

Commentary on the draft Corporation Tax (Taxation of Films Transitional Provisions) Regulations 2006

1. When the previous film tax reliefs were withdrawn, there were probably a small number of films which started principal photography whilst they were in place, but which were not completed until after their withdrawal.
2. The purpose of the draft [Corporation Tax \(Taxation of Films Transitional Provisions\) Regulations](#) is to modify the legislation in Chapter 3 of Part 3 to ensure that films in this category are able to qualify for the new film tax relief.
3. Specifically, the films affected will be those which started actual filming (principal photography) before 1 April 2006, and which have not been completed (that is, are not in a state to be shown in the cinema) at 1 January 2007. For brevity, this note describes these as [overlapping films](#) (because although they commenced before 1 April, they will be still in production when the previous relief has been withdrawn).

Low Budget Threshold

4. The previous reliefs drew a distinction between "low budget" and other films, according to whether or not their total budget was greater than £15 million. The new film tax relief draws a similar distinction between "limited-budget" and other films but uses a higher threshold of £20 million. However, for the purposes of overlapping films, the lower threshold of £15 million will be used when determining the amount of the new relief.

UK Expenditure and British Film criteria

5. Both the previous and the new reliefs were available for films which were certified as "British" by the Department for Culture, Media and Sport. However, a new test for determining a British film was introduced on 1 April 2006. Broadly, the previous test was based on the proportion of expenditure incurred in the UK, while the new test considers a range of cultural factors.
6. Overlapping films will have to satisfy the previous, rather than the new, test.
7. The new film tax relief has as a separate condition, that a film must incur 25% of its expenditure in the United Kingdom. Because any film which meets the previous test for a British film will necessarily meet this condition, it is not imposed on overlapping films.

Mechanism for giving relief

8. The previous film reliefs were only claimed after the film is completed (because a valid claim requires prior certification from DCMS that the film is British, which can only be given on completion). The new film tax relief, however, can be claimed whilst the film is in production (DCMS will be able to issue interim certificates, which will be confirmed on completion).

9. Because overlapping films will follow the principles of the old, rather than the new relief, claims will only be made on completion. It is therefore necessary to modify some of the detailed provisions of the new relief which are designed to accommodate claims made in successive accounting periods before completion of a film.

Phasing out the previous reliefs

10. Within Chapter 3 of Part 3, clauses 46 and 47 withdraw the previous films reliefs for corporation tax and income tax respectively.

11. The effect of clauses 46 and 47 is to ensure films which commenced principal photography before 1st April 2006 are dealt with by the previous film tax regime. The requirement that, to receive the old reliefs at ss 42 F(No 2)A 1992 and 48 F(No 2)A 1997, a film must be completed before 1 January 2007, is imposed by draft Regulation 3, discussed below, in line with previously announced Government policy.

Relationship with the intangibles regime

12. There is a special tax regime dealing with companies' gains and losses from intangible fixed assets, at Schedule 29 FA 2002 (the 'IP regime'). Films were excluded from the IP regime, but clause 51 removes this exclusion, for films that commenced principal photography on or after 1 April 2006, so far as film acquisitions are concerned. Since the purpose of the Regulations is to bring overlapping films into line with such films, they also bring acquisitions of overlapping films into the IP regime.

Detail of the draft regulations

Introductory

13. Regulation 1 provides the title and the coming into force of the Regulations on the day after they are made. It also provides that those provisions of Chapter 3 of the Finance Act 2006 will apply as if they had been in force at all material times. This means that those provisions can be applied before 1 April 2006, where relevant.

14. Regulation 2 is an interpretation provision: Chapter, Schedule or Section in the Regulations are to appropriate parts of FA 2006¹.

15. Regulation 3 provides for the application of the provisions of Chapter 3 and the enactments amended by that Chapter, as modified by the Regulations, to films that commenced principal photography before 1 April 2006 and which were not completed before 1 January 2007 (i.e. overlapping films).

16. Films which commenced principal photography before 1 April 2006 and were completed by 1 January are not within the scope of the Regulations. These are governed by the rules in clauses 46 and 47 of the Bill without modification. Such films therefore continue to be eligible for the previous reliefs, except that;

- relief for preliminary expenditure under s41 F(No 2)A 1992 and s 137 ITTOIA 2005, only applies to expenditure incurred before Royal Assent; and
- relief for acquisition expenditure is only available for acquisitions before 1 October 2007.

Level of Relief

17. Regulation 4 provides that for overlapping films, the threshold for a limited-budget film is £15m, rather than £20m. This preserves the level which was in place when the previous film tax reliefs were in place and which would have applied when the film started principal photography.

UK Expenditure and British films

18. Regulations 5 and 6 omit provisions relating to the 25% UK expenditure test for overlapping films to qualify for film tax relief. Overlapping films will have to satisfy the criteria for a British film which was in place before 1 April 2006 and which includes a more stringent UK minimum expenditure threshold.

¹ Because the regulations cannot be made until Chapter 3 is in force, they refer to the provisions of the Chapter as sections (of the Finance Act 2006) rather than clauses (of the Finance (No 2) Bill 2006, which, at the time of writing, is the state of the legislation). This commentary follows the regulations in referring to sections rather than clauses and to the Act rather than the bill.

19. The changes made broadly restore the position, for overlapping films, to that which obtained before 1 April 2006, so that a film which commenced principal photography before that date still has to satisfy the same requirements to obtain film tax relief as were in force at that time.

20. Regulation 15(6) modifies the provisions in Schedule 5 Part 2 that amend the rules in Schedule 1 of the Films Act 1985 setting out the requirements a film must meet to be certified as British. These rules were amended with effect from 1 April 2006 both by the Films (Definition of a “British Film”) Order 2006 (2006 No. 643) and by Part 2 of Chapter 3.

21. Regulations 15(6)(c), 15(7) and 15(8) restore the previous test of British nature of a film which existed before 1 April 2006, including the part of that test which required the maker of the film to be registered in a member State throughout the period when the film was made.

Mechanism for giving relief

22. Regulations 7, 8, 9, 14 (b) and (c) and 15(3), (4), (6)(a) and (b) and (9) omit the provisions relating to claims to film tax relief before a film is completed. These are not relevant to overlapping films which, in order to qualify for film tax relief, must meet the criteria for the pre 1 April 2006 test for a British film which can only be done once the film has been completed.

Phasing out previous reliefs

23. Regulations 10 and 11 modify sections 46 and 47 FA 2006, which withdraw the previous films reliefs. Since these modifications only operate for overlapping films, their effect is to specify the tax treatment of such films for both production and acquisition expenditure. (See table in [narrative 11] for a summary of this).

24. These are key provisions and Annex A to this commentary therefore includes the text of sections 46 and 47 as modified.

Relationship with the intangibles regime

25. Regulation 12 modifies section 51 FA 2006, which dovetails the new films relief with the existing regime for intangible assets at Schedule 29 FA 2002 (“the IP regime”).

26. The effect of section 51 is, so far as production expenditure is concerned, to exclude from the IP regime any film to which Schedule 4 FA 2006 applies (that

is, any film to which the new films regime applies – whether or not that film attracts the enhanced relief for British cinema films). This maintains the exclusion that applied to films under the previous films reliefs, with the difference that royalties were dealt with in the IP, rather than the films, regime, while under the new films rules, the situation is reversed.

27. So far as acquisition expenditure is concerned, regulation 13 makes changes that dovetail with those made by regulations 10 and 11 to sections 46 and 47. The purpose of this is that where a film is still subject to the previous films regime, which give relief for both production and acquisition costs, acquisition costs cannot also be within the IP regime. From 1 October 2007, such costs are fully within the IP regime and no relief will be given under the previous rules.

28. For an overlapping film, which is, in effect, lifted out of the old films rules and is subject to the new film tax relief, this change is brought forward and the 1 October deadline for acquisitions is irrelevant.

29. Annex B gives the legislation as it would be modified by regulation 12, and the table in [narrative 11] again shows the effect.

Miscellaneous

30. Regulation 15(5) inserts a new paragraph 13A into Schedule 5 setting out the consequences if its film tax relief depends on a DCMS certificate that is revoked. Any relief to which it was entitled on the basis of such a certificate is lost and must be repaid.

31. Regulation 16 makes provisions for amendments for returns, including amended returns, and for assessments, to give effect to the modified provisions of Chapter 3, including overriding time limits for such returns, amended returns and assessments.

ANNEX A: Sections² 46 and 47 as modified by Regulations 10 and 11

46 Films: withdrawal of existing reliefs (corporation tax)

1 Sections 40A to 40D of F(No.2)A 1992 (treatment of expenditure on production or acquisition of film) do not apply—

- (a) to production expenditure on a film that qualifies for film tax relief;
- (b) to acquisition expenditure—
 - (i) on a film that qualifies for film tax relief, or
 - (ii) that is incurred on or after 1st October 2007 on a film (whenever made).

2 Section 41 of that Act (preliminary expenditure) does not apply to expenditure incurred after the date on which this Act is passed.

3 Section 42 of that Act and section 48 of F(No.2)A 1997 (special reliefs for British films) do not apply to expenditure on the production or acquisition of a film).

4 References in this section to expenditure on the acquisition of a film, or to sums received from the disposal of a film, are to expenditure on the acquisition of, or sums received from the disposal of, the original master version of the film.

5 For this purpose—

- (a) “original master version” means the original negative, tape or disc;
- (b) references to the original master version of a film include the original master version of the film soundtrack (if any);
- (c) references to the original master version include any rights in the original master version that are held or acquired with it.

² Because the regulations cannot be made until Chapter 3 is in force, they refer to the provisions of the Chapter as sections (of the Finance Act 2006) rather than clauses (of the Finance (No 2) Bill 2006, which, at the time of writing, is the state of the legislation). This commentary follows the regulations in referring to sections rather than clauses and to the Act rather than the Bill.

47 Films: withdrawal of existing reliefs (income tax)

1 Sections 134 and 135 of ITTOIA 2005 (treatment of expenditure on production or acquisition of film) do not apply—

(a) to production expenditure on a film that qualifies for film tax relief;

(b) to acquisition expenditure—

(i) on a film that qualifies for film tax relief, or

(ii) that is incurred on or after 1st October 2007 on a film (whenever made).

2 Section 137 of that Act (preliminary expenditure) does not apply to expenditure incurred after the date on which this Act is passed.

3 Sections 138 to 144 of that Act (special reliefs for British films) do not apply to expenditure on the production or acquisition of a film).

4 References in this section to expenditure on the acquisition of a film, or to sums received from the disposal of a film, are to expenditure on the acquisition of, or sums received from the disposal of, the original master version of the film.

5 For this purpose—

(a) “original master version” means the original negative, tape or disc;

(b) references to the original master version of a film include the original master version of the film soundtrack (if any);

(c) references to the original master version include any rights in the original master version that are held or acquired with it.

ANNEX B: Section 51³ as modified by Regulation 12

51 Corporation tax: films and sound recordings as intangible fixed assets

1 In Schedule 29 to FA 2002 (corporation tax: gains and losses from intangible fixed assets), for paragraph 80 (exclusion of films and sound recordings) substitute—

“Assets excluded: certain films

80A 1 This Schedule does not apply to an intangible fixed asset held by a film production company to the extent that it represents production expenditure on a film to which Schedule 4 of the Finance Act 2006 applies.

Expressions used in this sub-paragraph have the same meaning as in Chapter 3 of Part 3 of the Finance Act 2006.

2 This Schedule does not apply to an intangible fixed asset held by a company to the extent that it represents expenditure by the company—

- (a) on the production of the original master version of a film that commenced principal photography before 1st April 2006;
- (b) on the acquisition before 1st October 2007 of the original master version of a film that
 - (i) commenced principal photography before 1st April 2006, and
 - (ii) does not qualify for film tax relief under section 38 of the Finance Act 2006.

3 In sub-paragraph 2—

- (a) “film” has the same meaning as in Chapter 3 Part 3 of the Finance Act 2006;
- (b) “original master version” means the original negative, tape or disc;
- (c) references to the original master version of a film include the original master version of the film soundtrack (if any);

³ Because the regulations cannot be made until Chapter 3 is in force, they refer to the provisions of the Chapter as sections (of the Finance Act 2006) rather than clauses (of the Finance (No 2) Bill 2006, which, at the time of writing, is the state of the legislation). This commentary follows the regulations in referring to sections rather than clauses and to the Act rather than the Bill.

(d) references to the original master version include any rights in the original master version that are held or acquired with it.

Provisions relating only to sound recordings are not modified by the Regulations and have been omitted for clarity