure – would be treated in future:

> The tax reliefs provided currently for British film production and acquisition are provided, for large budget films, in Section 42 of Finance (No. 2) Act 1992 and in

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46 SI 2006/643, which was amended by SI 2006/3430
47 Cm 6701 December 2005 paras 5.95-6
48 "Tax boost for film industry", *Times*, 6 December 2005
49 HMRC, *Film tax relief*, December 2005 para 4 At: http://www.hmrc.gov.uk/pbr2005/film-tax-relief.pdf. The Inland Revenue merged with HM Customs & Excise to form HMRC in April 2005.
50 *Film tax relief*, December 2005 paras 5-7

section 48 Finance (no. 2) Act 1997 for low budget films. Underlying both are sections 40A and 40B of Finance (No. 2) Act 1992 which provide that expenditure incurred on the production of a film is to be treated for the purposes of the Taxes Acts as revenue expenditure rather than capital, whether the film is sold on completion or kept and exploited to generate income. Expenditure is then recognised as income arises over time, thereby spreading profit across the life of the asset. The same treatment also applies when a film is acquired. This has provided an opportunity for significant avoidance in the past since it has allowed those with no direct involvement in film making to access the film tax relief to shelter taxable income and profits from other sources.

Even though the new relief itself will not be available for film acquisition, there would still be scope for avoidance involving film acquisition if sections 40A and 40B remain as they currently are. The Government therefore proposes to replace sections 40A and 40B, at the same time as the new relief is introduced, with a new treatment which will apply solely to film production. Film acquisition will be dealt with by normal tax rules. Under the new treatment for film production expenditure, a FPC will be deemed to be trading as soon as it receives any film-related income or incurs any film production expenditure. Film-related income would include grants and subsidies, fees and other amounts received for making a film, such as sale proceeds or royalties. Film production expenditure would be that incurred wholly and exclusively for the purposes of producing the film.

The new basic treatment for film expenditure will start to apply at the start of film production activity. This contrasts to the current situation in which sections 40A and 40B start to apply only when the film has been completed. This will allow long projects, such as animated films, to take advantage of the tax relief much earlier, whilst doing away with complex rules to deal with pre-commencement and abortive expenditure. This proposed treatment will only apply to companies. This will ensure that partnerships can no longer become involved in film production to shelter their members' income from tax. This will have no effect on any genuine film makers since films are produced exclusively by companies, and not individuals.

Film acquisitions will be included in the regime for Intellectual Property (IP) from which films are currently excluded. This will have the effect of giving the same broad treatment which sections 40A and B sought to give before the IP regime was introduced, but under a more modern, accountancy-based set of rules.[51]

Given the history of these tax incentives being exploited for tax avoidance, it is notable that after the PBR the Government announced *further* legislation to counter an avoidance scheme designed to exploit S42 & 48 relief, in both December 2005[52] and in March 2006.[53]

As noted above, initially the Government had proposed that to be eligible for the new relief, films would have to meet a UK spend threshold of 40%. In the 2006 Budget it was announced it would be 25% "to allow a wider range of films to qualify."[54] An updated regulatory impact assessment issued at the time summarised the benefits of the new relief:

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[51] *Film tax relief*, December 2005 paras 8-15

[52] HM Revenue & Customs press notice NAT65/05, 20 December 2005

[53] HM Revenue & Customs press notice NAT 19/06, 10 March 2006

[54] HC 968 March 2006 para 5.90. HM Revenue & Customs Budget Note BN04, 22 March 2006

> The benefits of removing the S42 and S48 reliefs and replacing them with a new regime are numerous. They can be broadly summarised as:
>
> - Better-targeted support, directly to filmmakers, with the minimum of leakage to financial intermediaries and other third parties. This will permit more generous levels of support for film production and a lower overall cost to the Exchequer.
> - In conjunction with the new 'cultural test', administered by DCMS, the new reliefs give more effective support for the sustainable production of culturally British films.
> - Increased levels of investment, from both domestic and foreign investors, fostering a sustainable market for film production in the UK with an incentive to retain the profits of filmmaking in the UK – and creating a critical mass in infrastructure and creative and technical skills.
> - A reduction in films tax relief-related tax avoidance, bringing with it an associated reduction in the need for anti-avoidance legislation and greater stability in the films-relief structure.[55]

The assessment gave estimates of the projected costs of the new relief: "The new film tax relief is estimated to cost £20 million in 2006-07 rising to around £120 million a year thereafter. Taking account of the savings from expected costs of the film tax reliefs being replaced, the total Exchequer effect is estimated to be +£30 million in 2006-07, -£20 million in 2007-08 and +£20 million in 2008-09."[56] It also tackled the wider question of the need for this form of state subsidy:

> Film production is a global industry, with location decisions influenced, amongst other factors, by the generosity of state support. The availability of Government support is therefore an important factor in investment decisions, particularly where it can reduce the costs of producing in a high-cost environment such as the UK.
>
> While the end of film tax relief would have the immediate benefit of removing a key source of avoidance and uncertainty in the tax system, it would also carry a significant social and cultural cost. In the absence of any enhanced tax relief, film production companies would not be able to capture any of the wider spillover benefits to society that stem from their production of culturally British films. Given this, films of significant cultural value but that might be marginally commercially unviable would not be made in the absence of tax relief.
>
> Beyond this, the removal of all tax relief would have significant impacts on sustainability of a critical mass of film production infrastructure in the UK. This is especially so given the global nature of the film industry, with location decisions influenced, amongst other factors, by the generosity of state support. In the absence of UK tax relief, cost savings abroad from cheaper labour and from similar tax incentives may encourage UK film producers to produce films outside the UK and there would be an associated drop in inward investment. The loss of tax incentives would therefore place in jeopardy the UK's 'critical mass' of key film production infrastructure and skills and would discourage the production of culturally British films in the UK. As a further consequence, film producers may seek to rely more heavily on alternative sources of public subsidy, including lottery funding.[57]

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[55] HMRC, *Regulatory impact assessment for reform of film tax incentives*, March 2006 para 3.44

[56] *op.cit.* para 3.45

[57] *op.cit.* paras 3.28-31

The relevant provisions are set out in chapter 3 to the *Finance Act 2006*; debate in standing committee on these clauses stretched over three sittings of the Committee.[58]

D. Recent developments

The delay in obtaining state aids approval for the new tax relief, and the associated delay in its implementation – from 6 April 2006 to 1 January 2007 – has required the Government to introduce transitional rules.[59] These determine which tax rules cover films on which principal photography began *before* 1 January 2007, whether they were completed before that date or not. The rules interlock with the two changes made in the cultural test for British films during 2006. The 'First Cultural Test', as it is referred to, was introduced for films where principal photography began on or after 1 April 2006 – replacing the '70% test' established by schedule 1 of the *Films Act 1985*.[60] As noted above, this was replaced by the 'Second Cultural Test' following consultation with the European Commission, and applies to films where principal photography began on or after 1 January 2007.[61]

Briefly, the test provides four categories to determine the extent of a film's British cultural character. Film makers are awarded points in each of these categoires, and must score a minimum of 16 points out of a possible 31 to pass the test. The categories are:

> **Cultural Content** – is the film set in the UK, does it have British characters, is it based on British subject matter or underlying material and is it filmed in English?
> **Cultural Contribution** – does the film reflect British culture in relation to cultural diversity, heritage and creativity?
> **Cultural Hubs** – is the film made in UK studios or on UK locations, does it use British visual or special effects or music recording facilities, does it use British post production houses?
> **Cultural Practitioners** – are the people who work on the film from the European Economic Area?[62]

Turning back to draft regulations which effect this move to the new tax relief, an explanatory memorandum issued alongside this secondary legislation gives a summary:

> **Films starting principal photography on or after 1 January 2007**
> 10. These will always be taxed according to the new rules in FA 2006. Those that meet the conditions for film tax relief (the additional benefit available to British films, under Schedule 5 FA06) will receive that relief; other films will simply be subject to the basic tax provisions in Schedule 4.

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[58] The sixth, seventh and eighth: SC Deb (A) 16-18 May 2006 cc 195-272.

[59] Draft regulations were laid on 2 March 2007: the *Corporation Tax (Taxation of Films) (Transitional Provisions) Regulations* 2007

[60] The Order making this change – SI 2006/643 – was debated on 15 March 2006 by the Eighth Standing Committee on Delegated Legislation. In broad terms films had to incur 70% or more of their costs in the UK to meet the old test, unless they had been certified as coproductions.

[61] The Order making this change – SI 2006/3430 – was debated on 11 December 2006 by the First Delegated Legislation Committee.

[62] DCMS press notice 147/06, 22 November 2006

Films starting principal photography before 1 January 2007
(a) Films completed before 1 January 2007
11. The new reliefs do not apply. Such films are simply taxed according to the previous rules.
12. In accordance with the First Films Order, where such a film (other than a coproduction) needs to be certified as British (e.g. for the purposes of section 42 F(No. 2)A 1992) the test that will apply depends on when principal photography began;

- if it began before 1 April 2006, then the relevant test is the 70% test in Schedule 1 of the Films Act 1985 as it stood before being modified by SI 643/ 2006;
- if it began on or after 1 April 2006, then the test is that introduced by SI 643/ 2006 (First Cultural Test).

(b) Films still in production at 1 January 2007 (transitional films)
13. If, at the time principal photography began, a film was intended for theatrical release, and if it is certified as British – either under a co-production agreement or under the Second Cultural Test – then the new provisions in FA 2006 apply.
14. If, upon application, the film is refused certification, then it is taxed according to the old rules. This includes the possibility of s42 relief if the film is British. Where a film needs to be certified as British for this purpose, the test that will then apply (other than for co-productions) is the First Cultural Test but without the requirement that the maker of the film be resident in the EU.[63]

Two classes of film are *not* brought within the new rules:

- **Transitional films that do not meet the new definition of a "British film" introduced in December 2006** because they neither pass the Second Cultural Test nor qualify under a co-production treaty. This is determined by whether or not the Secretary of State has issued the film with a certificate that it is British. If either an interim or final certificate is refused, then the new reliefs do not apply to the film, and the previous reliefs are not withdrawn from it.

- **Transitional films not intended, at the time principal photography commences, for theatrical release.** If the intention changes after principal photography commences, this does not affect which rules the film is taxed under. So if, for example, when principal photography commences, a film is intended to be shown on TV, it is within the old rules. Even if this changes and the film becomes intended for theatrical release, it is still taxed under the old rules (and may then be able to claim s42 relief).[64]

The draft regulations do not appear to have discussed in the House or the press, though earlier in the year the *Financial Times* reported that "international film producers returned to the UK last year thanks to improved sentiment ahead of the government's new tax credits on filming."[65] The potential impact of the relief was raised in a recent PQ:

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[63] HMRC, *Commentary on the draft Corporation Tax (Taxation of Films) (Transitional Provisions) Regulations 2007*, February 2007 p 4. This is available at: http://www.hmrc.gov.uk/films/draft-regs-s52-news-item.htm
[64] *op.cit.* p 3
[65] "Film-makers return as credits set to roll", *Financial Times*, 15 January 2007

> **Dr. Kumar:** To ask the Chancellor of the Exchequer what assessment he has made of the impact on the British film industry of the tax breaks for films made in the UK announced in 2005; and if he will make a statement. [124151]
>
> **Dawn Primarolo:** New tax reliefs for the production of British films were announced in 2005 and included in Finance Bill 2006. They came into effect from 1 January 2007. It is therefore too early to be able to say what effect they have yet had. However, the new reliefs were developed in close consultation with the industry and we anticipate that they will be extremely effective in promoting a sustainable British film industry.[66]

In an article on the new tax relief in the technical journal *Taxation*, one practitioner commented as follows:

> The new tax credit can deliver to the producer of a qualifying British film a cash rebate worth up to 20% of the core budget of films with qualifying expenditure of £20 million or less. For more expensive films the rebate is potentially 16%. These are meaty savings on a film's budget and should make the UK a competitive location for the making of films …
>
> Before the new relief, qualifying British films accessed the previous incentive using the much abused sale and leaseback mechanism. Over the years, new schemes were devised by advisers to the film industry to squeeze more and more 'soft money' from the incentive. These included claiming the relief on television soaps, the inflation of qualifying budgets with deferred fees that were unlikely ever to be paid, and claiming sale and leaseback more than once on the same film, known as 'double dipping'. The sale and leaseback mechanism was the cause of much Treasury frustration as each time one abuse was closed down a fresh one seemed to appear.
> Part of the perceived problem with sale and leaseback was that the incentive could only be received by involving a third party, usually a film partnership, who could make use of the accelerated tax deductible write-offs available on the acquisition of qualifying films. The Treasury regarded the shadowy middleman who brought these parties together as the principal cause of its problems. With demand for qualifying film write-offs exceeding the availability of films, this produced a market ripe for abuse. The new tax relief therefore aims to deliver the incentive direct to the producer of the film via its tax return. This cuts out the middleman and dramatically reduces the scope for abuse …
>
> HMRC have been very open in soliciting the views of the film industry and this is to be welcomed. Overall the new film tax credit should make the UK a competitive location for the continued production of British films.[67]

In a separate development the Government has revised proposals to tackle the exploitation of 'sideways loss relief', following representation from the industry that, as initially drafted, the new avoidance provisions would have jeopardised many films in production. In brief, on 2 March 2007 the Paymaster General made a statement on legislation to be included in the forthcoming Finance Bill, to counteract tax avoidance.[68] Details were set out in a technical

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66 HC Deb 5 March 2007 c 1677W
67 "Where is Narnia?", *Taxation*, 1 March 2007
68 HC Deb 2 March 2007 c 105WS

note issued alongside this statement.[69] Several tax specialists and film financiers argued that the changes could have a significant impact on film production,[70] and on 7 March the department issued a second statement, to clarify the circumstances where the new rules would not affect film related expenditure.[71] The *Financial Times* reported the Government's "U-turn" in some detail:

> Served croissants and platitudes at Tate Modern early on Tuesday morning, leading film producers and investors seethed as Tony Blair lauded a "renaissance of British culture". He was making a rare rhetorical foray into the art world but his words rang hollow to an industry that was still struggling to digest the shock axing of a valued tax break. Barely a day later, many of the same luminaries burst into applause as news reached an industry conference of a Treasury about-turn that would rescue the financing of more than 100 films. The film industry had used its considerable muscle to persuade Gordon Brown to execute one of the fastest government U-turns on record. "It's one of the most effective lobbies in the UK. It punches well above its weight. Who wants to be publicly mauled by (Lord) Dickie Attenborough?" one insider mused yesterday.
>
> The lobbying had been swift and organised, triggered when Revenue & Customs used a somnolent Westminster Friday afternoon to announce seemingly innocuous changes. They concerned "sideways loss relief", used to offset trading losses against income and capital gains. That evening "I got my first call from a film producer. The first e-mail landed on Saturday. And the first letter was in my mailbox Monday morning," Hugo Swire, shadow culture secretary, told the FT. The industry swiftly realised that the seemingly technical tax changes would hit the funding of more than 100 British films, including blockbusters such as the latest James Bond Casino Royale. While many of the movies were already on release, tax-deferral "sale and leaseback" schemes used in their financing were still being finalised ahead of the April end of the tax year.
>
> Actors and suppliers for many independent films risked being left out of pocket. Payments on such films are often deferred until the tax benefits come through, according to Pact, the independent producers' trade body. Some production companies risked insolvency. "I was called by someone at the weekend who has three subsidiary companies, each used to finance a film and each with deferred obligations. He told me: 'I'll have to let those companies swing'," Tim Willis, Pact's director of film, said yesterday. Investment companies offering the schemes were quick to point out to the Revenue that it had explicitly endorsed their use. Indeed, according to the British Screen Advisory Council, the government encouraged investors who were affected by the new "culture test" for films - limiting a tax break to movies that pass a so-called "Britishness" test - to use sale and leaseback as an alternative. The industry organised itself quickly. "I spoke to the Treasury on Friday. People spent the weekend counting up the films affected and the amount of money involved and then agreeing the approach that should be taken. Most of the industry issued letters on Monday and Tuesday," Fiona Clarke-Hackston, director of the Screen Council, said. "We're delighted with the outcome."

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[69] HMRC Brief 18/07, *Tackling Avoidance – Individuals in Partnership – Restriction of Loss Relief*, 2 March 2007. This is available at: http://www.hmrc.gov.uk/briefs/brief1807.htm

[70] "Tax specialists hit out at action on avoidance schemes", *Financial Times*, 3 March 2007

[71] HMRC Brief 19/07, *Tackling avoidance - individuals in partnership - restriction of loss relief: film-related losses*, 7 March 2007. At: http://www.hmrc.gov.uk/briefs/income-tax/1907.htm

That outcome - concessions announced on Wednesday, designed to ring-fence sale and leaseback films deals from the new rules - was a "clarification" rather than an admission that the rules had been badly drafted, the Revenue insisted yesterday. "This is not an about-face. We listened to film industry concerns and acted decisively and quickly," an official said.

But leading industry figures take a less charitable view, arguing the scale of the "collateral damage" inflicted by the Revenue's rules had forced the chancellor to backtrack. The U-turn was a "complete statement of the obvious. It was a real volte face because they screwed it up by issuing the rules in a hurry," Patrick McKenna, the founder and chairman of Ingenious Media, the investment and advisory group, told the FT. Mr McKenna warned that industry relish over Wednesday's victory was likely to revert to anger, as producers realised the effect of the loss of the tax break on future films. The concession for sale and leaseback will not help movies due to start shooting. Friday's "seismic change in tax policy" will "mean a huge reduction in inward investment into films", Mr McKenna forecast. The film industry lobbying will now be directed towards scrapping the change altogether.[72]

[72] "Film world savours victory of tax U-turn", *Financial Times*, 9 March 2007