EXPLANATORY MEMORANDUM TO

THE FILMS (DEFINITION OF "BRITISH" FILM) ORDER 2006

2006 No. 643

1. This explanatory memorandum has been prepared by the Department for Culture, Media and Sport and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 This Order modifies the definition of a British film in Schedule 1 to the Films Act 1985 by replacing the current expenditure and labour costs requirements with a requirement to pass a cultural test reflecting the content of a film, where a film is made and the persons who are involved in making a film.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 Schedule 1 to the Films Act 1985 sets out the requirements to be satisfied for a film to be a British film for the purposes of that Schedule: certification under paragraph 3 of that Schedule as qualifying for tax reliefs under section 42 of the Finance (No 2) Act 1992 and section 48 of the Finance (No 2) Act 1997. The Treasury intend to replace these reliefs with new tax incentives but certification as a British film (as modified by this Order) will continue to be the initial gateway for access to the new incentives. The Finance Bill will make further consequential amendments to the Films Act 1985 reflecting the changes to the tax system.

4.2 Paragraph 10(2) of Schedule 1 provides that the Secretary of State, with the approval of the Treasury, may make modifications to paragraphs 1 and 4 to 8 of that Schedule. This power has been exercised twice before[1]. This power is subject to the affirmative resolution procedure.

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Minister for Creative Industries and Tourism has made the following statement regarding Human Rights:

In my view the provisions of the Films (Definition of "British Film") Order 2006 are compatible with the Convention rights.

[1] S.I. 1999/2386 and S.I. 2000/756.

7. Policy background

7.1 In July 2005 the Treasury launched a consultation on the reform of the current tax reliefs in order to encourage stable and sustained investment in the production of culturally British films and to comply with EU requirements in relation to state aid (available from www.hm-treasury.gov.uk). At the same time this Department published a consultation document on the new cultural test for a British film (available from www.culture.gov.uk) developed with the advice of the United Kingdom Film Council.

7.2 The aim of the new cultural test is to apply objective criteria to the measurement of cultural attributes in order to identify culturally British films. Points will be awarded to all those elements that contribute to the cultural value of a film including, the content, where the film is made and the persons involved in making the film. The Department received 39 responses to the consultation on the new cultural test and revised the test in light of these – the final test is available from www.culture.gov.uk.

7.3 Whilst supportive of the principle of the cultural test most respondents felt strongly that that the test should provide clarity and certainty for producers. Many respondents felt that to do this it would be necessary to operate a system of pre-certification for the test, that is, an applicant would be able to apply, before the film is made, for a provisional indication whether the film would pass the test. A final application would be made once the film was completed. Consequently, it is the Department's intention to pre-certify films under the new cultural test, subject to the conclusions of a full regulatory impact assessment.

7.4 Respondents also made clear that alternative options for animation and documentary films would be needed so as not to exclude these films from passing the test as many of the elements of the main cultural test did not apply to these specific types of films. As a result the Order provides for varied cultural tests for these types of films.

7.4 More specifically responses called for a re-weighting of the sections, with the highest number of points allocated to where the film is made (Section B in the published tests). The location of the shooting of the film and where the work on visual effects is carried out were thought to have a significant cultural impact on the film and therefore should have the largest weighting within Section B. It was widely supported that the producer should be recognised within Section C (persons involved in making the film), along with the entire cast and crew and a larger group of heads of department. A summary of the consultation responses is available from www.culture.gov.uk.

7.5 The current guidance for Schedule 1 to the Films Act 1985 will be revised shortly to reflect the changes made by this Order and Department has already completed the draft guidance dealing with the requirement to pass to cultural test (attached).

8. Impact

8.1 A Regulatory Impact Assessment is attached to this memorandum.

9. Contact

Dee Davison at the Department for Culture, Media and Sport Tel: 020 7211 6435 or e-mail: dee.davison@culture.gsi.gov.uk can answer any queries regarding the instrument.

REGULATORY IMPACT ASSESSMENT

Revisions to Schedule 1 to the Films Act 1985

Title of Proposal

1. Revisions to Schedule 1 to the Films Act 1985.

Objective

2. Film plays an important role in British culture. The Government's core aim in providing tax relief is to promote the sustainable production of culturally British films. This aim is supported through:

a.) Encouraging the production of films that might not otherwise be made;
b.) Promoting sustainability in British film production; and
c.) Maintaining a critical mass of UK infrastructure, creative and technical expertise, to facilitate the production of culturally British films.

3. The Department for Culture, Media and Sport's proposals are for a new cultural test to better identify culturally British films that might be considered eligible to claim the new tax relief in line with the European Commission's rules on State Aid. We are aiming for the new Cultural Test to be in place by 1 April 2006.

4. Government intervention at this stage will help the development of a sustainable UK film industry whose public value has been recognised, and through export of Culturally British films will further establish the image of the UK abroad.

Background

5. To be effective, the qualifying criteria for a British film must be appropriate to industry requirements, clearly understood and easily implemented. Currently a film certified as a British film by DCMS, must fulfil either:

a.) The terms of Schedule 1 to the Films Act 1985; or
b.) The terms of an international co-production agreement to which the UK is party (including the European Convention).

Only proposed revisions to Schedule 1 to the Films Act are the subject of this RIA. Proposed revisions of international co-production agreements will, over time, be handled separately.

6. Under Schedule 1, the Secretary of State currently certifies a film – and opens the gateway to claim the existing film tax reliefs - when satisfied that the following criteria are met:

a) The Maker Test (Who makes the film) - A film must be made by a maker of the UK or another member state of the EEA. "Maker" means the person ordinarily resident in a member state or a company registered, centrally managed and controlled in a member state making arrangements for filmmaking throughout the time the film is made;

b) Moving Pictures created specially for the film (content of the film) - Moving pictures from a film by another maker (or from a previously certified film) should comprise no more than 10% of the playing time of the film. In the case of documentary films and in the light of their subject matter, this limit may be extended at the discretion of the Secretary of State;

c) The production costs test (Cultural Hubs) - Expenditure incurred on filmmaking activity carried out in the UK must account for at least 70% of the production costs of the film; and

d) The labour costs test (Cultural Practitioners) - The labour costs of citizens or ordinary residents of member states of the EEA and the Commonwealth must account for at least 70% (or 75%*) of the total labour costs of the film. Before doing this calculation, the applicant may if they desire deduct the cost of one (*or two) persons who are not from a member state or the Commonwealth.

7. It is proposed that the first test (a) be amended by the definition of a 'Maker' that will be set out in the HMT's revision to the Finance Act. The second test (b) will be retained and the latter two explicitly economic tests be removed from the statute book to be replaced by one explicitly cultural test.

8. We want to ensure that the cultural test is compatible with the European Commission's rules for providing state aid.

9. Some of the selection criteria for the current Lottery Funding Programmes include the requirement for a film to wholly or substantially qualify as British. It provides a discretionary grant with recoupment provisions.

The Need for Government Intervention

10. Cinematic film provides a universal and readily accessible medium for the expression and representation of British culture and national identity. As the Minister for Culture stated in her speech on Government and the Value of Culture, there is a distinction to be made between entertainment and cultural engagement. Where cultural contribution goes beyond providing entertainment in this sense, the social benefits often fail to be captured in the transactions that people undertake in the market. In this regard culturally British films can be regarded as merit goods that the market often fails to provide at the optimum level.

11. The social benefits that attach to cultural production suggest that there is a public interest in ensuring greater supply than the market would otherwise provide. Without Government intervention, a richer, more diverse and more representative range of voices may not emerge, resulting in a more impoverished and limited range of choices for the public. The aim of support is to address the market failure in the supply of culturally British films by way of an incentive for specific behaviour – the production of culturally British films.

12. The introduction of a new cultural test will ensure that Government support is directed to only culturally British films. This is in line with the Commission's state aid requirements.

Consultation

13. A formal consultation ran from 29 July 2005 – 21 October 2005, during this period consultation meetings were held with industry stakeholders in order to clarify the rationale behind the Cultural Test and take on board initial comments from interest groups. Thirty-nine responses were submitted by 21 October 2005.
The vast majority of responses to the consultation on the new cultural test were positive and the Department subsequently revised the test – the final test is available from www.culture.gov.uk.

14. The most common message received was that the test should provide clarity and certainty for producers. Many respondents felt that to do this it would be necessary to operate a system of pre-certification for the test, that is, an applicant would be able to apply, before the film is made, for a provisional indication whether the film would pass the test. A final application would be made once the film was completed.

15. Respondents also made clear that alternative options for animation and documentary films would be needed so as not to exclude these films from passing the test as many of the elements of the main cultural test did not apply to these specific types of films. As a result the Order provides for varied cultural tests for these types of films.

Options

Option 1 – Do nothing: allow the criteria in Schedule 1 to the Films Act 1985 to remain unchanged.

a) Leaving the current tests to run in their current form would not fulfill the Government's objective to ensure that support is directed to the production of culturally British films.

b) In addition, there is the risk that the European Commission may not consider the current test compatible with State Aid rules.

c) Implementation and delivery plans would not be applicable to this option.

Option 2 – Decouple Schedule 1 to the Films Act 1985 from the tax reliefs, so that British film certification is no longer needed as a gateway to film tax reliefs.

a) Entirely decoupling certification from tax reliefs would be an inefficient use of resources, as certification would still need to continue for lottery and co-production purposes. (In the case of the latter, certification would still be required for producers to obtain foreign tax relief).

b) Implementation and delivery of this option would have to happen before April 2006 and may involve decentralisation of the team of experts currently managing certification efficiently.

c) Although the above would be an inefficient proposal for Schedule 1, it should be noted that HMT intends to use its next Finance Act to loosen significantly the coupling between Schedule 1 and its new film tax reliefs in order to centre the gateway for film tax reliefs within HMRC instead of within the DCMS.

Option 3 – Review some of the criteria in Schedule 1 to the Films Act 1985 to incorporate a new cultural test.

a) The introduction of a new cultural test will ensure that films are genuinely culturally British. This test will be administered by the Department for Culture, Media and Sport in a similar way to the current certification process based on the 1985 Films Act. This will meet the requirements of the State Aid rules for support to film production. This will facilitate the centering of the gateway for film tax reliefs within HMRC, whilst guaranteeing HMT that only culturally British films may approach HMRC's gateway.

b) The test is designed to be very straightforward to comply with and therefore minimises the risk of non-compliance and the need to exercise administratively burdensome compliance and enforcement regimes.

c) A system of pre-certification for the Cultural Test was unanimously called for through the consultation. It is agreed that pre certification offers the certainty film producers need in order to begin work on production. Without it, there is a danger that finances would not be secured and this could in turn drive film makers away from the UK.

d) If the cultural test does not offer the certainty required by film makers, the new system may drive film business away from the UK and have an unintended adverse effect on the UK economy and film industry.

e) Option 3 would need to be in place by 1 April 2006.

Costs

Sectors and groups affected

14. The new cultural test is targeted directly at the UK film production sector and in addition to individual casts and crews, there are currently between 4000 to 5000 UK companies either directly involved in film production or who provide the necessary services to film producers (such as studio facilities, sound, lighting, post production and special effects). All will be directly affected by the new cultural test.

15. Indirectly affected will be the film financing sectors, in particular banks lending money to producers, and sectors that market and exploit the film once it is completed.

Benefits

16. The introduction of a new cultural test will benefit the UK film industry and film culture in the UK by encouraging the use of British content and hubs and practitioners. A thriving sustainable British Film Industry should also have the long term impact of utilising the wealth of talent emerging from training courses in media and film, who will make up the film industry of tomorrow.

17. In terms of the monetary value of the benefits, the Cultural Test is intended to attract more investment into UK film making facilities and practitioners across the board, from actors and Directors to technical crew, studios and post production houses.

18. Film production spending in the UK totalled more than £559 million in 2005, this was lower than 2004 spending levels, due largely to the industry's uncertainty about the new tax relief's. The film industry has widely welcomed the new tax credit system which was announced by the Chancellor on 5 December 2005, therefore we are confident that production spend in the UK will reach even higher levels once the new system is fully up and running.

19. The Cultural Test offers a more objective system through which to qualify as a British film. The test has been developed in partnership with the industry and offers producers the certainty they require to make their films in the UK. Therefore, it is expected to increase film making activity, and in turn production spending, in the UK.

20. A system of pre certification would allow producers certainty that they need in order to release the funds to begin making their films.

Policy costs

21. None identified.

Administrative costs

22. Several of the responses to the consultation asked for a system of pre-certification to be established. This option has been carefully considered and is concluded as absolutely necessary in order to attract and retain film making activity in the UK. Additional administrative costs may be incurred, as films currently certified under Schedule 1 are not pre-certified. However, although initially the costs of pre-certifying all British and co-production films may increase whilst the new system is bedded in, and for the duration of the transitional arrangements, in the long term the simplicity and objectivity of the Cultural Test will be less administratively and financially burdensome.

Implementation and Compliance costs

23. The new cultural test will be based primarily on objective criteria to determine the cultural content of a film. This test is likely to be less burdensome than the current certification tests.

24. As for compliance, it will lighten the administrative burden of using Schedule 1 to the Films Act 1985, as film businesses will no longer have to plan their expenditure to meet a 70% threshold for "activity in the UK". This costs saving may be offset through the introduction of a new test about expenditure to be administered by HMRC with a lower threshold and a different way of assessing British expenditure.

25. The DCMS and HMRC are working closely to ensure that the information required of a film maker for application to both the DCMS Cultural Test and the HMRC expenditure test for tax relief can be as closely aligned as possible. Joined up working across the two departments will help us to avoid placing unnecessary administrative burdens on the film maker to produce extra and duplicate documents at different stages.

26. It is proposed that film businesses will be required to keep records of the nationality and country of residence of all cast and crew, and some of the budget heads for particular activities, such as visual effects work. However, this is no more than what is already required under the current rules and so does not represent an increased burden.

Small firms Impact Test

27. A large proportion of businesses in the film industry are small (250 employees or less). The views of small businesses were taken account of before the consultation and during the formal consultation period

through stakeholder meetings and written responses. We have consulted with the Small Business Service during the consultation period, who are satisfied that the Cultural Test has little impact on small businesses, and any impact resulting from initial procedural changes, would not be disproportionate to that of other businesses. To ease the transition to the new system, a transitional period is proposed, which will follow in step with HMT's transitional period for its new film tax credits. The transitional period will allow producers to start and finish films under the old system by prescribed deadlines. Any films not meeting those deadlines will fall into the new system. The deadlines will be announced in advance.

28. Some films may score too few points and so fail the cultural test, but in this case the Government/industry consensus is that there is not sufficient justification for the associated benefits.

Competition Assessment

29. There will be no impact on competition from the new tests. The new test is designed to be equally accessible to all sectors of the market. The test does not dictate to film makers their choice of content, hubs and practitioners but it does ask for a reasonable amount of film making activity to take place in the UK in order for a film to qualify as 'British'. Officials are working with the European Commission to ensure that the tests comply with European competition rules on State Aid.

Enforcement and Sanctions

30. The Department for Culture, Media and Sport (DCMS) will manage the effective enforcement of the new test and thereafter ensure compliance. Non-compliance would result in a film not qualifying as British, or having its British certificate withdrawn, which in turn would prevent it from being eligible to apply for benefits available to British films. The new test has been drafted to avoid loop-holes which could lead to abuse of the test.

Monitoring and Evaluation

31. The new tests will be kept under continuous review. This information will also be linked with data from HMRC and UKFC and from other sources on the distribution and performance of British films at the box office and through other channels. This will allow the performance of the test against its wider objectives to be assessed and a judgement made about the effectiveness of the tests.

Implementation and Delivery Plan

32. The DCMS will implement and deliver the new Cultural Test. The key milestone will be the 1 April 2006, when we expect the Cultural Test to begin to apply. The

implementation of the test, as mentioned above, will not in itself be burdensome on staff or financial resources, but it will need to be operated alongside the previous system during a transitional period. Central to the implementation and delivery plan is communication with stakeholders. Seminars and workshops for the industry will be considered in order to effectively deliver the new system.

Post-implementation Review

33. A Post-implementation review will be conducted two years after the cultural test has been introduced. The success of the new cultural test will be measured against the objectives set out in this RIA as well as against performance results of British films, including box office admissions, number of certified films (British and co-productions) and the use of UK facilities and practitioners. It would be difficult to do a reasonable assessment within less than two years as initial take-up of the new system for films is anticipated to be slow, time is needed for films to be released, and box office figures over a reasonable period need to be considered.

Summary and Recommendation

Option	**Total benefit per annum**	**Total cost per annum**
1	No additional benefits	No additional costs
2	No additional benefits – in fact this option could become confusing to film makers and more burdensome for certifying bodies.	Inefficiency of continuing to certify films for co-productions and the lottery, yet not using the same system to assure HMRC that films are culturally British. Currently the entire certification mechanism, as administered effectively by DCMS, covers all these needs.
3	Ensuring that films are culturally British and create a sustainable, thriving British film industry by encouraging the use of, and investment into, Britain's creative content, facilities and practitioners.	Following the initial period of 'bedding in', and after the expiry of the transitional period, the new test will ultimately be less costly than the existing structure, as it will be easier to make certification decisions and therefore a more efficient use of staff time.

Conclusion

34. Based on the evidence provided in this RIA, the recommendation is to proceed with Option 3. As illustrated above, this option offers the most benefits to the British film industry and the smallest cost to the Exchequer.

DECLARATION

I have read these Regulatory Impact Assessments and I am satisfied that the benefits of each justify the costs.

James Purnell MP

7th February 2006

Minister for Creative Industries and Tourism
Department for Culture, Media and Sport

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