



CONFIDENTIAL

From the Secretary of State

The Rt Hon Sir Geoffrey Howe QC MP
The Chancellor of the Exchequer
HM Treasury
Parliament Street
London, SW1

From Mr. ...

Are you content with these modest proposals for continuing the NFFC? Treasury at official level or content. Shall I

Yes - agree on statements part.

*19 July 1979
say "Yes", subject to the Chancellor's views?*

Dear Geoffrey

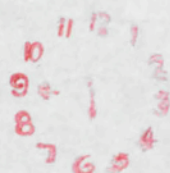
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POLICY ON FILM FINANCE

We now need to take and ideally announce by written answer a decision about the future of the National Film Finance Corporation (NFFC) which is in a state of suspended activity. We will also need to decide, though not necessarily with the same urgency, about other aspects of policy towards the commercial film industry, including the proposal for a new British Film Authority (BFA) which has been put forward by the Interim Action Committee on the Film Industry under Sir Harold Wilson's chairmanship.

The interest in this subject, and the potential political difficulty if we mishandle it, is disproportionate to the amounts of money involved. I have therefore had a special review of the issues carried out at top official level with the help of the Treasury, Inland Revenue, the Home Office and the official advisers of the Chancellor of the Duchy of Lancaster. The resulting report has been circulated to the Departments concerned at official level and I enclose a further copy. It does not make firm recommendations, but my proposals below are based on discussion of the report which I have had with my advisers and take account of representations which I have personally received from Sir Harold Wilson and others.

19 JUL 1979





From the Secretary of State

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I have come to the conclusion that there is a case on merits for a NFFC-type body to help mobilise finance for indigenous British feature films and that it would be a political mistake to do away with the NFFC and put nothing in its place. The NFFC has been part of the landscape since post-war days. On the other hand, in view of our general policies on public expenditure, I should be reluctant to propose even a small amount of continuing government finance for this purpose, or even government guarantees which should present less difficulty, if a workable alternative can be found not involving further public funds.

Annexed to this letter is an outline plan for a financial reconstruction of the NFFC which has been worked out, at my request, in discussion with the Chairman of the NFFC, Mr Geoffrey Williams, and Lord Seebohm who is the Chairman of Finance for Industry (FFI), embracing FCI and the ICFC. The only fresh government money involved in future years is £1 million in 1980-81, which produces a saving of £½ million on the amount previously allowed for the NFFC in that year. Otherwise the money would come from a small allocation from the levy on exhibitors (the Eady levy) and from the FCI. The plan could be based either on retaining the NFFC in its present form or reconstituting it as a company, which I should favour, though there would be no prospect of a public issue of shares in the company until it had established a track record.

The plan has not yet been put to the Boards of FCI or the NFFC, but it provides a basis for working out a firm and more detailed scheme if we can now approve it in principle and make an announcement accordingly. I must stress that the figures are the very minimum on which the parties concerned are willing to proceed, and will be criticised in some quarters as inadequate, but I should be reluctant to propose either a bigger injection of public funds or a larger diversion of funds from the Eady levy.



From the Secretary of State

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The main Eady scheme appears still to provide an effective incentive for the use of British studios, though not necessarily for the production of films of a British character. On the other hand, the existing Eady scheme may be vulnerable to challenge under EEC law, and that is a further reason for maintaining a NFFC-type body, which is less open to challenge from this point of view. We will at some stage have to inform the Commission more or less formally of our intentions.

As regards the proposal for a BFA, there might be some possible attraction in subsuming both the work of the NFFC and other functions relating to films in a single new body. However, that would require bigger funds and a more substantial piece of legislation than the contingent Bill for which allowance has been made in our programme. I feel, therefore, that this proposal must be rejected, though I am less sure whether to announce that decision at the present stage.

Against this background I enclose the text of a statement which I should like to make ^{his} ~~next~~ week and for which I should be grateful to have clearance. Since it is a rather low key statement, foreshadowing more detailed proposals to come, I feel that it could be made by means of a written answer. One incidental advantage of an early statement is that we could link with it the change of practice which Inland Revenue are prepared to introduce as regards the period over which expenditure by a film production company can be written off against its tax liability. I am grateful to Inland Revenue for holding back a separate announcement of this concession so far.

I am sending copies of this to the Prime Minister, the Home Secretary, the Lord President, the Chancellor of the Duchy of Lancaster, members of EA Committee, and Sir John Hunt..

Yours ever
John

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JOHN NOTT

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Draft Statement on Film Finance

As the House has been informed, I have had a special review carried out of the arrangements for financial support for commercial film production in Britain. I am now placing in the Library copies of the report on this subject which was made to me last month.

The Second Report of the Interim Action Committee on the Film Industry (Cmnd 7597) has already been presented to Parliament, and I have had the benefit of personal discussion with the Chairman of the Committee, the Rt Honourable Member for Huyton, and other members of the Committee. In this discussion it was stressed that the most immediate issue is the future of the National Film Finance Corporation, though the Committee continue to support the creation of a British Film Authority in the longer term.

The Government accept in principle that there is a continuing role for a body to help to mobilise finance for the production of British films of an indigenous character. We are not satisfied, however, that this should involve the provision of government funds on a continuing basis. I therefore propose to carry out more detailed consultations

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with a view to a financial reconstruction enabling the NFFC to carry on with a clean sheet. I also propose to extend the purposes for which funds can be allocated to the NFFC out of the Exhibitors Levy, usually known as the Eady levy, so as to make a limited amount available in this way for film production. On this basis I expect a reconstituted NFFC to be capable of raising further funds from non-government sources. I hope to set out these proposals in more detail later in the year.

I have no plans to set up a British Film Authority.7

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FINANCIAL RECONSTRUCTION OF THE NATIONAL FILM FINANCE CORPORATION (NFFC)

OUTLINE PLAN

- 1 The Government to write off all principal and interest owed to it by the NFFC.
- 2 The Government to make £1 million available to the NFFC in 1980-81.
- 3 The Government to take powers to allocate part of the proceeds of the Eady levy to the NFFC and to commit itself to an allocation of £1½ million a year for 5 years.
- 4 This would subsume the existing allocation of £¼ million a year of Eady money for pre-production expenditure, which would be terminated as a separate item.
- 5 The NFFC to be authorised to borrow not less than £5 million, to be drawn down to meet the requirements of its programme.
- 6 FCI and the NFFC to negotiate an agreement for a loan of this amount from FCI, to be secured in effect on the prospect of the Eady money plus the £1 million from the Government.
- 7 NFFC either to remain a statutory corporation or to be replaced by a company with the Department of Trade as initially the sole shareholder.



REVIEW OF POLICY ON FILM FINANCE

Department of Trade

June 1979



Review of Policy on Film Finance

Introduction

People now go to the cinema a great deal less than they did a generation ago. However, it is still an important medium of entertainment and popular culture.

Public taste in films is volatile, and large amounts of capital are at risk in a major feature film. A small number of very successful films make high profits, but there are many more unsuccessful productions. In Western economies it is natural that this kind of investment should rely primarily on private initiative and finance.

The United States market accounts for a high percentage of the total "world gross", that is, total box office receipts. The advantages which the American film industry derives from this and other factors, allied to the talent available to it, and further helped by the fact of a common language, have given American films a dominant position in British cinemas in terms of numbers of films shown and share of box office takings.

This situation is not paralleled in British television, which is now the prime medium for both entertainment and information, and it is arguable that this redresses the balance. The proportion of foreign material on both BBC and IBA channels is limited and, though there are popular television programmes imported from America, British viewers have a strong attachment to programmes made for the BBC and ITV within their own organisations.

Nevertheless, though this makes it less a matter for concern if American films have the lion's share of screen time in our cinemas, there is still a question about the share taken by the British film industry and about the role, if any, of the state in supporting it.

The financial aspects of this issue have been reviewed against the background of the government's general policy of reducing public expenditure and the scope of the public sector. A substantial number of people have been consulted in a representative



Review of Policy on Film Finance

Present Arrangements

1 There are two sources of financial support for commercial film production in Britain, one from the taxpayer and the other from the cinema-goer. These are:-

The National Film Finance Corporation (NFFC)

This was set up by Act of Parliament in 1949 to lend money for film production. Its capital of £11 million is now nearly exhausted.

The Eady Levy

This is a levy on the price of admission to all films, which at present brings in about £7-8 million a year.

The proceeds are distributed through the British Film Fund to makers of British films only (after deduction of sums used for making grants for other purposes, including the Children's Film Foundation, and the National Film School).

Thus part of the takings from the showing of American films goes to help British films. The legislation regulating this scheme lapses in 1980, unless renewed.

2 There is also a quota system, under which cinemas must exhibit a proportion of British films. These powers also lapse at the end of 1980, unless renewed.

3 In addition, some £5 million a year has been provided from the Department of Education and Science to support non-commercial film activities, mainly to the British Film Institute (including support for the National Film Archive and the National Film Theatre) and also the National Film School. This expenditure, for which the Chancellor of the Duchy of Lancaster now has policy responsibility, is outside the scope of this review, but it falls to be considered as part of the annual



public expenditure exercise as a whole.

New Proposals

4 The Interim Action Committee on the Film Industry, under the chairmanship of Sir Harold Wilson, has recommended the establishment of a British Film Authority, to be financed partly from a continued allocation from the Eady Levy. It would take over both the financing functions of the NFFC and the advisory functions of the existing Cinematograph Films Council and some of the regulatory functions of the Department of Trade. It would also have certain new functions including the provision of a limited amount of assistance to cinemas. The Committee has also recommended tax measures to help film production and the cinema.

5 The previous government was committed to legislation to provide further capital for the NFFC, and Department of Trade Ministers gave a fair wind to the creation of a British Film Authority as a longer term measure. The present government is uncommitted on these matters; its general policy is to reduce public expenditure and the scope of the public sector.

Decisions Required

6 An early decision is needed whether to provide the NFFC with further funds, for which a Bill would have to be introduced as soon as possible, or whether to terminate its existence. Under existing legislation this could be done by Order at any time after 1980.

7 Decisions for or against the BFA proposal, and on the future of the Eady Levy, could in one sense be left until later,



but in practice the future of the NFFC cannot be considered altogether in isolation from those issues. In addition, if there is early legislation, it could conveniently provide for continuation of the quota scheme if that course is approved; new legislation on this point will in any case have to be brought into effect by the end of 1980 if the quota is to continue after that date.

8 It has been necessary also to take a view on the tax proposals from the Interim Action Committee.

Background

9 The present support schemes date from a time when the cinema was the principal medium of mass entertainment. In the post-war period dollar shortage was a special reason for protecting production in this country.

10 Since then television has acquired the dominant role in popular entertainment and culture. The number of cinema screens has been reduced by two thirds since the immediate post-war period. Admissions are less than a tenth of what they were then, though there has recently been a moderate upturn. Employment in producing feature films for the cinema is much reduced, and accounts for a few thousand people on a full-time basis.

11 At the same time, television has an almost insatiable demand for films originally made for showing in the cinema. It also uses a great deal of other film material, and employs facilities and people working either exclusively for television or partly for television and partly on films for the cinema.

12 Film money and people in films are internationally mobile. American companies and American money finance films made wholly or partly in Britain and in other countries outside the United States, while British companies have now started to produce films in the United States. A significant element in



recent American demand for British technical facilities has been in connection with certain outstandingly successful science fiction films.

13 There are some moves towards production of films in this country for cinema distribution here but for early showing on television in the United States, though not on British television screens until later because of a trade bar operated by the Cinematograph Exhibitors Association. There are also some moves towards making feature films to be shown on television here in the first instance, with possibly some cinema distribution in other countries.

14 The prospective fourth television channel will provide an additional outlet for film material from the United Kingdom. In the longer run, possible technical developments such as the widespread use of film cassettes or video discs in the home, and conceivably of pay television, in conjunction with trends in leisure activities, may further change the pattern of the industry.

15 Meanwhile the general pattern still involves the production of feature films for showing in cinema theatres in the first instance, to be televised only after a lapse of several years. In spite of its contraction, the cinema remains an important medium of mass entertainment and culture. Cinema admissions in Britain in 1978, at 127 million (with box office takings of about £120 million), were between three and four times the number of theatre admissions and five times the number of admissions to football league matches.

The Case for Support

16 The second report of the Interim Action Committee poses the question whether the object of government policy for films should be to stimulate an industry for the normal economic reasons (that



is, in order to create employment, encourage productive investment and increase exports) or to aid an art form or to encourage the making of films which reflect British life. It expresses the view that all three objects are valid, and that the barriers between industry and art in relation to the film are largely artificial and subjective.

17 Nevertheless, it is understood that the Committee consider the case for government intervention and support to be based essentially on the need to encourage films which are of a high quality and representative of British life and society. Their report argues not so much that there is a shortage of finance for film production in this country, but that, in order to achieve international distribution which is essential for profitability, the films made here tend to be of a quality which does not do credit to this country.

18 Most of those who have been consulted in the course of this review and who have expressed support for a NFFC-type activity base their case on the desirability of producing indigenous British films for commercial showing. This does not mean films produced for only a minority audience or for showing only in specialised cinemas. It means films made with British talent, which are likely to have a British locale, though some may have overseas settings, and which will be likely to depict aspects of British life and culture. Such films will be influenced in the first place by the taste of British audiences, but they should also be capable of achieving some response in international markets, without which it is very difficult for a film to recoup its cost. To put the point in a negative fashion, the character of a film which is indigenous in this sense is not dictated predominantly by the requirements of the American market.

19 The question must be asked why, if there is a significant demand for indigenous films in this sense, it cannot be met by the functioning of the market. There are people in the film



business who believe that such is in fact the case and that, though films made on a purely commercial basis may not have artistic or cultural qualities, equally they may well do so. It is argued that the commercial industry has produced films of high quality and that, though modern communications have made popular taste and culture much more international and much less localised, the industry's output has included good films of a genuinely British flavour; if a film is both of a high standard and of potential popular appeal, it will attract commercial backing; on the other hand, if it cannot get such backing, this is an indication that it is not a commercial proposition and could be produced only on a subsidised basis.

20 The counter-arguments against this view are that there are frictions in the market and that private finance which might be available for British film production will not in fact be mobilised unless there is some agency such as the NFFC to act as a catalyst, and also that the pull of the American market, representing 60% of "world gross" as compared with a UK market which accounts for only 4%, is so strong that production which is motivated solely by commercial considerations is likely to be geared overwhelmingly to what is judged to be American taste. Though the big commercial interests in the British industry may from time to time back good indigenous films, the independent producer will find it more difficult to get backing for such films without the help of a body such as the NFFC, especially in the early stages of his career.

21 It is also argued that a case of this kind has been thought sufficient to justify schemes of support from public funds for indigenous film production in a substantial number of other countries, including France, Germany, Italy and Sweden, even though the difference in language means that they are less vulnerable to the domination of their screens by films made in the United States or for United States audiences. It is claimed



that a scheme of this kind in Australia has had considerable success recently and has made people in other countries conscious of Australia.

22 The argument has also been advanced that the difficulties of the independent producer in Britain are compounded by the "duopoly" of the EMI and Rank organisations, who between them are thought to own roughly half of all the cinema capacity in this country, though only a third of the cinema screens. EMI and Rank themselves do not accept that there is anything in this point: the management of their cinemas is separated from the distribution activity, and the cinemas are in the market for all films on offer with audience appeal. They comment also that many large cinema buildings have been subdivided into smaller theatres and have become more suitable for showing films with relatively specialised appeal.

The NFFC

23 The NFFC's capital has been provided by advances from the Department of Trade. The relevant legislation limits the principal outstanding to the Department to £11 million at any time. By May 1979 about £550,000 remained to be drawn.

24 This capital has been used as a revolving fund for investing in British films and over the years has enabled the NFFC to make investments to a cumulative total of £31 million. However, provision has had to be made for losses on some of these investments. When, in addition, we bring into account on the one hand profits of £4 million on the more successful films, but on the other hand the Corporation's operating expenses and the interest due to the Department, the total deficiency to be met out of the Corporation's capital as at 31 March 1978 was £8.6 million.



25 The Interim Action Committee, and the Corporation itself, argue that it has had to make equity investments out of loan capital and that, if operating expenses and interest to the Department can be excluded, the deficiency arising from these investments of £31 million has been only about £2 million, or £70,000 a year. As it is, the NFFC is in arrears with its interest payments, and is incurring interest charges on the deferred interest payments. As its capital has dwindled, and films have become more expensive, the number of feature films which the NFFC has helped to finance has declined from 62 in 1950 and 46 in 1960 to an average of 4 a year in the past 5 years - out of an average of 60 British feature films a year, and 300 feature films a year from all countries which were registered here in this period.

26 If the NFFC is to go on, the interest which it already owes the government might be entirely or very largely written off, so as to give it a fresh start. To relieve it of any future obligation to meet interest or cover operating costs would of course be a straightforward subsidy, for which there is no good case so long as the objective is to finance commercially viable films. There would be a case, however, for giving the Corporation, if its funds were to be renewed, the financial objective of making a return on its portfolio of investments as a whole rather than on each investment. It has been represented also that the Corporation needs to be financed in such a way that, like others in the business, it could take risks on films which might turn out to be either loss-makers or highly profitable, the successful projects covering the losses on the inevitable proportion of failures; this could be achieved either by providing it with government capital on more flexible terms than in the past, or by an admixture of funds from the Eady Levy, or by a combination of the two. On this basis the finance from



the Eady Levy would not be regarded as soft money and, if the Corporation both revolved the whole of the funds available to it and was more successful in making a return on its investments than in the past, it would be able to build up its resources over time.

27 It could be expected that, with the new management appointed during the past year, the NFFC would play a more active part in the projects with which it was associated and take the initiative in some projects. However, on the assumption that any replenishment of its capital was of necessity relatively modest, it could hardly expect, at any rate at the outset, to make a significant contribution to the financing of the more expensive kind of film which costs millions of pounds to make as compared with, say, half a million or less for a more modest production.

British Film Authority

28 The Interim Action Committee propose that the functions of the NFFC should be subsumed in a new British Film Authority. This would have an initial injection of Government capital, which would be taken over from the NFFC if that body had been provided with such funds in the meanwhile as an interim measure. Although illustrative figures have been mentioned in the past implying capital on a significantly larger scale than the NFFC has enjoyed, it is understood that the Committee are not wedded to any particular figure or to any particular period of years over which it might be injected. In addition, it is proposed that the BFA should receive on a continuing basis half the money available from the Eady Levy.

29 Under these proposals the BFA would have a considerable measure of discretion in the disposal of these funds to help the



film industry. Although NFFC-type investments would be made in production of commercial films, other assistance could be given on more favourable terms, since the BFA itself would not be obliged to make a return on that part of its finances derived from the Eady Levy. A limited amount would also be allocated for the provision and improvement of cinemas.

30 The Committee do not base the case for a BFA solely on the arguments for more plentiful and flexible assistance. It is also based on an argument to the effect that a new body is needed as a focal point for the various interests in this factionalised industry, to bring more weight to bear on policy matters relating to the industry, and to provide the Government on a permanent basis with authoritative and independent advice on such matters. It is argued that the existing Cinematograph Films Council (CFC) is unsatisfactory in this respect because it is composed of representatives of all the different and conflicting interests in the film world; and that the creation of a BFA would be justified on these grounds even if it had to operate on a much more limited budget than they have envisaged.

The Eady Levy

31 The levy on exhibitors - the Eady Levy, as it is generally called - raises at present about £7-8 million. About £1 million of this is allocated to the Children's Film Foundation, the British Film Institute, the National Film School and to the NFFC to help pre-production work, mainly the preparation of scripts. (This last activity is administered by the NFFC through a company which it has set up called the National Film Development Fund⁽ⁱ⁾.) The rest is distributed to films made in this country (whether with British or foreign capital) under an automatic formula

(i) If the other activities of the NFFC were to lapse, the implications for this pre-production support would have to be considered.



related to box-office takings of each film, so that the more successful films get more help from the levy. The formula includes a weighting in favour of low-budget and short films.

32 The levy is collected by Customs and Excise and paid by them to the British Film Fund Agency, who in turn preside over the mechanics of distributing the money. The Agency, set up by the legislation on the levy, is an inexpensive and serviceable piece of machinery, using a firm of accountants for much of the work.

33 The Interim Action Committee comments that the levy is regarded by producers as an effective incentive, but that the Committee themselves have reservations on this score. A number of individuals consulted in this review have suggested that this money would be more effective in supporting British films if it were made available for allocation selectively by an NFFC-type body. One consideration advanced in favour of this view is that rights in the levy are not infrequently assigned to the distributor rather than the producer as part of the bargain between the two.

34 This view is not, however, supported by most of those with experience or current involvement in decisions on film investment who have been consulted in this review; though one view expressed is that the levy provides a bonus rather than an incentive, the general opinion is that the prospect of levy receipts is a factor in investment appraisals and decisions and in the industry's cash flow, and that in some cases it can be a determining factor in decisions whether or not to make a film in Britain or in British studios, and in other cases in decisions by British-owned companies whether to go ahead at all.

35 A good deal of objection could therefore be expected from commercial production circles if levy funds were diverted from the automatic distribution scheme to a NFFC-type operation,



especially if the amount switched was substantial. A more limited switch might secure a degree of acceptance, in conjunction with matching government finance, but would hardly be acceptable to the industry in the absence of a government contribution. Under such an arrangement there would be an expectation that the commercial side of the industry would be appropriately represented in the direction of the scheme since, though the levy is paid by the cinema-goer, it is regarded in the trade as "industry money", in the sense that, if it were not siphoned off by the levy, the money would probably accrue to the industry.

36 The CFC's views on this question are set out in a letter of 23 June 1979 from its Chairman, Mr Allan Grant; the text of his letter is annexed to this report. Broadly these views are not out of line with the appraisal in paragraphs 34-35 above, except that Mr Grant's letter stresses the view that any allocation of Eady money to the NFFC would radically alter the relations between the commercial film production sector and the corporation.

37 On a different aspect of the Eady scheme, there is a good deal of criticism of the weighting of the distribution of the levy in favour of short films (which can give a windfall bonus to a short sharing the same bill as a hit feature film) and in favour of low-budget films, a term which nowadays is often associated with sex films. The Interim Action Committee propose that the BFA should have power to disallow payment of levy money for films which exploit sex or violence; this would raise a different set of considerations. There appears, however, to be a good prima facie case on a number of grounds for reviewing the details of the formula for distributing the levy, and this is in fact being looked at under the aegis of the CFC; but that need not hold up decisions on the broader issues discussed here.



The Public Expenditure Position

38 The White Paper on the Government's Expenditure Plans 1979-80 to 1982-83 (Cmnd 7439) which was issued by the previous administration in January 1979 subsumed, in the "Other support services" item in Table 2.4, provision of £1.5 million for advances to the NFFC in 1979-80 and also in 1980-81, though these figures do not appear as separate entries. This implied legislation to enable these amounts to be paid. Pending decisions on longer term policy, and in particular on the question of a British Film Authority, the White Paper projections did not make specific provision for further such amounts after 1980-81 and these, if subsequently approved and not offset by savings elsewhere, would have represented a claim on the contingency reserve in the public expenditure totals.

39 The policy of the present government is to make substantial reductions in previous White Paper programmes. A fortiori any proposals for expenditure not allowed for in those programmes have to satisfy exceptionally stringent criteria. Although the amount of government money at issue in connection with the film industry is small as compared with the main expenditure programmes, any sum approved is liable to be at the expense of some other item of expenditure. The Government have so far decided to reduce the provision for the NFFC for 1979-80 to £1 million, pending decisions on the future of the NFFC.

Taxation

40 The second report of the Interim Action Committee has recommended a number of tax concessions for either investment in film production or individuals engaged in the film industry. Inland Revenue have been consulted about these proposals and their comments are annexed.



41 It can be argued that the tax regime which has prevailed in the United Kingdom, in conjunction with the speculative nature of film production, has been a factor in the weakness of the British industry as compared with the American film business, since potential investors from outside the industry have faced a high risk of loss not balanced by an adequate possibility of net profit. However, there is a general difficulty about the concessions which have been requested in that, although they would obviously be helpful to the film industry and people in it, they would also be regarded as helpful by other industries who could be expected to request the extension to themselves of any such concessions. The case has not been made out for discriminatory tax concessions confined to the film industry alone, while more general concessions would of course be that much the more expensive.

42 This comment applies in particular to the request that investments in films by individuals or companies should be deductible for the purpose of their personal or corporate tax liability. There is a provision of this kind in the United States, and it is no doubt an important incentive to investment in films, but the American concession is of general application and is not confined to investment in films, though its application to films appears to operate more favourably for films made in the United States than elsewhere. It is reported that some other countries do allow at least a limited degree of special tax treatment for film production, but it is difficult to see how any new investment incentive in our own tax system could be confined to investment in films.

43 This difficulty does not, however, apply to one aspect of the taxation proposals in the Committee's report, involving the period over which expenditure by a film production company is allowed against its own tax liability. This is a question of the way in



which existing general provisions should be applied in practice in these particular cases, and the comments by Inland Revenue show that they believe that in most cases these representations can be accepted. It is understood that this would be regarded by the industry as of considerable value.

44 The Committee have also recommended that the capital allowances which were made available for expenditure on hotels under the Finance Act 1978 should be extended to cinemas. In general capital allowances for buildings, as distinct from plant and equipment, are given for only industrial buildings and not commercial buildings. The concession for hotels in the 1978 Act was based on the economic importance of tourism in this country from the point of view of employment and as a major contributor to the balance of payments. There is no equally strong economic case with regard to cinemas, and there would be difficulty over a piecemeal extension of the special treatment allowed for hotels to further particular types of non-industrial buildings.

45 The Committee's tax proposals relating to individuals include a recommendation for special treatment of tax exiles involved in the production of British films. It can be argued that film stars and others with a creative input into films are a special case in that, if they come to this country to work on a film, when they go they leave behind them a product with a continuing value to the country. But it is difficult to accept that this factor by itself is sufficient to justify special treatment in a sensitive area of tax policy.

46 However, it appeared to be generally accepted in these consultations, which took place before the June 1979 Budget, that the problem of the emigration of talent (and to some extent other aspects of the problem of film finance) would be eased by a reduction in the generally applicable high rates of income tax, even if they were not reduced as far as the American level. The



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view was expressed that film people with creative talents would be more likely to return to live in Britain and play a more continuous part in making films here, thus enhancing the attraction of Britain for foreign investment in film production in this country.

June 1979



Text of Letter from
the Chairman of the Cinematograph Films Council
to Sir Leo Pliatzky, Department of Trade

23 June 1979

Dear Sir Leo

At the meeting of the Cinematograph Films Council on Thursday last I put to members the question of the possible use of an unspecified portion of the Eady Levy as a contribution to the National Film Finance Corporation's film production fund. I had previously circulated to members a note explaining my intention to do so and giving something of the context out of which the question rose.

The immediate response of the cinema exhibitors was to express their concern lest the Eady fund suffer any further erosion by diversion from its original purpose and function to reward film producers who invested in British film production. They agreed with the producer members who, for their own part, claimed that a significant number of British films would not have been made without the incentive of some return from the levy. They emphasised that Eady returns play a role in generating investment finance for production much more important than the calculation of their purely economic value would suggest. In answer to some members who argued that the levy in its present form had not been able to prevent a serious decline in British film production, the producers replied that, even though there may be no objective yardstick by which to measure the value of Eady distributions to production, without them the decline would have been even more serious.

Turning to the hypothetical situation in which Eady money were to be diverted to support the National Film Finance Corporation, there was general agreement that to do so would radically alter the relations between the commercial feature film production sector and the Corporation. The Corporation is regarded as the instrument of state support for the industry; were it to be supported by money that might otherwise have returned to the producers, then they, the producers that is, might find themselves in direct competition with the Corporation for sources of finance. Whether in favour or not, members felt that any such change would entail a re-structuring of the Corporation.

On the question of the proportion of the Eady fund to be so diverted, members agreed that if it reached 50% the fund's present purpose would be seriously jeopardised without securing much benefit to the Corporation. Any relatively much smaller



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proportion would be useless without continued government support.

The subject of the Eady Levy has been exercising Council for some time now. A sub-committee is about to report to Council with a number of recommendations and members trust that the views that emerge from their discussion of the topic at their July meeting will be taken into account by Ministers when policy decisions come to be made.

Allan Grant
Chairman
Cinematograph Films Council

TAXATION RECOMMENDATIONS INCLUDED IN THE SECOND REPORT
OF THE INTERIM ACTION COMMITTEE OF THE FILM INDUSTRY

1.(a) Tax relief for a loss from an investment by either an individual or a company should be granted on the same basis as currently applies to banks and financial institutions, ie treated as trading. Income received from a film would correspondingly be subject to tax.

The effect of this proposal would be to enable investors - both individuals and companies - to obtain relief from income tax or corporation tax in respect of a loss from an investment by way of loan, or participation in a partnership, for film production. At present such relief can only be obtained where an advance of this sort forms part of the trade of the person making it.

It is difficult to envisage such a measure being accepted solely in relation to investment in the film industry. The Interim Report on the Financing of Small Firms by the Committee to Review the Functioning of Financial Institutions raised the possibility of a relief of this kind in respect of investment in small businesses (paragraphs 44-47) but after outlining arguments in favour and against were unable to reach agreement on a firm recommendation.

At present, where the investment is in shares or debentures and there is a loss on their disposal or in certain circumstances their value has become negligible capital gains tax loss relief will be available (Section 23(4), Finance Act 1965). In addition where the participation takes the form of a loan then under the provisions of Section 49, Finance Act 1978 a loss on such a loan or a guarantee payment made in respect of it can, under certain circumstances, be regarded as an allowable loss for capital gains purposes. For those providing investment capital in the form of participation or "angels" agreements any profit made on the investment is liable to tax under Case VI of Schedule D and a loss made in respect of such investment can be set against other Case VI income for the year of loss or any subsequent year.

Reference is sometimes made in this context to the incentives which exist in America in respect of investment in film production. It is of course extremely difficult to compare tax regimes between one country and another and it does not necessarily follow that a particular provision in one country could be fitted into a different taxation structure in another. Our understanding is, however, that under the American provisions tax credit is available in respect of capital investment, the amount of the credit being determined by among other factors the life of the asset. The 1976 Tax Reform Act confirmed that investment in films qualified under these provisions and enabled increased credit to be obtained

if the film were made in the US rather than elsewhere on the grounds that this encouraged employment. The credit available is limited to an individual's tax liability up to \$25,000 and is further restricted beyond that point.

1.(b) Expenditure incurred by a film production company or partnership in the making of a British film should be deductible for tax purposes as it is incurred.

There are no statutory rules dealing with the computation of the tax liabilities of film producers. In the accounts of film companies the cost of producing films is normally treated as deferred revenue expenditure, ie it is not written off immediately but spread over a period of years following the principle of matching expenditure to receipts to produce a true view of the profit or loss arising from the production of the film. Tax treatment normally follows accountancy treatment with the result that expenditure has been regarded as qualifying for tax relief not when it is incurred but at some later date when it is written off in the accounts.

It has recently been suggested that, although production expenditure is not capitalised in film companies' accounts, it is nevertheless capital expenditure; and that the end result - the master print of the film - ranks as "plant" for tax purposes so that the whole of the production costs should qualify for capital allowances. Since the tax code provides 100 per cent first year allowances for capital expenditure on plant, it would follow that in most circumstances tax relief would be given for production expenditure as it was incurred ie significantly sooner than under the present arrangements.

We have now considered this claim, and have concluded that in most cases capital allowances are due on film production expenditure. A claim to capital allowances would be regarded as admissible if the master-print of the film had an anticipated potential life of at least 2 years, so that it was in fact a capital or permanent asset in the business. This would, we presume, invariably be the case with feature films, but might not be so with news or current affairs films.

If it is accepted that the expenditure qualifies for capital allowances, the relief would normally be given as and when the expenditure is incurred. However, in the case of a new film production company - and we understand that it is not uncommon for a new company to be set up for a particular film - no relief can be given until the company starts to trade. This follows from a general rule in the capital allowances code that pretrading expenditure is treated as if it were incurred on the day on which trading begins. However, a film production company is normally regarded as beginning its trade when it starts filming, so any delay in giving relief for such expenditure is likely to be small.

The film production industry regards its present tax arrangements as unsatisfactory since it does not qualify for stock relief on film production expenditure, and has to wait to obtain tax relief on production costs for some time after they are incurred. The acceptance that film production expenditure qualifies for 100 per cent first year allowances, and thus immediate tax relief, represents a significant improvement in the film industries' tax regime.

1.(c) The 20 per cent initial and 4 per cent straight line writing down allowances available for expenditure on hotels under the Finance Act 1978 should be made available for expenditure on cinemas licensed with the Department of Trade under Sections 25 and 26 of the Films Act 1960.

A substantial part of the capital expenditure on the construction, reconstruction or refurbishing of a cinema will qualify as expenditure on machinery and plant for 100 per cent first year allowances, for example expenditure on central heating and air conditioning equipment, sprinklers and alarm systems, lifts, projectors, sound equipment, screens, carpets and furniture.

The only commercial buildings which qualify for capital allowances in respect of structural expenditure are hotels, for which allowances were introduced last year on the basis of their central importance to the tourist industry and thus employment and the balance of payments. The position of cinemas is clearly much different; in any case, notwithstanding the special treatment of hotels, it remains very difficult to single out one type of commercial buildings for tax allowances while withholding them from others. There is, for instance, considerable pressure at present for allowances for shops. Moreover, it would in any event be difficult to propose a relief for cinemas only and not to extend it to other places of entertainment. This would be a very broad and more costly relief; and given the nature of some such places it would be difficult to justify giving them priority over other forms of investment.

2.(a) An individual involved in the production of a British film should be able to work on such film in the United Kingdom for an average of up to 120 days a year over any four year period without becoming liable to UK income tax on world-wide income.

Under the present rules an individual (including a British National) whose permanent home is abroad can visit this country up to an average of 91 days per tax year over a four year period without falling into the resident category for UK tax purposes. The individual must also not exceed a stay of six months in any one year nor keep a place of abode in the United Kingdom. This rule is more flexible

than it may appear since if the average is exceeded the individual is regarded as resident for tax purposes in the fifth and possibly subsequent years but not for the four earlier years. In effect, therefore, the individual can work for up to six months in, say, one or two years provided that the visits are strictly contained for the other two. Alternatively, visits can be made for up to six months for four years provided no visits were made in the fifth year.

The proposal to increase the average to 120 days a year would in our view have to be generally applicable and in any case it is arguable that the present rules are too generous. It could also be expected that there would be less need for easing of this rule, following a reduction in the higher rates of tax.

2.(b) Those working in the British film industry should be entitled to average their income for UK income tax purposes over a period of not less than three years.

There are, of course, many industries and professions which are subject to fluctuations in income and it would be very difficult to limit such a relief as proposed to those working in the film industry. The limited provisions for averaging for farmers introduced last year were justified in the light of the unique combination of dependence on the climate and the need for sustained capital investment in agriculture. The introduction of averaging for all taxpayers on the lines proposed would have serious administrative consequences.



ASSISTANCE TO THE FILM INDUSTRY THROUGH THE ITV LEVY

The Independent Broadcasting Authority Act 1974 provides for payments to be made to the Exchequer by independent television programme contractors out of the profits attributable, directly or indirectly, to the provision of television programmes in Britain. Schedule I to the Act defines the leviable profits of a programme contractor as the excess of 'relevant income' over 'relevant expenditure'.

2. 'Relevant income' means, in particular, advertising revenue but includes any other earnings from the provision of programmes; 'relevant expenditure' means, broadly speaking, the cost of providing television programmes. The assessment of relevant income and relevant expenditure is carried out by the Independent Broadcasting Authority.

3. The Prime Minister's Working Party proposed (paragraph 67-72 of Cmnd 6372)¹ that expenditure by programme contractors on production of feature films intended to be shown first in cinemas (and on TV only after three years) should be counted as 'relevant expenditure' and deductible in the assessment of levy. Similarly, the earnings from the exhibition of the films in cinemas would be excluded in reckoning 'relevant income'. As a result, the levy would be diminished.

4. Expenditure on programmes (including films) for television qualifies as 'relevant expenditure' in the year in which the programme is first shown on television. If the same principle is applied to expenditure on cinematograph films, there would be a delay of 3 years before the expenditure would qualify; but if, alternatively, the expenditure qualified in the year in which it

¹ Published in January 1976



was actually spent, it would be difficult to resist applying the same principle to expenditure on other programmes.

5. Legislation would be needed and this would need justification in much the same way as direct subvention to the film industry.

6. Briefly, the arguments against any such proposal are as follows:

(a) There is no guarantee that additional funds would be drawn into film production since it is likely that a good deal of existing film production investment by television contractors (or linked companies) could easily qualify for levy relief and would be put forward to qualify for this.

(b) When account is taken of the levy on the independent television companies (broadly 66.7% of their profits) and of Corporation tax, so that, at the margin, over 80% of their profits accrue to the Government, companies would need to recover only one third or less of the costs of making a film to break even. Thus they would be unlikely to apply normal criteria to this investment.

(c) ITV companies would be diverted from their principal purpose which is providing television programmes.

(d) There will be a reduction in the yield from the levy over the next few years in connection with the fourth channel.

(e) The present basis on which levy is calculated is that expenditure on programmes does not qualify for exemption until



the programme is shown. Unless this basis is changed (which would also require legislation) and this would create serious problems, the same would apply to expenditure on films. This would mean that there was a substantial delay of perhaps 3 to 5 years before money expended qualified for exemption - a serious objection to such an arrangement from the film industry's point of view.

(f) At present the IBA is responsible for policing the levy. Amongst other things it has responsibility to see that expenditure is not excessive. It would be difficult for the IBA to carry out its responsibilities in relation to activities falling outside its main responsibility, ie. for television.

(g) The proposal would favour the ITV companies to the disadvantage of the BBC.



Those Consulted in the Course
of the Review

Sir Harold Wilson)	Chairman, Interim Action Committee
Lord Lloyd of Hampstead)	Member, Interim Action Committee
Sir Max Brown)	Member, Interim Action Committee
Mr G Williams		Chairman, National Film Finance Corporation
Mr M Hassan		Managing Director, National Film Finance Corporation
Miss F Green		Board Member, National Film Finance Corporation
Mrs R Hart		Board Member, National Film Finance Corporation
Mr C Young		Board Member, National Film Finance Corporation
Mr W A Grant		Chairman, Cinematograph Films Council
Lord Brabourne		G W Films Limited
Lord Grade		Chairman and Chief Executive, Associated Communications Corporation
Sir John Read		Chairman, EMI Limited
Mr R Evans		Group Managing Director, Rank Organisation
Mr T E Chilton		Chairman of Hotel and Leisure Division, Rank Organisation
Mr K L Maidment		President, British Film Producers Association



Mr J A Craven	Chairman, Association of Independent Producers
Mr P Livingstone	President, Kinematograph Renters Society
Mr R Camplin	President, Cinematograph Exhibitors Association
Mr A Sapper	General Secretary, Association of Cinematograph Television and Allied Technicians
Mr D Puttnam	Enigma Productions
Mr S Hartog	Convener, Film Policy Group, Film Makers Association
Mr M Relph	Boyd's Co