

Part 1: Film production

Overview

1. This Part treats certain film production and exploitation activity by certain companies as a separate film trade for corporation tax. It is based on Chapter 3 of Part 3 of, and Schedules 4 and 5 to, FA 2006 (Films and sound recordings).
2. In relation to some separate film trades, this Part also provides for
 - additional trading deductions, and
 - payments for the surrender of losses (“film tax credit”).
3. This Part deals solely with film production companies. Provisions about the corporation tax treatment of sound recordings (that are also dealt with in Chapter 3 of Part 3 of FA 2006) will be dealt with in a separate Part (which also covers other material that is unrelated to this Part).
4. The structure of the Part is:
 - Chapter 1 defines key concepts for, and gives an overview of, the Part including when a company is the film production company in relation to a film;
 - Chapter 2 treats activities of a company in respect of a film as a separate trade (“separate film trade”) if the company is the film production company in relation to that film;
 - Chapter 3 provides, in relation to certain separate film trades, for additional trading deductions and for payments for the surrender of trading losses. Conditions relating to theatrical release, certification and UK expenditure have to be met in relation to the film before these reliefs are available;
 - Chapter 4 modifies, in relation to separate film trades, the rules that normally apply to trading losses; and
 - Chapter 5 deals with claiming relief under this Part on a provisional basis and, if necessary, for the adjustment of relief when the final outcome is known.

Chapter 1: Overview and interpretation

Clause 1: Overview of Part

5. This clause gives an overview of the Part. It is new.

Clause 2: Meaning of “film” etc

6. This clause provides for the meaning of “film” in this Part, when a series of films is treated as a single film and when a film is completed. It is based on section 31 of FA 2006.

7. The definitions are the same as in paragraph 1 of Schedule 1 to the Films Act 1985 (Certification of British Films for Purposes of Film Tax Relief) which was inserted by paragraph 16 of Schedule 5 to FA 2006.

Clause 3: Meaning of “film production company”

8. This clause defines “film production company” for this Part. It is based on section 32 of FA 2006.

9. There can be at most one company that qualifies as the “film production company” in relation to a particular film. There may well be no such company. A company might be a film production company in relation to some of the films that it is involved with but not in relation to others.

10. If a company is the film production company in relation to a particular film its production and exploitation activities in relation to the film are, for corporation tax purposes, treated as a separate trade (see Chapter 2: taxation of activities of film production company). A film production company may, but need not, be entitled to additional reliefs in relation to the film concerned (see Chapter 3: film tax relief).

11. *Subsection (7)* provides for a company to elect that it is not to be treated as a film production company in relation to films. The company may then not be deemed to have (possibly numerous) separate trades, each subject to the rules in this Part. Such an election may be helpful to companies that are not entitled to the additional reliefs in relation to films that they are involved with, for example TV production companies.

Clause 4: Meaning of “film-making activities” etc

12. This clause gives the meaning of “film-making activities” for this Part and gives the Treasury power to make regulations that alter the meaning. It is based on section 33 of FA 2006.

13. The activities mentioned in *subsection (1)* are not further defined. Those activities are however well understood in the film industry.

14. *Subsection (2)* ensures that “principal photography” has an appropriate meaning in cases where images for a film are generated by computer (rather than being produced by traditional photography).

Clause 5: Meaning of “production expenditure” etc

15. This clause defines the terms “production expenditure”, “core expenditure” and “limited–budget film”. It is based on section 34 of FA 2006.

16. Limited–budget films are eligible for more generous levels of relief than other films (see clauses 21(3) and 23(3)). To reduce the risk of this being abused by arrangements involving connected parties, *subsection (3)* substitutes, in certain cases, (greater) arms length prices in determining whether a film is a limited–budget film.

Clause 6: Meaning of “UK expenditure” etc

17. This clause gives the meaning of “UK expenditure” in this Part and gives the Treasury power to make regulations that alter the meaning. It is based on section 35 of FA 2006.

18. *Subsection (2)* provides that any apportionment of expenditure be made on a “just and reasonable basis”. The source legislation refers to “fair and reasonable”. The formulation used in this clause has generally been adopted in ITTOIA and ITA 2007. See *Change {jc218}* in Annex 1.

Q1. We welcome comments on the proposal that clause 6 refer to apportionment being on a “just and reasonable” basis where section 35(2) of FA 2006 refers to a “fair and reasonable” basis.

Clause 7: Meaning of “qualifying co-production” and “co-producer”

19. This clause defines “qualifying co-production” and “co-producer” for this Part. It is based on section 36 of FA 2006.

Clause 8: Meaning of “company tax return”

20. This clause defines “company tax return”. It is based on section 32(10) of FA 2006.

21. Whilst the definition in section 32(10) of FA 2006 is not explicitly applied to instances where the term “company tax return “ appears in Schedules 4 and 5 to FA 2006, it is considered that the same meaning applies in those instances. So the definition in this clause applies to the whole Part.

Chapter 2: Taxation of activities of film production company

Clause 9: Activities of film production company treated as a separate trade

22. This clause treats a film production company’s activities in relation to the film as a separate trade for corporation tax purposes and provides for when that trade is treated as starting. It is based on paragraphs 2 and 3 of Schedule 4 to FA 2006.

23. *Subsection (3)* introduces the label “the separate film trade” in this Chapter as a means of avoiding cumbersome references such as “the separate trade that a film production company is treated as carrying on in relation to the film in respect of which it is the film production company”.

Clause 10: Calculation of profits or losses of separate film trade

24. This clause provides rules for bringing into account income from the film (as defined) and costs of the film (as defined) in calculating the profit or loss of the separate film trade for a period of account. It is based on paragraph 7 of Schedule 4 to FA 2006.

Clause 11: Income from the film

25. This clause gives the meaning in this Chapter of the term “income from the film”. It is based on paragraph 6 of Schedule 4 to FA 2006.

26. *Subsection (3)* provides that capital receipts are treated as having a revenue nature for this purpose. So, for instance, all receipts from the sale of the film will be treated as income for the purposes of this clause.

Clause 12: Costs of the film

27. This clause gives the meaning in this Chapter of the term “costs of the film”. It is based on paragraph 5 of Schedule 4 to FA 2006.

28. *Subsection (3)* prevents expenditure being treated as capital purely because it is on the creation of the film. It does not therefore apply to, say, capital expenditure on plant and machinery since that would be capital regardless of the creation of the film.

Clause 13: When costs are taken to be incurred

29. This clause makes provision about when costs are taken to be incurred. It is based on paragraph 9 of Schedule 4 to FA 2006.

30. Costs are regarded as incurred when actually represented in the state of completion of the work in progress. To prevent avoidance, there are specific rules preventing costs being treated as incurred before they are the subject of an unconditional obligation to pay.

Clause 14: Pre-trading expenditure

31. This clause allows expenditure incurred by the film production company on development of the film, but before the separate film trade starts, to be treated as incurred immediately after the separate film trade starts. It is based on paragraph 4 of Schedule 4 to FA 2006.

32. If pre-trading expenditure is so treated, the company must amend any company tax returns that have previously taken account of the same expenditure. This may be done regardless of any normal time limit for amending the return.

Clause 15: Estimates

33. This clause provides that estimates for the purposes of this Chapter are to be made at the balance sheet date and on a just and reasonable basis. It is based on paragraph 8 of Schedule 4 to FA 2006.

34. The clause provides that any estimate is to be made on a “just and reasonable basis”. The source legislation refers to “fair and reasonable”. The formulation used in this clause has generally been adopted in ITTOIA and ITA 2007. See *Change {jc218}* in Annex 1.

Q2. We welcome comments on the proposal that clause 15 refer to estimates being on a “just and reasonable” basis where paragraph 8 of Schedule 4 to FA 2006 refers to a “fair and reasonable” basis.

Chapter 3: Film tax relief

Clause 16: Availability and overview of film tax relief

35. This clause gives an overview of the Chapter and gives signposts to film tax relief and to the three conditions that must be satisfied in order for the relief to be available. It is new.

Clause 17: Intended theatrical release

36. This clause sets out the condition about intended theatrical release. It is based on section 39 of FA 2006.

Clause 18: British film

37. This clause sets out the condition about certification as a British film. It is based on section 40 of FA 2006.

Clause 19: UK expenditure

38. This clause sets out conditions about the minimum percentage of core expenditure that must be UK expenditure and gives the Treasury power to alter that percentage. It is based on section 41 of FA 2006.

Clause 20: Additional deductions for qualifying expenditure

39. This clause allows a company, entitled to film tax relief, to claim additional trading deductions in respect of qualifying expenditure on the film. The clause also gives the Treasury powers to amend the definition of “qualifying expenditure”. It is based on paragraphs 1 to 3 of Schedule 5 to FA 2006.

Clause 21: Amount of additional deduction

40. This clause sets out the amount of additional deduction for which a claim may be made under clause 20, based on the amount of qualifying UK expenditure up to a maximum of 80% of the total qualifying expenditure, and gives the Treasury power to alter this percentage. It is based on paragraphs 4 and 5 of Schedule 5 to FA 2006.

41. *Subsection (3)* sets out the rates at which the additional deduction is given. It provides for a higher rate if the film is a limited-budget film.

Clause 22: Film tax credit may be claimed if company has surrenderable loss

42. This clause defines a surrenderable loss, and allows a company entitled to film tax relief which has a surrenderable loss for an accounting period to surrender such a loss for a payment. It is based on paragraph 6 of Schedule 5 to FA 2006.

Clause 23: Surrendering of loss and amount of credit

43. This clause allows a company to claim a film tax credit for all or part of its surrenderable loss and quantifies the resulting film tax credit. It is based on paragraphs 7, 8 and 11 of Schedule 5 to FA 2006.

44. *Subsection (3)* sets out the rates of tax credit, providing a higher rate for limited-budget films.

45. *Subsection (4)* provides that the company's loss is reduced by the amount which it surrenders for a film tax credit.

Clause 24: Payment in respect of film tax credit

46. This clause requires the Commissioners for Her Majesty's Revenue and Customs to pay to the company any film tax credit to which it is entitled and for which a claim has been made. It is based on paragraphs 9, 10 and 14 of Schedule 5 to FA 2006.

47. Various circumstances in which a payment need not be made, or may be postponed, are set out. These include cases where the company owes HMRC payments of tax or national insurance contributions, and where there is an enquiry into the return.

48. *Subsection (5)* provides that a payment in respect of film tax credit does not count as income of the company.

Clause 25: No account to be taken of amount if unpaid

49. This clause requires costs that remain unpaid four months after the end of a period of account to be treated, for the purposes of this Chapter, as if they had not been incurred by the end of that period. It is based on paragraph 12 of Schedule 5 to FA 2006.

50. The restriction in this clause is additional to that in clause 13. Clause 13 is concerned with whether, and when, a trading deduction may be made in respect of expenditure in calculating the profit or loss of the single film trade. The further restriction in this clause applies in deciding whether (and, if so, how much of) an additional trading deduction may be claimed or a trading loss may be surrendered for payment.

Clause 26: Artificially inflated claims for additional deduction or film tax credit

51. This clause requires transactions to be ignored for film tax relief purposes if they are attributable to arrangements whose main purpose, or a main purpose, is obtaining, or increasing, entitlement to that relief. It is based on paragraph 13 of Schedule 5 to FA 2006.

Clause 27: Confidentiality of information

52. This clause permits disclosure of information by HMRC to the Secretary of State for the purpose of functions relating to certification of films, and permits the Secretary

of State to disclose such information to the UK Film Council, but prevents the recipient of such information making further disclosure except in specified cases. It is based on paragraph 24 of Schedule 5 to FA 2006.

Clause 28: Wrongful disclosure

53. This clause makes it an offence to disclose information in contravention of clause 27(3) if the disclosure reveals, or one can deduce, the identity of the person to whom the information relates. It is based on paragraph 25 of Schedule 5 to FA 2006.

Chapter 4: Film losses

Clause 29: Application of sections 30 and 31

54. This clause introduces, and provides defined terms for, the next two clauses dealing with losses of separate film trades. It is based on sections 43(3) and 44(5) of FA 2006.

Clause 30: Restriction on use of losses while film in production

55. This clause restricts the offset of single film trade losses arising in accounting periods ending before the film is completed or abandoned (“pre-completion periods”). It is based on section 43(1) and (2) of FA 2006.

56. The profits against which pre-completion period single film trade losses can be offset are restricted to those provided for by section 393(1) of ICTA (carry forward against trading profits of the same trade). But this restriction may effectively cease to apply in respect of some, or all, of those single film trade losses from the accounting period in which the film is completed or abandoned (see clause 31).

Clause 31: Use of losses in later periods

57. This clause modifies, for accounting periods from that in which the film is completed or abandoned (“the completion period”), the rules on trade losses and their offset against other profits. It is based on section 44(1) to (4) and (6) of FA 2006.

58. *Subsections (2) and (3)* allow some (or all) of single film trade losses brought forward to the completion period to be treated as if they were single film trade losses of the completion period. Single film trade losses of the completion period are not subject to the restrictions in clause 30. Any brought forward losses that are attributable to film tax relief (see *subsection (6)*) will not be “freed-up” in this manner. Nor will losses be “freed-up” if they are brought forward because of clause 32 (terminal losses) (see *subsection (7)*).

59. *Subsections (4) and (5)* prevent single film trade losses being offset against other profits to the extent that such losses are attributable to film tax relief (see *subsection (6)*).

Clause 32: Terminal losses

60. This clause allows certain single film trade losses, attributable to a trade that ceases, to be treated as if they were brought forward losses of certain other single film

trades and it allows the Treasury to make regulations appropriate to the operation of the clause. It is based on section 45 of FA 2006.

61. This is an exception to the normal rule that trade losses do not survive the cessation of the trade in which the losses were made. This clause operates if the trade that ceases (trade A) is a single film trade that qualifies for film tax relief and, at the time of cessation, there is another single film trade (trade B) carried on which also qualifies for film tax relief. Subject to conditions being met, the losses of trade A that would otherwise have been available for carry forward under section 393(1) of ICTA may be treated as if they were losses of trade B that are carried forward under section 393(1) of ICTA.

62. Trade B may be carried on either by the film production company that had carried on trade A or by another member of the same group (for group relief) as that film production company.

63. The Corporation Tax (Surrender of Terminal Losses on Films and Claims for Relief) Regulations 2007 (SI 2007/678) have been made under section 45(5) of FA 2006.

Chapter 5: Provisional entitlement to relief

Overview

64. It cannot be definitively established that a film qualifies for film tax relief, or transfer of terminal losses, until the accounting period in which the film is completed or abandoned (“the final accounting period”). This Chapter provides for film tax relief to be obtained, or terminal losses transferred, for earlier accounting periods (“interim accounting periods”) on the basis of provisional assumptions – and for later adjustments if those assumptions prove wrong.

Clause 33: Application of Chapter etc

65. This clause defines terms used in the Chapter and requires the appropriate company tax return of the film production company to state that the film has been completed or abandoned. It is based on paragraph 30 of Schedule 5 to FA 2006.

66. The term “special film relief” covers both film tax relief (which requires that the film in question satisfy the requirements listed in clause 16(2)) and the transfer of terminal losses from one separate film trade to another (which requires that both of the films satisfy those requirements).

Clause 34: Certification as a British film

67. This clause relates to the requirement that a film must be certified as a British film in order for there to be entitlement to special film relief. It is based on paragraph 31 of Schedule 5 to FA 2006.

68. Special film relief cannot be claimed for an interim accounting period unless the company tax return is accompanied by an interim certificate. For the final accounting

period the company tax return must be accompanied by a final certificate (if the film was abandoned rather than completed, an interim certificate will suffice). Special film tax relief previously obtained is withdrawn if the conditions in this clause are not met.

Clause 35: The UK expenditure condition

69. This clause relates to the requirement that a film must meet the UK expenditure condition in order for there to be entitlement to special film relief. It is based on paragraph 32 of Schedule 5 to FA 2006.

70. Special film relief cannot be claimed for an interim accounting period unless the company tax return indicates that the UK expenditure condition will be met. For the final accounting period the company tax return must show whether the UK expenditure condition is met. Special film relief previously obtained is withdrawn if the conditions in this clause are not met.

Clause 36: Film tax relief on basis that film is limited-budget film

71. This clause relates to the requirement that a film must be a limited-budget film in order for there to be entitlement to film tax relief at the enhanced rates in clauses 21(3)(a) and 23(3)(a). It is based on paragraph 33 of Schedule 5 to FA 2006.

72. Film tax relief at the higher rates applicable to a limited-budget film cannot be claimed for an interim accounting period unless the company tax return indicates that the film will be a limited-budget film. For the final accounting period the company tax return must show that the film is, or if it had been completed would have been, a limited-budget film. Film tax relief previously obtained at the higher rates is reduced if the conditions in this clause are not met.

Clause 37: Time limit for amendments and assessments

73. This clause allows any amendments or assessments, required by this Chapter, to be made even if it would otherwise be out of time to do so. It is based on paragraph 34 of Schedule 5 to FA 2006.

Part 2: Trading income

Chapter 1: Trade profits: other specific trades

Overview

74. These clauses deal with the corporation tax treatment of traders who incur expenditure on the production or acquisition of the original master version of a sound recording. They are based on sections 48 to 50 of FA 2006.

75. Section 46 of FA 2006 brought to an end previous corporation tax rules for the taxation of film production and acquisition in F(No2)A 1992. ESC B54, dealing with the corporation tax treatment of the production or acquisition of master versions of a sound recording was based on those F(No2)A provisions. That is why sections 48 to 50, which legislated the extra-statutory concession, are in the same Chapter of FA 2006 as provisions that deal with film production companies.

76. We now propose to separate out the sound recordings provisions and place them, under an appropriate italic subheading, in a Chapter dealing with special rules for calculating trading profits for certain specific trades.

77. Sections 48 to 50 of FA 2006 were based on, and are similar to, Chapter 9 of Part 2 of ITTOIA (trade profits: sound recordings) (note that section 47 of FA 2006 has brought to an end the income tax rules for films formerly included in that Chapter of ITTOIA).

Clause 38: Revenue nature of expenditure

78. This clause provides for the trader's expenditure, on producing or acquiring the original master version of a sound recording, to be treated as expenditure of a revenue nature. It is based on section 48 of FA 2006.

79. If this clause applies to a sound recording any of the trader's receipts from it are treated as having a revenue nature.

Clause 39: Allocation of expenditure

80. This clause provides for the allocation of a trader's expenditure on producing or acquiring the original master version of a sound recording except where that master version is trading stock. It is based on section 49 of FA 2006.

81. Square brackets are used in *subsection (1)(b)* to indicate that the reference to section 100(2) of ICTA will be replaced with a reference to the provision rewriting section 100(2) of ICTA when these clauses are shown as part of a complete draft Bill.

Clause 40: Interpretation of sections 38 and 39.

82. This clause provides definitions of terms used in the previous two clauses. It is based on sections 31 and 50 of FA 2006.

Schedule 1: Consequential amendments (film production)

83. Square brackets are used in the Schedule to indicate that the Part numbering and Bill description will alter when these clauses are shown as part of a complete draft Bill.

FA 2006

84. The provisions about film production companies, film tax relief and supporting definitions in sections 31 to 36 of FA 2006 are rewritten. Those definitions are therefore repealed along with the other provisions that are rewritten. But since those FA 2006 definitions also apply for the purposes of sections 46 and 47 of FA 2006 (withdrawal of existing reliefs), which are not rewritten, and are not repealed, *paragraph 5(d)* ensures that the rewritten definitions apply for the purposes of sections 46 and 47 of FA 2006.

Schedule 2: Transitional provisions (film production)

85. Square brackets are used in the Schedule to indicate that the Part numbering and Bill description will alter when these clauses are shown as part of a complete draft Bill. And the references to “section {j062980a}” will then be replaced by a reference to the provision that rewrites paragraph 80A(2) of Schedule 29 to FA 2002 (intangible fixed assets: master version of films).

Application of Part [1] etc to films that commenced principal photography before 1 January 2007 but were not completed before that date

86. Section 52 of FA 2006 contains powers to make transitional provisions relating to films (“overlapping films”) that started principal photography before 1 January 2007 but which were not completed before that date. *Paragraph 4* rewrites these powers.

87. The Corporation Tax (Taxation of Films) (Transitional Provisions) Regulations 2007 (SI 2007/1050) have been made under section 52 of FA 2006. Some of the tax provisions which are modified, for overlapping films, by SI 2007/1050 are to be rewritten in one Part of [Bill 5], others are not rewritten (such as the withdrawal of existing film reliefs in sections 46 and 47 (see paragraph 84)) while others are, effectively, rewritten elsewhere in [Bill 5] (in the Part dealing with intangible fixed assets).

88. *Paragraph 5* adapts the transitional provisions in SI 2007/1050 so that they refer to the appropriate places in FA 2006, Part [1] of [Bill 5] or elsewhere in [Bill 5].

Change {jc218}: Requiring an apportionment to be just and reasonable: clauses 6 and 15

This change requires apportionments and estimates that are required to be made on a fair and reasonable basis in the source legislation to be made on a just and reasonable basis.

Apportionments of expenditure for the purposes of Chapter 3 of Part 3 of FA 2006 (films and sound recordings) are to be made on a fair and reasonable basis (see section 35(2) of FA 2006). Estimates for the purposes of Schedule 4 to FA 2006 (taxation of activities of film production company) are also to be made on a fair and reasonable basis (see paragraph 8 of Schedule 4 to FA 2006).

Change 14 in ITTOIA noted instances where the source legislation provided that apportionments were required to be on a “just” basis, a “reasonable” basis, a “just and reasonable” basis or sometimes on an unspecified basis. It noted that there was no reason why those apportionments should not be just and reasonable and it was desirable that such apportionments should be made on the same basis. So in those instances apportionments required by ITTOIA were uniformly to be made on a “just and reasonable” basis.

Accordingly, the apportionment required by clause 6 and the estimate required by clause 15 is to be on a “just and reasonable” basis where source legislation refers to a “fair and reasonable” basis.

This change makes minor amendments to existing rules, but is expected to have no practical effect as it is in line with generally accepted practice.