



Prime Minister ⁽²⁾ B
 I expect Mr Tebbit to find
 this insufficient and to
 call on you to arbitrate.

Treasury Chambers, Parliament Street, SW1P 3AG
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2 July 1984

The Rt. Hon. Norman Tebbit MP
 Secretary of State for Trade and Industry

Dear Secretary of State

TAXATION OF THE FILM INDUSTRY

When we discussed this issue on Wednesday, I promised to give further consideration to the proposal that the industry should be permitted to write off part of the expenditure on a film before receipts started to come in. You suggested that the proportion might be rather smaller than that for which the industry were asking.

I have looked at this proposal very carefully but I am afraid that I cannot agree to such a concession, even in its more restricted form. As I explained to you, its object is to allow investors (whether financial institutions or individuals) to create up-front tax losses, even where a film proves to be highly profitable. These tax losses can then be "cashed in" by setting them against the investors' other income for tax purposes. The gain to the investors represents a tax subsidy, and in practice it means that the Exchequer funds part of the cost of film production generally.

I do not believe we should allow this to happen, for the following reasons.

First, the cost. The industry's proposal, even on the less ambitious basis, would involve giving film companies a further £20m in 1986/87, more still in 1987/88 and 1988/89, but declining thereafter. This would represent a very considerable amount of support - over £100m in four years - on top of what I have already said I am prepared to do.

Second, our Budget strategy. As you know, we have been very successful in maintaining broad approval for our business tax reforms, even from those who are likely, initially at least, to be adversely affected. To continue to provide an overt tax subsidy to one industry will be widely seen as a weakening of our resolve, and it will make it that much more difficult for us to resist pressure for special exemptions from other industries, many of which have a far better case.

Third, abuse. Tax incentives for the film industry have a bad history of being exploited for tax avoidance purposes. That was why Geoffrey Howe had to tackle the leasing of films in 1982. Any continuing facility to create tax losses will lay us open to attempts to gear up such losses through devices which have been widely publicised (and were referred to by Jeff Rooker in a recent Finance Bill debate). Very large additional amounts of revenue could be at stake here - tax already in dispute between the Revenue and film investors for previous years is approaching £200m. It is not certain that we can effectively counter these schemes under existing legislation. To re-introduce opportunities for this sort of abuse would look highly perverse.



Fourth, the "export" of subsidies. The 1982 action was, as you know, concerned only with totally foreign films. The film industry want their present proposals to apply to Eady films generally, including large productions effectively owned and financed abroad, particularly in the USA. Any tax subsidies for these productions will therefore be fed back to the American investors - mostly major Hollywood studios. And the profits from the films will normally be remitted abroad, so that we cannot tax those either. I know that the industry argue that the tax subsidy bring work here. But even if tax were crucial, I believe that subsidies of this order to foreign studios are too high a price to pay for additional jobs, especially bearing in mind what else could be done with the revenue involved.

Fifth, the independent television contractors do not want the sort of changes being proposed by the feature film representatives, because they would adversely affect their pattern of production and receipts. If we were to make the concession being pressed on us, we would thus face the likelihood of a new - and just as vocal - outcry from the television sector.

Having said all this, I fully recognise the difficulty you face in achieving your object of abolishing the Eady levy and the supporting institutional apparatus. That is why I am offering three concessions to the industry.

First, I have said that the industry will have the option to choose to take either the normal capital allowances at the going rate or the special formula for writing off expenditure on revenue account which is contained in section 72 of the 1982 Finance Act. I estimate the value of the option will rise to over £30m in 1988-89, in mitigating the effect of the capital allowance changes in the Budget. This already puts the film industry in a more favourable position than all other industries.

Second, I intend to make changes to the Business Expansion Scheme to allow it to embrace film production. This will be of special help to the smaller, independent British producers where there is genuine risk involved. We are already discussing the details with the industry on a without prejudice basis.

Third, as I mentioned to you at our meeting, I am ready to give the industry the opportunity to set off its expenditure against income in accordance with a technique known as "cost recovery", so that expenditure is set off as rapidly as income is received. This will be an improvement on the Section 72 formula as it stands, and goes as far as I can without breaching the crucial requirement that expenditure should not be written off in a way which anticipates tax losses.

With this package of measures I have gone as far as I reasonably can in proposing changes which help the industry, while remaining consistent with our underlying strategy and the proper protection of the Exchequer. With Report Stage of the Finance Bill next week, we urgently need to finalise this matter, and I do hope that on reflection you will feel able to go along with my proposals.

I am copying this letter to the Prime Minister, Geoffrey Howe, Leon Brittan and Grey Gowrie.

David Peetz

PP NIGEL LAWSON
(approved by the Chancellor, and signed in his absence)

2 JUL 1984

