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**Subject: State aid SA.37176 (2014/N) and SA.38306 (2014/N) – United Kingdom
Modifications to the UK Film Tax Relief**

Sir,

1. PROCEDURE

- (1) By letter dated 13 February 2014, following pre-notification discussions, the authorities of the United Kingdom (hereafter: "UK") notified certain amendments of the film tax relief to the Commission (SA.37176). Separately, the UK notified additional modifications to the film tax relief on 26 February 2014 (SA.38306). The UK authorities agreed that the Commission would assess both sets of modifications together.
- (2) The modifications amend an existing measure SA.33234 - UK film tax incentive¹, which was approved until 31 December 2015. The UK film tax incentive was first approved by Commission decision of 22 November 2006 in case N 461/2005².

¹ State aid SA.33234 (2011/N) – United Kingdom, UK film tax incentive extension:
http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_33234.

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2. DESCRIPTION OF THE MEASURE

- (3) The UK film tax relief was set up to encourage film makers to produce culturally British films. It provides tax incentives for expenditure incurred in the UK on pre-production, principal photography, and post-production of a film which is intended for release in the cinema.
- (4) Those film production companies that are entitled to the tax relief can claim a) an additional deduction in computing their taxable profits, and b), where that additional deduction results in a loss, a payable tax credit.
- (5) The aid is granted by Her Majesty's Revenue and Customs, the UK national tax authority.
- (6) The UK authorities have notified changes that affect the following elements of the scheme:
 - a) The territorial spending requirements;
 - b) The cultural test;
 - c) The tax rates of the relief.
- (7) The goal of the proposed changes is to reduce the territorial restrictions; update the cultural test to reflect developments in the wider film environment; address access to finance issues and make the film tax relief scheme easier to use; and encourage the development of culturally relevant British and EEA films of all budgets. According to the UK authorities, taken together, the changes will improve the responsiveness of the film tax relief and open the relief to easier use between Member States.
- (8) The modified tax relief will run for a period of five years, from 1 April 2014 until 31 March 2019.

2.1. Modifications to the territorial conditions

- (9) Both the additional tax deduction and the payable tax credit are calculated on the basis of UK core expenditure, defined as expenditure on pre-production, principal photography and post-production. A maximum of 80% of the total core expenditure can be claimed under the tax relief.
- (10) In order to be eligible under the modified scheme, at least 10% of the core expenditure has to be incurred on goods or services used or consumed in the UK. This minimum spending requirement originally stood at 25%.

2.2. Changes to the Cultural Test

- (11) The UK Cultural Test is a points-based system which gives each film a score on a number of criteria, grouped into four sections: A) cultural content, B) cultural contribution, C) cultural hubs, and D) cultural practitioners.

² State aid N 461/2005 – United Kingdom, UK film tax incentive:
http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_19919.

- (12) Under the updated Cultural Test, the maximum number of points awarded for Cultural content, Section A4 will be increased from 4 to 6 points and the maximum number of points awarded for Cultural hubs Section C1 will be increased from 2 to 4 points.
- (13) There will be a maximum score of 35 points for all the four sections, with a pass mark of 18.
- (14) The cultural content requirements will include EEA as well as British settings, subject matter, characters and language.
- (15) The Cultural Test will operate an updated "Golden Points Rule"³ to ensure that a film cannot pass with only points in sections C and D, together with the points for language (A4). Thus, a film would be required to score 2 or more points in A1, A2 or 4 points in A3 in order to pass the test.
- (16) Under the proposed test, a film satisfying Sections A1-A3 and Section B will pass the cultural test if it has original dialogue in mainly an EEA language.
- (17) In conclusion, the modified Cultural Test is as follows:

Proposed Cultural Test	Points
SECTION A: CULTURAL CONTENT (maximum total : 18 points)	
A1: Film set in the UK or an EEA state	4
A2: Lead characters British or EEA citizens or residents	4
A3: Film based on British subject matter or relates to an EEA state	4
A4: Original dialogue recorded mainly in English or an EEA language	6
SECTION B: CULTURAL CONTRIBUTION (maximum total : 4 points)	
B: Film represents/reflects a diverse British culture, British heritage or British creativity	4
SECTION C: CULTURAL HUBS (maximum total : 5 points)	
C1: Studio and/or location shooting/visual effects/special effects	4
C2: Music recording/audio post production/picture post production	1
SECTION D: CULTURAL PRACTITIONERS (maximum total : 8 points)	
D1: Director	1
D2: Scriptwriter	1
D3: Producer	1
D4: Composer	1
D5: Lead actors	1
D6: Majority of cast	1
D7: Key staff (lead cinematographer, lead production designer, lead costume designer, lead editor, lead sound designer, lead visual effects supervisor , lead hair and makeup supervisor)	1
D8: Majority of crew	1
TOTAL ALL SECTIONS (pass mark 18)	35

³ The specific rules described in recitals 46 – 54 of the Commission decision N461/2005 are also called "Golden Points Rule".

2.3. Modifications of the rates of relief

(18) Under the existing UK film tax relief scheme, a payable tax credit was established with two rates of relief:

- 25% for limited budget films (less than GBP 20 million).
- 20% for larger budget films.

(19) In practice, this has resulted in a cliff-edge and the UK authorities wish to remove this unintended outcome of the distinction between limited and large budget films.

(20) Therefore the UK authorities seek to amend the tax credit rates, and to allow film tax relief to be available to all productions at the following rates:

- 25% on the first GBP 20 million of a production's qualifying core expenditure.
- 20% beyond that threshold.

(21) The table below demonstrates the impact of the modifications on the cliff-edge. It compares the tax credit for three films of a different budget for which all core expenditure is qualifying under the scheme:

Budget	GBP 19 million	GBP 20 million	GBP 22 million
<i>Tax credit under the existing tax relief</i>	GBP 19 million * 80% (qualifying expenditure) * 25% (tax credit) = GBP 3.8 million	GBP 20 million * 80% (qualifying expenditure) * 20% (tax credit) = GBP 3.2 million	GBP 22 million * 80% (qualifying expenditure) * 20% (tax credit) = GBP 3.5 million
<i>Tax credit under the modified tax relief</i>	GBP 19 million * 80% (qualifying expenditure) * 25% (tax credit) = GBP 3.8 million	GBP 20 million * 80% (qualifying expenditure) * 25% (tax credit) = GBP 4 million	GBP 20 million * 80% (qualifying expenditure) * 25% (tax credit) + GBP 2 million * 80% (qualifying expenditure) * 20% (tax credit) = GBP 4.3 million

(22) The changes to the relief rates will also impact the maximum aid intensities that can be attained under the scheme:

- The maximum aid intensity will be 20% for films with a budget of up to GBP 20 million.
- Maximum aid intensities for films with budgets above GBP 20 million gradually decrease, with e.g. a maximum aid intensity of 19.20% for a film of GBP 25 million and a maximum aid intensity of 18.67% for a film of GBP 30 million.

2.4. Other elements of importance

- (23) The scheme will be amended to make sure that the aid is awarded in a transparent manner, according to the transparency requirements set by paragraph 52(7) of the new Cinema Communication adopted in 2013⁴.
- (24) The 2013 Cinema Communication invites the Member States to encourage and support producers to deposit a copy of the aided film in the film heritage institution designated by the funding body for preservation, as well as for specified non-commercial use agreed with the right holder(s).
- (25) The UK authorities have confirmed their commitment to support the UK's national and regional archives, in order to protect, preserve and make moving image material accessible to all. Producers are encouraged to deposit their film material with the British Film Institute ("BFI").
- (26) The proposed modifications have an impact on the budget of the scheme. The value of this impact amounts to around GBP 20 million per year. Taking these modifications into account, the latest estimates of the UK authorities forecast a total cost for the film tax relief of GBP 340 million per year. This brings the overall budget of the scheme for the period 2014-2019 up to GBP 1 700 million.
- (27) All other aspects and conditions of the scheme remain unchanged.

3. ASSESSMENT OF THE MEASURE

3.1. Existence of aid

- (28) The changes introduced to the existing measure do not alter the previous conclusion of the Commission that the measure constitutes State aid within the meaning of Article 107(1) TFEU⁵.

3.2. Compatibility of the aid

- (29) The notified measure concerns the prolongation and modifications of an aid scheme which has previously been approved by the Commission as compatible with

⁴ Communication from the Commission on State aid for films and other audiovisual works, COM(2013), OJ C 332, 15.11.2013, p. 1.

⁵ See recitals 23 to 29 of the decision N 461/2005.

the internal market based on Article 107(3) (d) TFEU and the Cinema Communication of 2001⁶.

- (30) Published on 15 November 2013, the new Cinema Communication updated the rules for the assessment of state aid for films and other audiovisual works under Article 107 (3) (d) of the TFEU. The aid can be justified if the aid scheme complies a) with the general legality principle and b) with the specific compatibility criteria set out in the 2013 Cinema Communication.
- (31) With regard to the general legality principle, the 2013 Cinema Communication has modified the limits set to the territorial spending obligations of film support schemes. In case the aid amount is calculated as a percentage of the expenditure on film production activities in the granting Member State, the territorial linking cannot exceed 80% of the overall production budget. Moreover, the Member States may, as an eligibility criterion, not require a minimum level of production activity in their territory that exceeds 50% of the production budget. The modifications to the territorial obligations indicated under section 2.1. do not raise any issues in respect of these territorial spending conditions and are therefore in line with the new rules of the 2013 Cinema Communication.
- (32) Regarding the specific compatibility criteria, the 2013 Cinema Communication confirms that each Member State should ensure that the content of the aided productions is cultural according to its own national criteria, through an effective process to avoid a manifest error. While the UK authorities have introduced a number of amendments to the Cultural Test, the modified tax relief remains dependent on a cultural assessment on the basis of a points system.
- (33) In particular, the Commission notes that the modifications to the number of points awarded under different sections of the cultural test are accompanied by an updated "Golden Points Rule", which ensures that the content of the aided production is cultural. Therefore, the Commission considers that the UK authorities have put in place an effective verification process to avoid a manifest error by establishing a list of cultural criteria against which each film will be verified.
- (34) Moreover, according to the 2013 Cinema Communication, the aid intensity levels are in principle limited to 50% of the production budget. The updated aid intensity levels under the tax relief never amount to more than 20%, and are therefore in line with these criteria.
- (35) The modifications to the UK film tax incentive do not affect the assessment done with regard to aid granted for specific production activities in paragraph 65 of the Decision in State aid case N 461/2005.
- (36) Lastly, as described above (see paragraph 23), the scheme respects the transparency conditions set by paragraph 52(7) of the new Cinema Communication.

⁶ Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on certain legal aspects relating to cinematographic and other audiovisual works of 26/09/2001 (OJ C 43 of 16/02/2002); extended in 2004 (OJ C 123 of 30/04/2004); 2007 (OJ C 134 of 16/06/2007); and 2009 (OJ C 31 of 07/02/2009).

(37) On the basis of the foregoing assessment, the Commission's analysis confirms that the criteria set out in the Cinema Communication are met, hence the aid involved in the notified measure is compatible with Article 107 (3) (d) of the TFEU.

4. CONCLUSION

(38) On the basis of the above assessment, the Commission has decided that the notified State aid measures SA.37176 (2014/N) and SA.38306 (2014/N), which amend the UK film tax relief, can be considered compatible with the internal market in accordance with Article 107 (3) (d) of the Treaty. The Commission does not raise objections in this respect. The amended scheme has been approved until 31 March 2019.

(39) The Commission reminds the UK authorities to submit annual reports on the implementation of the aid scheme. The Commission moreover reminds the UK authorities to inform the Commission according to Article 108 paragraph 3 of the TFEU on all plans to prolong or alter the aid scheme.

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<http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent by encrypted e-mail to stateaidgreffe@ec.europa.eu, by registered letter or by fax to:

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President