

## Putting You In The Picture – UK Film Tax Credits

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### Introduction

For many years UK governments have sought to encourage the film industry with tax incentives. In 2007 an entirely new tax regime was introduced for film production companies. This was to replace the previous tax reliefs for film costs, which had been seen as placing too much emphasis on tax breaks for individuals at the cost of real investment in UK films.

### Summary

The new tax rules allow film production companies to claim an enhanced tax relief on qualifying film production costs, depending on the size of the film. This additional relief can then be “surrendered” in exchange for a payment, the amount again depending on the size of the film, for up to 25% of the amount surrendered.

### Who qualifies for the Film Tax credit ?

Only film production companies (FPCs) qualify (and not for example partnerships). FPCs are companies that are responsible for pre-production, principal photography, post-production and delivery of the completed film. An FPC must be actively engaged in production planning and decision making during these periods, as well as directly negotiating, contracting and paying for rights, goods and services in relation to the film. It does not have to have been involved in development of the film before pre-production.

Note there can only be one FPC in respect of each film; if more than one company could qualify, the company that is most directly engaged in the activities above is the FPC. In the case of qualifying co-productions (see below) a company that makes an effective creative, technical and artistic contribution to the film is the FPC.

### What films qualify for the Film Tax credit ?

A film is defined as a sequence of visual images capable of being used as a means of showing that sequence as a moving picture. It includes the soundtrack.

To qualify for Film Tax credits, the film must be intended for theatrical release at a paying public commercial cinema and that a significant proportion (HM Revenue & Customs will accept at least 5% as meeting this test) of the intended earnings from the film are obtained in this way. It is intention that is important; the film does not subsequently need to have a theatrical release. This condition must be met at the end of each accounting period of film making activities by the FPC. Once the condition is failed, it cannot be qualifying in that or any later period.

The film must also be certified by the Secretary of State for Culture, Media and Sport as a British film (based on a recommendation of the UK Film Council, to whom an application should be made).

In addition at least 25% of the core expenditure (see below) must be incurred by the FPC. In the case of qualifying co-productions this condition must be met by the co-producers.

### How are FPCs taxed ?

Firstly, the FPC's activities in respect of a film are treated separately from any other activity for tax purposes, commencing at pre-production or, if earlier, when income from the film is received. The notes below look at the position of one film only.

Secondly, the FPC for each period of account brings in as income a proportion of the estimated total income from the film, less the costs of the film incurred to date. The proportion of income brought in is the proportion of costs of the film incurred to date compared to the estimated total costs of the film.

Income for this purpose is any receipts from the making or exploitation of the film treated as earned at the end of the accounting period.

Costs are those in respect of the film making activities in connection with the film, or with a view to exploiting the film. No deduction is available in respect of expenditure that would not be allowed for tax purposes (eg entertaining), but expenditure is not regarded as being of a capital nature because it is creating an asset (the film).

### When is expenditure incurred ?

To be a cost of an accounting period, it must have been incurred in the period. Generally this will be when it is reflected in work in progress. However the following should be noted;

- advance payments are only recognised when the work is carried out;
- deferred payments are recognised when the work is recognised in the state of completion of the film;
- there must have been an unconditional obligation to pay;
- if payment is linked to income from the film, the cost is only recognised when the income is earned;
- pre-trading expenditure is recognised when the trade commences. Also no claim can be made in respect of any amount which has not been paid within 4 months of the end of the accounting period.

### What costs qualify for an additional deduction ?

Some of the FPC's expenditure will qualify for an additional tax deduction. The amount depends on the FPC's “core expenditure”. Core expenditure is the FPC's film making expenditure on pre-production, principal photography and post-production. It does **not** include development expenditure, marketing and distribution costs, or financing costs. Where costs relate to both core and non-core expenditure, an apportionment on an appropriate basis will be necessary; an example being writer's fees.

The additional deduction is calculated as the lower of;

- UK expenditure within the core expenditure, and
- 80% of core expenditure.

For other than limited budgeted films (see below) the additional deduction is 80% of the figure calculated.

As the calculation is cumulative for each accounting period, additional deductions given in previous periods are deducted.

### What counts as UK expenditure ?

This is expenditure on goods or services which are used or consumed in the UK. For example a US director, paid in dollars by the FPC for the time he is filming in the UK, is regarded as UK expenditure.

### FPC's surrenderable loss

From the film income and costs calculated as above, the FPC can in addition set off the additional deduction. If this produces a loss for the accounting period, this can then be surrendered for a Film Tax credit. However the surrendered amount cannot exceed the available core expenditure for the period (so effectively capping the surrender to the additional deduction for the period).

### How much tax credit is payable ?

In respect of limited budget films the payable credit rate is 25% of the amount surrendered, for other films this is 20%.

A limited budget film is a film whose total core expenditure is £20 million or less.

### Claims for Film Tax credits

The FPC makes the claim as part of its corporation tax return and computation. Interim claims can be made during the film production period, but claims must be accompanied by a certified copy of the certification as a British film (either interim or final as appropriate). Claims must also state the planned UK core expenditure and confirm that the 25% condition regarding this will be met.

The tax return for the film completion period must state the final amount of core expenditure that is UK expenditure.

### Qualifying co-productions

For film tax purposes a qualifying co-production is one within the UK's official co-production agreements or the European Convention on Cinematographic Co-production. The UK currently has agreements with Australia, Canada, France, India, Jamaica, New Zealand and South Africa (Morocco is expected to be added in 2010).

### Planning points

The choice of the FPC's accounting period is important as it will determine the period of expenditure which will form the FPC's claim for film tax credits. Terminating accounting periods early will speed up claims, but has to be balanced against how much expenditure will then fall into the next accounting period. The tax rules regarding timing of expenditure referred to above will also be important to consider. The Companies Act rules regarding changing accounting dates should be borne in mind.

Particular care should be taken with co-productions. For international films, other countries have their own film tax incentives and where expenditure is incurred and by whom will be important. Note that if the co-production is not a qualifying co-production, there could be issues about whether the UK co-producer is a qualifying FPC.

The FPC should ensure that its PAYE/NIC obligations and payments are up to date and that it has complied with the "foreign entertainers" withholding tax obligations, as the tax legislation allows for the set off of amounts outstanding for payment periods ending in the accounting period of the film tax credit claim. It will also delay repayment of the film tax credit.

Anti-avoidance rules prevent artificially inflated claims for additional deductions or film tax credits.

### Taxation of FPCs

Whilst Film Tax credits are the most important part of the tax regime for FPCs, they are not the only part. As indicated above, the profit or loss of each film is considered separately and is based on a cumulative position of income and expenditure in respect of the film.

To the extent that in an accounting period there is a loss in respect of the film, this is carried forward to set off against profits in the future from the same film by the FPC.

On the film either being completed or abandoned, the FPC may elect that, so much of the loss that does not relate to the additional deduction, is set off against profits of another trade the FPC carries on, or to carry the loss back to a previous accounting period (in accordance with the normal tax rules), or to carry it forward as if it were in connection with another film the FPC is producing, or finally it may surrender the loss to another FPC in the same tax group for set off against that company's profits for the period.

When the trade of the FPC is terminated, any remaining losses of the FPC (including in respect of the additional deduction not surrendered) may be transferred for use in respect of another film production of the FPC or transferred to another FPC, which is producing a film, in the same tax group.

Because any loss carried forward relating to the additional deduction can only be set against profits from the same film (until the trade of the FPC is terminated), it will usually be advantageous to surrender the maximum amount of the additional deduction.

### Action

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