Leaders in Tax

Film Tax Relief Consultation
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2

31 August 2012

Response to Consultation on Section 481 Film Relief

Dear Sir / Madam

The Irish Tax Institute welcomes the current review of section 481 Film Relief ("section 481"). This review allows sufficient time for broad consultation and an informed decision to be taken well in advance of the scheme's scheduled expiry date of 31 December 2015.

Our submission contains some general comments on the operation of the relief, and we have also responded to the specific questions posed in the consultation document. In formulating this submission, we have consulted with our AITI Chartered Tax Adviser (CTA) members, whose considerable knowledge of how section 481 projects work in practice has largely informed our comments.

General Comments

The film sector is a highly mobile industry. A significant range of jurisdictions have incentives to encourage production. To be considered to be an attractive location for this industry, and competitive in comparison with other jurisdictions, it is important that a jurisdiction's fiscal policy reflects its support of this industry.

Certainty

Section 481 is relatively unusual among film incentive schemes internationally, in that it encourages private investor involvement in film production. For example, under the Film Tax Relief scheme in the UK, it is the film production company itself which is afforded

the favourable tax treatment, in the form of special rules dictating how the company's profits are to be calculated and losses utilised.

In the case of section 481, the investment is provided upfront to the production company and available at or before the time principal photography commences. In this way, section 481 offers an element of certainty to other financiers in the particular film production as there is no risk for the other financiers that the amount they are expecting to be available in the Irish jurisdiction could change or become unavailable. All risk associated with the meeting of the tax requirements is borne by the Section 481 investors and not the other financiers, which again is attractive.

An alternative to this type of incentive would be a tax credit system where the tax benefit arises once the project has been completed. This system would lose the advantages set out above. If funds had to be borrowed for the investment, which is typical in these types of investments, this may present difficulties in the current environment where it can be challenging to secure medium-term loan finance.

Profile of investors

The feedback from our members is that, in practice, investment in film projects is largely made by middle-income earners, many of whom do not even make the maximum investment of €50,000. For investors whose incomes are at the upper end, the "high earner's restriction" operates to limit the amount of relief available to them.

The nature of the investment means that the investor in practice receives a relatively low return. They rely upon the producers and their advisors to select productions that are properly funded with an experienced team attached. This is why fundraisers are able to source investors who are not high net worth individuals and whose incomes fall into the middle income bracket.

Investment risk

The consultation document states that film investments are "very low risk", as there has only been one instance of a failed production. There is a legislative requirement that the investment be made at the risk of the investor, and our members have stressed that significant risks do exist in practice.

Equity investments (i.e. subscriptions for shares) are the riskiest form of capital, as they enjoy the lowest priority in the case of insolvency or the collapse of a production. The entitlements of all creditors, whether secured or unsecured, rank in priority to shareholders. If the production company incurs an overspend or is left with a financial deficit for any reason, the deficit will impact directly on the return to any section 481 investors. If the conditions for availing of the relief are ultimately not met, it is the investor who will directly bear the cost of any withdrawal of relief.

In these circumstances, we understand that producers and, in particular, the professionals engaged in raising section 481 funding take great care to satisfy themselves that each production is properly budgeted, funded and managed. Extensive due diligence is undertaken by such professionals prior to the making of each investment. The reputational damage that would be suffered by the Irish film industry if a professional firm introduced investors into a poorly conceived or managed project would be very significant.

This approach has the effect of mitigating, but not eliminating, investor risk. Indeed, our members advise us that industry participants have stepped in to troubled productions on a number of occasions and have sourced or provided alternative funding to ensure that projects which were close to failure made it through to completion. Therefore, it is more accurate to say that the high risk associated with film investments has been managed very effectively by the industry, although not eliminated. Given the modest return on such an investment, it is not unexpected that investors would seek a minimum level of safeguard against certain risks in respect of the investment being made.

The successful policing by the producers and their advisors in extracting projects that are not adequately funded or which lack key elements, has gained Ireland a strong reputation in the industry. This assists in encouraging future productions to come to Ireland.

Administration

Feedback from members is that the administration of the scheme is well understood by investors and is well managed and strictly controlled by Revenue. Projects are subject to the following stipulations:

1. The project must be fully financed before certification is granted by Revenue.

2. There is a standard application form for certification, which requires extensive detail on the production, including:

   - An itemised production budget.
   - Details of eligible expenditure in the State.
   - A diagram detailing all the parties involved, their respective responsibilities and the flow of funds between them.
   - Letters of intent/commitment from all sources of non section 481 funding.
   - A detailed person-hours schedule, with information on the residence status of crew and cast.
   - Details and confirmations on trainees employed by the production - there are minimum requirements for trainees on every certified project.

3. The application for a certificate must be submitted to Revenue at least 21 days prior to the earlier of:

   - the commencement of the raising of the section 481 funding, or

- the commencement of the principal photography or equivalent.

4. No later than 4 months after the completion of production of the film, the film production company must provide a compliance report in relation to the film to Revenue. The compliance report must prove that all of the requirements of section 481 have been met and that any conditions attached to the issuing of the certificate have been fulfilled. It is required to be accompanied by a copy of the completed film, and a report by the film production company's auditors on the financial aspects of the production.

   Under amendments made in Finance Act 2012, a penalty will be imposed on the directors or secretary of the company where a compliance report is not filed with Revenue within 6 months of completion of the film. Crucially, no return can be issued to investors until a completed compliance report is acknowledged by Revenue.

The combination of the above, plus the efforts of the producers and their advisors in carefully assessing productions, has ensured that only productions of the highest quality reach the standards required to be funded by section 481.

It is worth making one further observation in the context of administration and compliance. Because section 481 tax relief is delivered to the investors rather than, for example, to a special purpose company as is typically the case with the UK's film tax incentive, the Revenue can ultimately withdraw the relief from the taxpayer within the normal criteria for non-compliance set down in tax law. This provides Revenue with a straightforward means of recovery in any cases where there has been material non-compliance, and represents a significant safeguard to ensure that any irregularities are avoided or remedied. In contrast, under the direct tax credit model, once the relief has been granted and the tax credit amount has been paid it will typically be used to repay the lender which provided cash flow financing. In such cases it will be difficult or impossible to recover the amount of the relief should compliance issues subsequently be discovered.

The Consultation Questions

1. Is the Exchequer's support to the film and TV sector in Ireland through Section 481 relief an efficient use of scarce resources and if so why?

The efficiency of section 481 as a tool for deploying scarce resources has been measured in monetary terms by a number of reviews.

The IBEC Audiovisual Federation review in 2011 indicated that section 481 resulted in a net benefit to the Exchequer of €8.6 million in 2010. The earlier Indecon review, which took place in 2007, reported a total net benefit of €5.4m for the period 2004-2006.

The IBEC Audiovisual Federation calculations include direct tax benefits in terms of PAYE, PRSI, schedule D income tax and corporation tax, and indirect tax benefits

including VAT and excise. Indirect benefits are taken into account by the multiplier effect of investment in audiovisual production. The cost associated with section 481 is calculated as the tax foregone on the funds invested under the scheme.

The Indecon report identifies the following multiplier effects of section 481:

- additional tax revenue arising from incremental expenditure of section 481 employee incomes, and
- additional tax revenue from the incremental expenditure of section 481 companies.

It also notes that there are wider benefits, including:

- the cultural benefits of indigenous film production activities,
- the development and retention of skilled creative talents, and
- the potential tourism benefits arising through increased awareness of Ireland through film and other productions distributed internationally.

The development of a viable indigenous creative industry is a significant wider benefit arising from section 481. The feedback which we have received indicates that the section 481 "spin-off" has resulted in reinvestment in the sector in Ireland and the establishment of vibrant stand-alone Irish businesses, which are not solely project-driven.

There are at least five well established animation companies in the country now employing in excess of 20 people on a full time basis and this figure can go as high as 100 in particular cases. Animation companies, such as Jam Media, Cartoon Saloon, Brown Bag Films, Telegael Teoranta or Boulder Media currently advertise vacancies to be filled, which is a positive reflection of industry activity.

In addition, the availability of the relief has allowed post production studios in Ireland (in particular Telegael Teoranta, Screen Scene, Egg and Windmill Lane) to compete for work internationally and bring high value and highly skilled jobs into Ireland. Recent examples of this include the first series of "Game of Thrones" and "Sinbad", currently showing on Sky Television.

The PwC report on section 481, prepared in 2003, noted that there are 3 key conceptual models under which film incentives are provided throughout the world. These are the investor deduction model (the section 481 model), the tax credit model and the direct subsidy model. The report found that the section 481 model compares favourably to other investor-based incentives, when ranked under the key criteria.

It is worth noting that the section 481 tax incentive scheme is directly linked with the level of expenditure which is incurred in Ireland and importantly, any expenditure incurred outside the State does not qualify as "eligible" spend for the purposes of section 481, as it does not yield any tax benefit in Ireland. Therefore, this required Irish expenditure in itself yields an economic benefit to the State through the creation of jobs

and the expenditure on Irish goods and services. There are various ways in which this leads to a tax benefit for the Exchequer; through taxes paid by individuals who are employed in the industry, through corporation taxes payable by production companies operating in Ireland and through taxes stemming from the expenditures incurred.

It is also worth noting that, unlike the UK, payments to any cast or crew members who are not citizens or residents of the EU do not qualify as eligible expenditures. To illustrate this, payments to a US "star" actor working in Ireland do not qualify for the purposes of the tax relief, whereas such payments would qualify under the UK's scheme.

2. Is the current scheme maximising the potential economic benefits to Ireland in terms of stimulating activity in the film and TV sector? If not, why not?

We believe that introducing a further measure of certainty in relation to section 481 would help to maximise the economic benefits to Ireland from activity in the film and TV sector. There are significant lead times to film projects and signalling an intention to extend the scheme for, say a 10 year period, would assist in planning productions and marketing Ireland as an attractive long-term location.

The UK government is currently expanding its supports to the creative industries and is planning to introduce corporation tax reliefs for the video games, animation and high-end television industries from April 2013. The UK has recognised its competitive disadvantage compared to countries, such as Ireland, who offer incentives targeted at TV productions. An RSM Tenon/Wiggin report to the UK government illustrated how the UK is currently losing out to countries which offer tax incentives to attract big budget dramas. The report estimated that a targeted tax credit for high-end TV production would generate an additional direct production spend of at least £350 million per year as a result of production taking place in the UK.

The UK has carefully examined the evolving opportunities in the industry and taken steps to improve its competitive position. Ireland should continually review the marketplace and identify new ways to maximise opportunities for Ireland.

3. What are the economic arguments for restricting or terminating the scheme?

In light of the data outlined above which shows the continued net benefit which the scheme is delivering to the Exchequer, we believe that there are strong arguments that the scheme should be extended, rather than restricted or terminated.

The industry is providing employment for electricians and set-construction workers, who may otherwise be unemployed as a result of the downturn in the construction industry. Other specialist film-production staff who are currently employed on Irish projects may be obliged to move abroad to where the work is if the film industry were to decline in Ireland.

The UK government's stated ambition is to make the UK "the technology centre of Europe". In light of the competitive threat being presented by the UK at present in relation to TV productions and the fact that it is a highly mobile industry, we should be more alert than ever to challenges from competing jurisdictions.

Given the steps outlined above which the UK are taking to improve their relief, the need for competitiveness of our film industry is even more important than ever and we should not be restricting or terminating the relief.

4. What possible changes to the existing scheme, if any, should be considered and why?

As outlined above, we believe that some consideration should be given to extending the termination date of the scheme which would allow Irish companies compete for international productions which could have creative lead times between 2 and 5 years depending on the production / studio / broadcaster's requirements. In addition, given that the UK is looking to expand their tax incentive scheme for this industry, Ireland will need to do the same with section 481 to remain competitive.

5. Do interested parties agree that there is merit in extending section 481 Film Relief Tax incentive scheme beyond 2015? If yes, why? If no, why not?

It is the view of our members that there is merit in extending section 481 over the longer-term. It is vital to be able to offer long-term certainty in promoting Ireland as an attractive location for highly-mobile international productions, particularly in light of emerging competitive challenges. It is also vital to secure existing employment in the industry and to ensure the opportunity to grow this employment base is not lost. The fact that the UK plans to have its new scheme for high-end television production in operation during 2013 lends further urgency to the need to bring certainty to Ireland's offering.

6. How does the scheme interact with other enterprise tax incentives such as the BES/EII?

It is the experience of our members that there is little or no interaction between section 481 and the Employment and Investment Incentive Scheme (EIIS). A company which carries on significant activities related to the production of a film (within the meaning of section 481) cannot be a qualifying company for the purposes of the EIIS.

The activities which are incentivised by each relief and the profile of investor availing of each scheme are quite different. Film relief investments generally have a shorter turn-around time of around 12 -18 months. However, under EIIS, the shares must be held for at least 3 years if the investor wants to avail of full tax relief. Accordingly, if relief for investment in films were to switch to a model closer to that of EIIS, then it is possible that many current investors in section 481 schemes could be deterred from investing, especially given the modest return on investment available. They may face challenges in

securing medium-term loan finance for the period required or they may be unwilling to tie up their capital for a longer period.

Conclusion

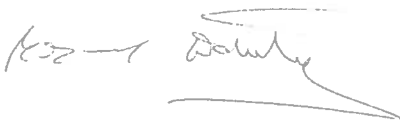
Our feedback is that the combination of the following features makes section 481 an effective tool for fostering the audiovisual industry in Ireland:

1. The scheme is well-regulated and audited – offering a significant degree of certainty to international and national financiers of film and television product.
2. The production receives the benefit of the relief up-front.
3. The scheme is relatively easy to understand and market.
4. There is a high degree of self-regulation within the industry due to the very real risk associated with subscribing for share capital in a film production company.
5. The investor-based nature of the incentive represents a powerful lever for ensuring compliance and, where necessary, securing reimbursement of the State's investment.
6. Given the relatively modest return on investment available to individuals, the turnaround time of typically 12 – 18 months in realising their tax benefit is appropriate.
7. The certainty associated with the scheme makes it easy to budget for and plan productions.
8. We are facing increased competitive pressure from the UK, which would be one of the main competitor jurisdictions for the projects we currently win.
9. The industry currently employs in excess of 15,000 people directly and indirectly and as discussed above this figure is growing as evidenced by the job vacancies available for a number of production companies, particularly animation companies.

In conclusion, we would like to emphasise the necessity of having a fiscal incentive such as section 481 in order to sustain a viable film industry in Ireland. We believe there is a compelling case for extending the term of the relief well beyond 31 December 2015.

We are available for further discussions on any of the matters raised in this submission.

Yours truly



Bernard Doherty
President
Irish Tax Institute