4.25 CONFIDENTIAL

F - film   For information

Amanda, See PS I

PS/KB
PS/Sec I
Mr Croft
Mr Leeming SPF
Mr Whiting CP
Mr Hill SPF
Mr Butcher SPF - on file.

NOTE OF A MEETING HELD AT 11 DOWNING STREET AT 4.30 PM ON WEDNESDAY 27 JUNE 1984

Those present:

Chancellor of the Exchequer
Mr Monck
Mr Corlett

Secretary of State for Trade and Industry
Mr Leeming
Mr Whiting

FILM INDUSTRY

The Chancellor recalled that he had discussed this year's corporation tax changes in outline with the Secretary of State for Trade and Industry before the Budget and that the Secretary of State had at that stage thought they should not cause too much difficulty for the film industry, provided films were treated in exactly the same way for capital allowance purposes as plant and machinery. The Chancellor said he had accordingly provided in the Budget for Eady films to be entitled permanently to the new capital allowances and he had gone on to announce that the Government would give such films the option of being taxed under Section 72 of the 1982 Finance Act. He was, however, reluctant to make any further concessions: substantial sums of money were involved and he did not regard the industry as a particularly deserving case. He noted that it was as a result of the abuses of the post-1979 regime that Sir Geoffrey Howe had announced in his 1982 Budget the withdrawal of 100 per cent first year allowances for films (with a 2-year transitional period for Eady films). He enquired whether the Secretary of State wanted to help only genuine British production companies or whether he was looking for a concession which would also continue to attract the large US film companies to Britain.

2. The Secretary of State explained that he had indeed hoped at an earlier stage that the corporation tax package would be accepted by the film industry but had naturally not been able to explore the position with them before the Budget. It now appeared that

the changes were likely to have a far greater impact on the film companies' behaviour than he had at first envisaged. He emphasised that it was necessary to consider the proposed changes in the tax treatment of the industry in the context of the wider reforms which the Government was planning to put forward in its forthcoming White Paper on films. He was, for instance, most anxious to abolish the Eady levy but feared that unless further tax concessions could be made, it would be impossible to encourage private sector investors to put up sufficient funds to take the levy's place. It was difficult to define a US film but Mr Leeming suggested that a tax regime which applied only to those companies which benefited from the Eady levy would meet the Department's objective.

3. The Chancellor explained the way in which the pre-Budget capital allowance regime had been exploited. Companies, having made a film, would sell it, generally to a bank (which need not necessarily be British, as long as it was liable to UK tax). The bank would take the benefit of the capital allowances and then lease the film back to the company which made it at a reduced rate. If the company were a foreign one, the Exchequer subsidy would effectively go abroad and the profits from the film could be remitted outside the UK and escape UK tax entirely. The Chancellor stressed that substantial sums were at stake. He noted that until the last Budget, the major banks had enjoyed many outlets for their leasing business and so had not paid special attention to the film industry. The interest had come mainly from foreign banks and other City institutions. But with this year's reductions in first year allowances for plant and machinery, they would be looking for new business through which to shelter their profits, and films, on the Secretary of State's proposals, would be an obvious candidate.

4. The Chancellor noted that the net cost to the industry of the Budget, after taking account of the Section 72 concession already announced, amounted to £20 million in 1985-86, £80 million in 1986-87 and £95 million in 1987-88 but fell away thereafter. He suggested two other areas of possible concession to the industry which might ease the political problems DTI ministers faced over publication of their White Paper. First, the Government might attempt to bring films within the ambit of the Business Expansion Scheme. This would provide scope for tax sheltered capital and would also have the advantage of confining assistance to British films. He accepted that the US companies also provided employment in the UK but commented that to offer them special tax treatment on these grounds alone would be a very expensive form of job creation. The second concession the Chancellor had in mind was a modification of Section 72 to provide for a cost recovery

system which would enable expenditure to be written off as quickly as possible as soon as receipts began to come in. He freely acknowledged that these measures would not satisfy the industry's demands but he suggested that they would enable the Government to demonstrate that it had made some further response to the industry's requests.

5. Mr Leeming believed that the industry would be grateful for both these measures but stressed that film companies were seeking some recognition of the special circumstances under which they produced a long-term product through one-shot companies and received very little income until the product was completed. For this reason the industry had proposed a formula where by 50 per cent of expenditure would be written off on delivery of the completed film, a further 25 per cent on first release and the final 25 per cent 12 months later. The DTI accepted that this formula was probably too generous but hoped it could be modified to produce something which was more attractive than straightforward cost recovery but which nevertheless was not open to the abuses to which the Chancellor had drawn attention. The Chancellor suggested that there was no need for the industry to organise itself in the form of single-shot companies but the Secretary of State explained that the only way in which the industry had found it possible to attract sufficient investment was to insulate the profits received on successful films from the potential losses which could be incurred on their successors.

6. Mr Whiting noted that the Section 72 option which the Financial Secretary had already announced was not attractive to the industry because it did not give sufficient certainty about future cash flow. The Chancellor suggested that the introduction of a formula along the lines the film companies had suggested would work to the detriment of the TV companies - the indigenous industry - and pointed out that any concession beyond straightforward cost recovery would create artificial tax losses which could lead to abuse. The Secretary of State asked whether nonetheless the Chancellor could explore the possibility that a certain proportion of expenditure could be written off as soon as production was completed in advance of receipts, in order to create an up-front tax loss, with cost recovery applying thereafter. He stressed that the proportion need not be very large and certainly not as big as the industry had been canvassing under its formula. He suggested that this concession could form part of a package which would also include the Section 72 option and the extension of the BES.

7. The **Chancellor** accepted that the forthcoming White Paper posed difficult political problems for DTI ministers and therefore agreed to consider whether a further concession could be devised along the lines the Secretary of State had proposed which he himself would also find acceptable. If it could, Inland Revenue officials would then consult the industry on the contents of the package.

8. The meeting closed at 5.30 p.m.

MOM

MISS M O'MARA

2 Ju~~ne~~ly 1984

Distribution

Those present
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State
PS/Economic Secretary
Sir P Middleton
Mr Bailey
Mr Monger
Mr R I G Allen
Ms Conn
Mr Lord o.r.
PS/IR