

Chancellor stages cliffhanger with a Hollywood ending

Commentary

Jonathan Ivinston

However history judges Gordon Brown, the chancellor has made a name for himself in Hollywood. In the run-up to the budget, representatives of the studios were worrying that further changes to the film tax relief rules in Britain could cause a number of funding deals to fall through. There was relief when it became clear that the budget contained no unpleasant surprises.

The chancellor's notoriety among Hollywood executives is a testament to the success of British government policy towards the film industry since 1992. The Major government introduced tax relief for preliminary expenditure on British films and a three-year write-down of production costs, resulting in a substantial tax saving.

In 1997 Mr Brown introduced an immediate write-off of production expenditure where the total did not exceed £15m. Due in no small part to this policy, production spending in the UK rose from £58m in 1992 to £539m in 2000.

The tax environment attracted a number of Hollywood productions to Britain. The reason for the nervousness of Hollywood executives before the budget was because in December's pre-budget report, a number of anti-avoidance measures were introduced to clamp

down on perceived abuses.

Many people feared that the budget would herald further restrictions or the existing system being abandoned altogether. The tax avoidance industry had found ways of exploiting loopholes in the law that enabled investors to claim tax relief more than once, known as "double dipping".

Production companies often entered into sale and leaseback transactions with investor partnerships to realise the economic benefit of the tax relief. Partnerships comprising self-employed higher-rate taxpayers were formed to acquire the rights to a film, setting off their expenditure against other income and so making use of the tax relief immediately. The film would then be leased back to the producer and the investors would pay tax on the lease rental stream over a 15-year period.

But what was intended to be a tax-free loan from the government became in some cases an unintended tax-free gift as loopholes were exploited to escape tax on the rental stream, claim tax relief twice on the same expenditure or artificially prolong the 15-year leaseback period.

When the Treasury acted to block these schemes it did so in a way that caused panic in the industry. It introduced specific anti-avoidance measures. There was a great deal of concern on the part of financiers about entering into forward-funding deals with the tax legislation seemingly in a state of constant flux. Something needed to be done. The primary purpose of government legislation since 1992 has been to foster the

development of the domestic film industry.

The government clearly had this in mind when it announced a new form of tax relief for low-budget British films in the 2004 budget. The significance of the chancellor's announcement is that a similar relief will be introduced for all qualifying British films.

Crucially, the new relief takes the form of either a tax write-off for production costs or, if the producer has insufficient taxable income to take full advantage of the write-down, a cash credit from the Treasury. This will almost certainly spell the end of the sale-and-leaseback structures and introduce a degree of transparency into what had become a complex game of cat and mouse between the promoters of tax avoidance schemes and the Inland Revenue.

There are concerns that the new system leaves no role for private investors as the days of the risk-free tax break appear to be over. Investing through the enterprise investment scheme or venture capital trust vehicles is still possible but involves taking a risk. Many small independent producers believe the changes will lead to a dramatic reduction in the number of low-budget films made in Britain. This is a situation that the Treasury need to monitor. While attracting big-budget productions is essential to maintaining a vibrant British film industry, to do so at the expense of emerging talent would be self-defeating.

Jonathan Ivinston is head of tax in the London office of Hogan & Hartson