


New Motion Picture Tax Incentives in France and Hungary

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To reduce costs, many French film productions are now hosted outside France, often in Central Europe.¹ In an attempt to reverse this trend, the French legislature created a new tax credit for qualifying producers who conduct most of the production of a full-length feature film within France. On September 24, 2004, the French tax authority released guidelines explaining how the new tax credit works.

In a similar attempt to encourage production, the Hungarian legislature created new tax allowances for cinema in Hungary's first Motion Picture Act, which came into force on April 1, 2004. The Motion Picture Act should give a boost to the production of local or foreign motion pictures in Hungary. This article will focus on the operation of the new tax incentives enacted in France and Hungary this year.

Operation of the new French tax credit

The French legal framework: The Finance Law for 2004

Article 88 of the French Finance Law for 2004 created a tax credit for the benefit of CNC-approved production companies that produce feature films after January 1, 2004 and that also qualify for French

production subsidies.² The tax credit equals 20 per cent of the qualifying technical expenses related to production of the relevant picture, provided that the expenses are for technical services performed in France. The amount of the tax credit is capped at €500,000 for live-action features, and €750,000 for animation features. These caps will probably be increased in 2005. The French tax authority published guidelines on September 24, 2004 that clarify application of the tax credit regime.³

Companies eligible for the new tax credit

"A production company approved by the CNC ..."

Pursuant to Art. 220, series I of the French Tax Code, only a production company licensed by the French National Cinema Center ("CNC") and subject to corporate income tax in France may benefit from the tax credit. To be authorised by the CNC, a film production company must be a *corporate entity based in France*. A foreign company must therefore create a subsidiary in France. A second condition is that the production company must be eligible to receive French production subsidies. Those subsidies are awarded only to companies "controlled" by European⁴ persons. The concept of "control" by European persons is currently being litigated before the Paris Administrative Court. The CNC ruled that the production company "2003 Productions" was entitled to French production subsidies because it was "controlled" by European persons. An

1. According to statistics published by the French CNC, about 46.5 per cent of French-initiated pictures supported by the CNC in 2003 were, in whole or in part, filmed outside France. The number of weeks spent filming those pictures outside France increased in 2003 by 49 per cent compared to 2002, and by 77 per cent compared to 2001. The reasons for delocalising are sometimes artistic, but producers often delocalise to save costs (Portugal, Rumania) and/or to have access to local financing (Belgium, Luxembourg, Great Britain).

2. *Loi de Finances pour 2004* dated December 30, 2003. The law was codified in the French General Tax Code as Arts 220 sexes and 220F.

3. *Instruction fiscale 4 A7-04* dated September 24, 2004, *Bulletin officiel des Impôts*, No. 148.

4. Europe means, in this context, (i) countries that are members of the European Union, (ii) countries signatory of the Council of Europe's Convention on Transfrontier Television, and (iii) countries with which the European Union has signed treaties in the audiovisual sector.

association of independent French producers challenged the CNC's decision before the Paris Administrative Court, arguing that Warner Bros (a non-European entity) exercises *de facto* control over 2003 Productions by virtue of the fact that Warner Bros owns 33 per cent of the share capital directly, and that Warner Bros' European employees own the remaining 67 per cent. The advocate general said that he agrees with the plaintiff's argument, *i.e.* that Warner Bros exercises *de facto* control over 2003 Productions and that the company therefore should not be entitled to production subsidies. If the Paris Administrative Court—and ultimately the French Conseil d'État—support the advocate general's opinion, US studios will have more difficulty in structuring investment in French production companies in ways that do not jeopardise their eligibility for production subsidies and tax credits.

To benefit from the tax credit, the production company must also qualify as a "producteur délégué", *i.e.* a production company that "takes the initiative and the financial, technical and artistic responsibility" for a particular film and "guarantees the completion thereof".⁵ Generally a picture will have only one *producteur délégué*, but the guidelines state that there can be up to two companies acting jointly who may qualify as *producteur délégué* for purposes of the tax credit. In that case, the credit is granted to each of the production companies in proportion to its share in the expenses.

Other entities (*e.g.* French television channels) that are passive co-producers are not eligible for the tax credit—only the *producteur délégué* is.

"... who request CNC approval before the actual filming begins ..."

The production company must apply for an initial approval from the CNC before the beginning of principal photography, and then seek final approval after completion of the picture. The first request for "temporary approval" must include, among other things, a detailed estimate of the film's budget (with particular mention of the production expenses to be spent in France), and a list of the technicians and service companies that will participate in the production. The temporary approval process verifies that the film will earn enough points to qualify for the tax credit regime. The point system for the tax credit is similar to the system used by the CNC to allocate production subsidies. Points are attributed for a particular picture depending on whether, *e.g.* the employment contracts of technicians, collaboration artists or workers in the actual filming and post-production are governed by French law, and social contributions paid in France; whether the service providers and laboratories used for filming and post-production work are based in France, etc. For purposes of the tax credit, the nationality of the director, screenwriter and/or the actors is irrelevant, because their compensation does not qualify as a "technical expense".⁶

5. See Art.6 of Decree 99-130 of February 24, 1999 regarding financial support to the movie industry, as amended by Decree 2001-771 of August 28, 2001.

6. It should be noted that two different scales apply for (i) the CNC's approval related to public subsidies and (ii) the CNC's approval related to the tax credit. Does that mean that two separate approvals should be requested to the CNC?

The minimum number of points a production must obtain varies depending on whether the film is a live-action feature (38 points needed out of 40) or an animation feature (40 points needed out of 64). The tax guidelines say that the CNC has some flexibility in attributing points for productions "wholly or principally financed by French partners".⁷ For those productions, the CNC has discretion to grant certain points, even if applicable requirements are not met, if the producer can show that there were artistic or technical reasons for not being able to satisfy the points requirements. For example, if a producer can show that it requires the services and know-how of a service provider not based in France because the services are special, and could not be found in France, or if the producer can show that a particular scene needs to be shot outside France for artistic reasons, the CNC can tally the relevant points as if those particular services had been performed in France. This flexibility only applies to French-financed productions, which seems surprising and could raise problems of discrimination under the EC Treaty.

The producer must file for its final approval with the CNC within eight months after delivery of the picture's theatrical release visa ("*visa d'exploitation*"). Final approval will be granted by the CNC after review of the actual expenditures, as compared to those presented in the initial budget.

"... and who produce full-length feature films"

As mentioned above, the only works covered by the new tax credit are full-length feature films, *i.e.* pictures destined for theatrical release in France and that have a duration greater than one hour, with some very limited exceptions. Television productions do not currently qualify for the tax credit regime, although this is likely to change in 2005. The qualifying feature films may be works of fiction, documentaries, or animation movies.

Qualifying technical expenses

The technical expenses taken into account for purposes of the new French tax credit must correspond to services actually performed in France. As regards live-action features, those expenses may include, *inter alia*:

1. wages paid to technicians, creative assistants and production staff employed for the production;
2. expenses linked to the use of studios, construction or rental of sets, special effects, costumes, make-up;
3. the rental of filming equipment;
4. post-production expenses, including special effects, film, digital equipment, and laboratory work up to the creation of the initial negative.

The list of qualifying expenses for animation features is substantially similar to that for live-action features, but also includes fees paid to service providers for the preparation and creation of computer animation. The guidelines do not indicate how the

According to a CNC member, the CNC will only require one global filing before the actual filming begins. However, that initial filing will need to contain the information required by law for tax credit purposes.

7. Instruction fiscale 4 A7-04, para.25

CNC and tax authorities will verify whether all services are in fact performed in France. The tax guidelines say that a French laboratory doing post-production work may not subcontract the work outside France,⁸ but this may be hard to enforce, particularly if the subcontracting only involves minor post-production tasks.

Qualifying expenses must be actual out-of-pocket expenses. If the producer receives production subsidies, then the amount of the subsidy will reduce pro rata the amount of the qualifying technical expenses. For example, assuming (a) a production budget of €2 million, (b) qualifying technical expenses of €1.2 million, and (c) production subsidies of €200,000, the amount of qualifying technical expenses would be adjusted as follows:

$$1,200,000 - [(1.2/2.0) \times 200,000]$$

It is unclear how year-end rebates and retroactive discounts given by laboratories and other service providers will be treated. Presumably, the amount of expenses qualifying for the tax credit should be the net amount, after any applicable discounts, including year-end rebates. But this rule may be difficult to enforce in practice.

Amount of tax credit, applicable ceiling

The French tax credit is equal 20 per cent of the total amount of qualifying technical expenses for the picture spent in the course of the fiscal year. In the case of a joint production, the amount of the tax credit is granted to each of the *producteur délégué* pro rata to its share in the expenses, *not* pro rata to its share in the joint production.⁹ The amount of tax credit is capped for each picture. A live-action feature may generate, over one or several financial years, a maximum tax credit of €500,000. For animation features, the cap is higher: €750,000. The cap is per picture. Consequently, if a given production company produces several motion pictures, the relevant cap would be multiplied by the number of pictures. Moreover, if the production company is part of a consolidated tax group, the tax group can use the tax credit as well as other tax credits that might be generated by other motion picture production subsidiaries in the group. For groups that produce several motion pictures a year, this can add up to significant amounts.

In a press conference relating to the 2005 budget, the French Culture and Communication Minister announced that the relevant caps would be increased for 2005.¹⁰ In the course of that conference, the Minister also announced the creation of a similar tax credit for television productions.

Article 220F of the French Tax Code provides that the tax credit is deducted from the amount of corporate tax payable by the company for the financial year during which the monies were

expended. If the company owes no corporate tax because it has made no taxable profits, the amount of the tax credit is paid by the tax administration to the production company.

Using the tax credit to help finance the film

As noted above, the tax credit is a set-off against income tax due by the production company. But if the production company owes no tax, the tax administration pays the amount of the tax credit directly to the production company. This creates a new revenue stream that could potentially be discounted to help finance the picture up front. According to the tax administration, the producer can assign its contingent receivable against the French State to a bank, by using a mechanism used for discounting trade receivables, provided for in Arts L313-23–L313-35 of the French Monetary and Financial Markets Code. The French Cinema Industry Code provides that any pledge or assignment of future revenues in connection with motion pictures must be registered at the French Cinema Registry in order to be valid against third parties. The question arises whether financing companies receiving assignments of tax credit claims should comply with both the formalities described in the French Monetary and Financial Markets Codes *and* the formalities described in the French Cinema Code. Article 33 of the French Cinema Code only covers assignments of “revenues from a motion picture”. It could be argued that payment of a tax credit amount from the tax administration is not a payment of “revenues from a motion picture” and consequently does not have to be registered at the Cinema Registry. Prudent banks may register the assignment at the Cinema Registry anyway.

In any event, the tax credit payment is a highly contingent claim, depending on a number of factors, including whether the qualifying technical expenses claimed by the producer will all be allowed, and whether the producer will have no taxable profits. Because of these uncertainties, financing companies will use caution when accepting future tax credit payments as collateral for film-financing loans.

Overview of the new Hungarian motion picture tax incentives

Now a member of the European Union, Hungary can pride itself on some glorious pages in the history of movie production. Hungary became famous with the names, among others, of George Cukor, the founder of Paramount Pictures; Vilmos Fried, who under the name of William Fox, founded 20th Century Fox; Istvan Szabo, who won the best foreign motion picture Academy Award for *Mephisto* and received a nomination for *Sunshine*; and Vilmos Zsigmond, the outstanding cinematographer and Oscar winner with the motion picture, *Close Encounters of the Third Kind*. Even if it was not publicised, the majority of the scenes in *Evita* were shot in Hungary, the streets of Buenos Aires recreated in the streets of Budapest. Similarly, movies like *Red Heat*, *Music Box*, *I Spy* and *American Rhapsody* were largely shot in Hungary. Still, Hungary has historically had a weak film production industry, primarily due to lack of financial resources. Unlike many sectors of the Hungarian economy, the country's film industry has not yet benefited

8. Instruction fiscale, para.19

9. Thus, a company responsible for 50 per cent of a co-production may have incurred more than 50 per cent of the qualifying expenses. In that case, the tax credit will be computed based on the percentage of qualifying expenses *actually paid* by that company.

10. See Press Conference relating to the 2005 Budget, Renaud Donnedieu de Vabres, Minister of Culture and Communication, September 22, 2004, currently available at www.culture.gouv.fr/culture/actualites/conferen/donnedieu/budget05.htm.

from the political and economic transformations of the 1990s. The tax incentives created in April 2004 pursuant to the Hungarian Motion Picture Act may change this.

The Hungarian legal framework: The Motion Picture Act—eligible pictures

The 2004 Motion Picture Act (the “Act”) divides motion pictures that are partially or wholly produced in Hungary into two large categories: (i) films produced “by order”, and (ii) films produced “without an order.” Films produced by order are motion pictures that, under the regulations of the Act, may not be granted direct state production subsidies. In this case, a Hungarian entity participates in the production of the film, but is not deemed to be the film producer.¹¹

Films produced without an order are those films in which the entity is deemed to be a Hungarian film producer,¹² or those films in which the Hungarian entity acquires incorporeal rights in certain film-related intellectual property.

To simplify the above definitions, films produced by order are primarily motion pictures produced by foreign producers with the participation of Hungarian entities in Hungary, while films produced without an order are motion pictures produced by Hungarian producers, or motion pictures in which the production is supported by Hungarian entities in exchange for certain rights in film related intellectual property. The act defines the latter as “investments”.

Tax allowances are available in respect of any investment in motion pictures produced in Hungary, including commercials, feature films, television series, etc. The scope of the Hungarian tax device is thus much broader than the one currently in force in France, which is generally limited to feature films. Motion pictures that may harm the physical, intellectual or moral development of minors, particularly films that contain pornography or extreme or unjustified violence, cannot qualify for an investment allowances.

The National Film Office

The Motion Picture Act called for the creation of the National Film Office. The National Film Office is a central administrative agency established by the Ministry of National Cultural Heritage, and is responsible for the state supervision of the Hungarian motion picture industry. The National Film Office is in fact a national authority, similar to France’s CNC, empowered to deliver decisions on almost all issues related to film production, financing and subsidies.¹³ As regards the tasks of the Office, it must be

11. Pursuant to the Act, only entities that initiate and organise in their own name the production of the motion picture and provide for financial and other conditions for the production.

12. Pursuant to the Act, only entities (i) having a registered seat in Hungary, (ii) most of whose executive officials are citizens of a member state of the European Economic Area, or a country that is a signatory to the European Convention on Transfrontier Television, and (iii) that are controlled by persons in such member states or countries, can be considered film producers.

13. Appeals against the resolutions of the National Film Office may be filed with the Ministry of Cultural Heritage. Resolutions delivered pursuant to the appeal may be contested before courts of law.

emphasised that tax allowances are available only for those film-production related costs and investments that were previously examined and approved for tax allowance by the Office. Furthermore, the Office maintains a public record about motion picture industry organisations and films that require subsidies and the list of those Hungarian entities that qualify for tax allowances. The Office’s missions are substantially similar to those of the French CNC.

Functioning of Hungarian tax allowance

Investors are entitled to film allowances from their corporate tax. According to the regulations, all domestic economic organisations and all foreign nationals conducting business activities in branch offices are subject to corporate tax in Hungary. Foreign taxpayers pay corporate tax to the extent of sales revenues generated by the local branch office.¹⁴ The average rate of corporate tax is currently 16 per cent of the tax base but the government plans to raise the corporate tax rate of financial organisations to 24 per cent from 2005. The current corporate tax allowances affect both the corporate tax and the tax base.

In the case of foreign films produced with the participation of Hungarian undertakings, the investor/sponsors are entitled to a tax credit against corporate tax in the year when the investment is made, and from the corporate tax for three tax years to the extent of the amount specified in the tax allowance certificate issued by the National Film Office. If the tax credit cannot be used up within three years, it is lost. Unlike France, Hungary does not reimburse unused tax credit amounts. A similar provision applies to motion pictures produced without an order. It is the investor/right-holder that is entitled to the tax allowance in the amount designated in the tax allowance certificate, not the producer. The corporate tax allowance related to one particular motion picture is limited to the extent that the tax allowance may not exceed 20 per cent of the total film production costs of that film production, as approved by the National Film Office. For motion pictures made by order, only the Hungarian production costs are eligible for the allowance.

Investments in motion pictures produced by Hungarian producers are eligible also to a corporate tax deduction. The investor may deduct 50 per cent of the amount of investment from his corporate tax base for the specific tax year, to the extent of the amount specified in the allowance certificate issued by the Film Office. Having regard to the fact that the certificate issued by the Film Office serves as the basis for the tax allowance, the allowance granted in respect of the tax base is available for up to 20 per cent of the production costs as approved by the Film Office.

The Hungarian Corporate Tax Act does not stipulate any provisions for cases in which the amount of investments and subsidies exceeds 20 per cent of the production costs or the Hungarian production costs as approved by the National Film Office. Since in such cases the certificate issued by the National Film Office shall serve for the tax allowance base in respect of particular sponsors and investors, such issues will primarily be

14. The corporate tax payment obligation of foreign persons may be affected by international treaties concluded between Hungary and the foreign person’s country of residence subject to laws on the avoidance of double taxation.

settled on the basis of the practice of the Film Office. A possible solution is the proportionate decrease of tax allowances available to each specific investor or sponsor. However, it is also feasible that eligibility for tax allowances will be decided in a chronological order of investments and subsidies. Resolution of this issue will thus be at the discretion of the Film Office.

Are tax incentives here to stay?

The European Commission may reform public subsidy (and hence tax incentives) systems based on territoriality. In a communication to the European Council dated September 26, 2001, the European Commission emphasized that pluralism and cultural diversity were public-interest objectives, and that European cinematographic works were facing strong competition, particularly from the United States.¹⁵ It was thus admitted at the time that a Member

State could require a motion picture producer benefiting from public subsidies to spend up to 80 per cent of its budget for a given movie in the subsidising country. As we have seen, this territoriality principle underlies the French and Hungarian tax incentives.

In December 2003, some EU Commission members questioned the notion of territoriality in that context, on the theory that territoriality would impair free competition and fragment the internal market. After an extensive debate on the issue, the Commission finally resolved to maintain the status quo until June 30, 2007, at which time the Commission is scheduled to re-examine the issue of public support of movie production.¹⁶ The new Hungarian and French tax incentives may therefore come under pressure if the European Commission finds in 2007 that the territoriality principle is no longer compatible with the EC Treaty.

15. European Commission, Communication dated September 26, 2001, COM (2001) 534.

16. Commission Press Release IP/04/343 of March 16, 2004.