



HM Treasury

# Visual effects: providing further support to the industry

summary of responses

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December 2013





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# 1

## Introduction

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### Policy context and background

**1.1** The creative industries not only make a valuable cultural contribution to the UK, they are also an important part of a dynamic and diversified economy. To ensure that these highly skilled and innovative industries thrive in the UK, the government has introduced new reliefs for animation and high end TV, and already committed £16 million, industry match-funded, to support creative, digital skills in the UK and £15 million for innovative digital media content creation.

**1.2** At Budget 2013, the Chancellor announced that the government would consult on tax options to support the visual effects industry. A consultation was published on 21 May 2013.<sup>1</sup> The responses (from individuals, companies, representatives and other bodies) received during the consultation are summarised in this document, alongside the government's policy response. The government is grateful to all those who contributed to the consultation process.

### Summary of respondents views

**1.3** The majority of respondents welcomed the consultation's discussion of additional support for the visual effects industry, stating that further support would enable growth in the sector and ensure productions could return to the UK which had been lost to jurisdictions outside of Europe.

**1.4** Several respondents made reference to the positive impact that the reliefs could have in supporting greater investment both within the UK, from overseas and in international co-productions, resulting in higher levels of economic contribution from the sector, more stability for a highly skilled workforce and the creation of culturally important products.

**1.5** Respondents pointed towards an increasing trend of visual effects activity moving outside the UK and Europe and the negative impact this may have on the sustainable production of culturally British and European films. A key driver for this trend identified in responses to the consultation was the range of generous tax incentives and subsidies offered for visual effects work in non-European jurisdictions.

**1.6** The majority of respondents did not support the two tax options set out in Chapter 4 of the consultation document. A minority of respondents believed the government should not use tax incentives to further support the industry. However the majority of respondents proposed alternative measures to support visual effects and the wider film industry.

**1.7** A list of respondents can be found in Annex A.

### Autumn Statement 2013

**1.8** Following the consultation, the Chancellor announced a series of measures at the Autumn Statement 2013 to support the creative sector, including film and visual effects production.

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<sup>1</sup> Visual effects: providing further support to the industry.

The government will from April 2014:

- increase the rate of film tax relief for large budget films from 20 per cent to 25 per cent for the first £20 million of qualifying production expenditure;
- reduce the UK minimum spend threshold from 25 per cent to 10 per cent; and
- make changes to modernise the film tax relief cultural test.

These changes are subject to state aid clearance.

In addition, that the government intends to seek state aid clearance to increase the rate of relief to 25 per cent for all qualifying expenditure when re-notifying film tax relief in 2015.

**1.9** These reflect responses to the consultation on providing further support to the visual effects industry, the government's wider consideration of film tax relief and the recently revised European Cinema Communication guidelines.

## Structure of the document

**1.10** Chapter 2 of this document sets out responses to the request for supporting evidence on the shape of the UK visual effects industry and recent trends.

**1.11** Chapter 3 discusses views on the options to support the industry through tax set out in Chapter 4 of the consultation document.

**1.12** The document also outlines the measures announced at Autumn Statement 2013 to support visual effects and the wider film industry, and sets out next steps.

## Stages of consultation

**1.13** The questions in the consultation document were primarily at stages 1 and 2 of the government's tax consultation framework. The government has now entered stages 3 and 4 of the consultation process.

- **Stage 1:** Setting out objectives and identifying options
- **Stage 2:** Determining the best option and developing a framework for implementation including detailed policy design
- **Stage 3:** Drafting legislation to effect the proposed changes
- **Stage 4:** Implementing and monitoring the change
- **Stage 5:** Reviewing and evaluating the change

## Next steps

**1.14** The measures announced at Autumn Statement 2013 will be introduced from April 2014, subject to state aid clearance. The measures will be included in Finance Bill 2014.

**1.15** Draft Finance Bill legislation was published on 10 December 2013 and is open to technical consultation until 4 February 2014



# 2

## Assessment and supporting evidence

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**2.1** This chapter summarises comments put forward in response to the questions outlined in Chapters 2 and 3 of the consultation document, which considered the criteria that the government would use in evaluating proposals. It also provides a high level summary of the evidence provided and key themes which emerged. It finally, sets out the government’s response to each area.

### Criteria for assessment

**Question 1:** Do you agree with the proposed criteria for assessing options to provide further support for the visual effects industry through the tax system? Please provide any comments as appropriate.

### Consultation responses

**2.2** Respondents who answered this question generally agreed that the proposed criteria were sensible, stating that any support for the visual effects industry should be as simple and straightforward as possible to operate and administer. A number of respondents also emphasised the need for further support to be designed in such a way that it has the confidence of the UK taxpayer, government and the wider UK film industry as a whole. One respondent raised concerns that the industry could become too reliant on tax relief and subsidies and as such any further support should have a limit.

### Government response

**2.3** The government believes that the criteria for assessment set out in Chapter 2 of the consultation document are necessary and appropriate. When evaluating proposals in the consultation and assessing the proposals suggested by respondents the government has continued to assess policy options in light of the following criteria:

- effectiveness;
- affordability;
- being simple and straightforward to administer;
- being sustainable and not open to abuse; and
- compliant with EU state aid rules.

**2.4** The government will continue to ensure these criteria are met when considering comments on the draft legislation and in the implementation and approval process.

## Supporting evidence

**Question 2:** Please provide information on the current size and composition of the UK visual effects industry. For example, information on the total number and size of companies, levels of employment, amounts spent on visual effects annually, estimates of total revenues or GDP contribution, and breakdown of activity by market (film, television, video games, advertisements etc.).

**Question 3:** In what ways are visual effects produced in the UK different to visual effects produced in other countries? Please include details of any aspects of UK visual effects that may be identified as culturally distinct to non-UK visual effects.

**Question 4:** How has the UK visual effects industry performed in recent years, and what have been the main business and wider economic trends? Please provide detailed information or examples, including (but not limited to):

- changes in overall levels of activity and employment within the UK visual effects industry;
- trends in visual effects activity on culturally British films;
- examples of visual effects activity, companies or employment moving overseas, and estimates of the value of this activity; and
- details of British films (particularly large budget films) choosing to spend their visual effects budgets outside the UK.

**Question 5:** What are the three or four main factors that have driven the changes in the visual effects industry that you have identified?

**Question 6:** What impact will these factors have on the UK visual effects industry's ability to contribute to the UK economy and to British culture in the future?

## Consultation responses

### Shape of the UK visual effects industry

**2.5** Many respondents provided their own data or findings from existing published research.

**2.6** Respondents considered that the visual effects industry consists of a wide range of companies, producing extensive content for film, television, video games and for advertisements. The majority of respondents commented that the visual effects industry is comprised of a large number of small companies and five larger companies. The smaller companies tend to work on advertisements and small scale film and television projects and the larger companies work predominantly on larger film and television projects. The proportion of freelance artists was suggested to be lower than the wider creative sector.

**2.7** Industry survey data provided as part of many responses showed that the visual effects workforce is based mostly in London, with the remainder spread across the UK. The majority of the workforce in visual effects work as animators and in art and design, with the remainder working in production and business management. Some estimates suggested that revenue and employment in the visual effects sector is roughly a sixth the size of the core UK film industry.

**2.8** Representations considered that a loss of work and skills in visual effects would impact across all the creative sectors and needs to be addressed. Several respondents commented that

UK visual effects companies have in-house training provision to develop staff skills with one respondent stating that from 2010 to 2012 four of five visual effects employers reported expenditure on training and recruitment of nearly £3 million.

### **Recent trends in the industry**

**2.9** Respondents generally agreed that the UK visual effects industry is internationally competitive when it comes to core skills, creativity and expertise. However, respondents shared concerns that visual effects activity has been moving outside of the UK and Europe, with job losses threatening skills levels at a number of UK visual effects companies.

**2.10** One report submitted to government suggested that between 2008 and 2010 there had generally been an increase in activity and employment and visual effects activity on culturally British films throughout the period. However this has since declined due to visual effects work moving to territories outside of Europe with more favourable tax incentives or lower staff costs.

**2.11** Figures submitted suggested that the UK visual effects industry has seen a 23 per cent decrease in total employment during the last three years. The ability to take the visual effects element of a production to another international territory outside Europe which offers tax credits for visual effects is likely to have a negative impact on employment and skills.

**2.12** Some respondents commented on the challenges that the UK visual effects industry faces as activity, companies and employment move overseas; where international operations see an increase in headcount at the expense of the UK and the rest of Europe; and instances where UK visual effects companies without international operations are reducing in size or closing as a result of the reduction in demand. Whilst there have always been films that have chosen to spend visual effects budgets outside the UK, they suggest this trend appears to be on the rise.

**2.13** The majority of respondents referred to the proliferation of incentives available in non-European jurisdictions as a significant driver of changes to the visual effects industry. There have been instances of large visual effects companies that have set up international operations in order to win work that cannot be won in the UK. Producers of large budget films have also pointed to the range of support provided in different jurisdictions. This together with the portability of visual effects and the current film tax relief which allows for 20 per cent of a film's budget to be spent outside of the UK without a loss in tax relief, has led to more films opting to do their visual effects work outside the UK and Europe.

**2.14** Without further support for the visual effects industry, many respondents felt that visual effects houses will reduce in size and focus growth on other countries which will affect the scale and complexity of work that can be undertaken in the UK. Such a loss in skills and infrastructure is likely to result in a decrease in economic contribution and ultimately fewer British films being made.

**2.15** A minority of respondents raised a concern that further support could exacerbate labour market difficulties in the industry.

### **Trends in film-making and the role of visual effects**

**2.16** Individual case-study data was also provided that demonstrated visual effects spend on mainstream films can be a very significant part of the budget, with this trend being more limited in smaller scale productions.

**2.17** Several respondents identified the increased use of visual effects in films and techniques developed by visual effects practitioners being used in film-making. Wholly digital characters starring in films or mixed-visual effects and live action is becoming more significant.

**2.18** Respondents also cited the creative importance of visual effects in several films, where the status of the visual effects director has increased, working closely with the director and producer. Where previously visual effects were part of the 'post-production' process, respondents showed that they can be used in the 'pre-visualising' process in advance of production and are utilised at every stage of the production process.

## **Government response**

**2.19** The government recognises the role that the skills, creativity and expertise of the visual effects industry has played in the development of British film and the other creative sectors. The government also acknowledges the increasing trend of visual effects activity moving outside the UK and Europe and the negative impact this may have on the sustainable production of culturally British and European films and maintaining a highly skilled and creative hub in the UK.

**2.20** The government notes the increasing importance of visual effects on the creative process and how this has the potential to influence the character, feel and cultural expression within a film production. From the evidence provided it would seem that, at present, the ability of visual effects to have this influence is less prevalent in television and advertising media due to the lower amount of visual effects and digital production expenditure and use.

# 3

## Options for support through tax

**3.1** This chapter summarises comments put forward by interested parties in response to the questions outlined in Chapter 4 of the consultation document, and covers the tax policy options proposed in the document and also sets out respondent's views and the government's response.

**3.2** The consultation document proposed two possible options for providing support through the tax system:

**Option 1:** To offer an enhanced 25 per cent payable credit for large budget films where the vast majority (80 per cent or more) of the film's expenditure on visual effects is qualifying UK expenditure.

**Option 2:** Decreasing the UK minimum expenditure requirement in film tax relief from 25 per cent to 20 per cent.

**Question 7:** Overall, would pursuing either of these proposed options be an effective way to provide further support for the visual effects industry through the tax system?

**Question 8:** What are the likely economic impacts of introducing either of these options?

**Question 9:** How far would these options support or increase visual effects activity on culturally British films or aspects of films?

**Question 10:** What risks or potential unintended consequences, if any, would the proposed options have for the visual effects or other industries?

**Question 11a:** For large budget films, what proportion of the total production budget is typically spent on visual effects?

**Question 11b:** Are you aware of examples of large budget films that do not include any expenditure on visual effects? If so, please provide details.

**Question 12:** What incentive effect do respondents believe the reduction of UK expenditure requirement will have on visual effect expenditure in the UK?

**Question 13:** At what level should the minimum proportion of expenditure on visual effects be to qualify for the relief?

**Question 14:** Should there be a minimum visual effects spend threshold and, if so, at what level?

**Question 15:** Is pursuing option 1 likely to introduce any additional administrative burdens for businesses, particularly the need to separate expenditure on visual effects from the wider film budget? If so, please identify and include any cost estimates where possible.

## Consultation responses

### Policy proposal comments – option 1

**3.3** The majority of respondents suggested that visual effects spend on large budget films varies significantly depending on genre and style of film. Based on averages, typical spend ranges from 40 to 50 per cent of a film's budget.

**3.4** All respondents agreed that whilst the genre and style of a film might lead to a less significant spend on visual effects, every large budget film would have an element of visual effects.

**3.5** The majority of respondents would welcome additional support for the industry. Respondents felt that both options could potentially be an effective way of encouraging visual effects work to remain in the UK, but there was no unanimity of option and both options raised concerns.

**3.6** A number of respondents supported both options, agreeing that they would encourage a higher proportion of film production companies to carry out their visual effects work in the UK, but a large number of respondents stated that the options presented would not be a complete solution to address the difficulties facing the industry.

**3.7** A significant number of respondents felt that the proposed option of offering an enhanced 25 per cent payable credit for large budget films that undertake at least 80 per cent of their visual effects work in the UK could simply transfer the problem of retention to the next most portable part of the film budget, such as studio filming. Taking this into account and the detrimental effect it could have on the wider UK film industry, these respondents did not support option 1. Another respondent felt that option 1 could push production away from the UK to a jurisdiction with a more flexible incentive programme.

**3.8** The majority of respondents believed that option 1 would not introduce any additional administrative burdens for businesses. One respondent, however, suggested that the requirement on companies to set out separate expenditure costs on visual effects for the purpose of claiming any additional tax relief could result in an additional administrative cost.

### Policy proposal comments – option 2

**3.9** The majority of respondents felt that the proposal to reduce the minimum threshold of UK expenditure in film tax relief from 25 to 20 per cent would not have a significant material impact. One respondent expressed concern that there would be no compensating targeted mechanism to ensure that more funding went on UK visual effects expenditure.

**3.10** Some respondents believed option 2 would encourage a greater amount of inward investment and positively support the visual effects industry. Many respondents believed that reducing the minimum spend requirement to 10 per cent would go even further to encouraging more productions to come to the UK. One respondent suggested that a 10 per cent threshold would also increase official co-production with partner countries and Member States of the European Union.

### Other comments

**3.11** Respondents highlighted that even if a project is able to reach the 25 per cent minimum spend threshold, if the majority of work is taking place outside the UK, there is a good chance that the project will not be culturally British. Due to the possible migration of other mobile elements of film production such as studio work, option 1 could see consequential damage to culturally British films. Option 2 was seen to have little effect on culturally British films. Nevertheless, some respondents felt that both options have the potential to support the UK visual effects industry and increase production activity on culturally British films.

**3.12** One respondent highlighted that whilst support for the visual effects industry is welcomed, it could have unintended impacts on other areas such as music recording and audio work at the post-production stage due to the cap of relief on 80 per cent of qualifying UK expenditure for film tax relief. Suggestions were made that all areas of film production should be closely monitored over the next three years.

**3.13** Many respondents also suggested that the visual effects industry should be closely monitored over the next three years to consistently evaluate the levels of activity within the industry to get a better understanding of its performance and factors such as cultural impact, employment and size.

### **Government response**

**3.14** The government believes that film tax relief is an appropriate mechanism to address concerns raised in the consultation but agrees that the two options proposed in Chapter 4 of the consultation document may not be entirely effective at addressing the concerns raised and could lead to negative unintended consequences for the wider film industry.

### **Alternative proposals from consultation**

**Question 16a:** Are there other areas of the relief that could offer a more appropriate way to provide support, for example should the balance of the cultural test be adjusted to allow more weighting to visual effects? Please describe and explain how this would meet the criteria set out in Chapter 2.

**Question 16b:** What alternative proposals could the government consider to further support the visual effects industry? Please describe and explain how this would meet the criteria set out in Chapter 2.

### **Consultation responses**

#### **Alternative proposals**

**3.15** A minority of respondents believed the government should not use tax incentives to further support the industry and one respondent suggested that the industry is already too reliant on tax incentives internationally.

**3.16** Most respondents to the consultation proposed an alternative option to support the industry through the tax system, consisting of:

- an increase in the large budget film tax relief rate from 20 per cent to 25 per cent;
- changes to the cultural test; and
- a reduction in the minimum UK spend requirement from 25 per cent to 10 per cent.

#### **Government response:**

**3.17** The government recognises the case for the alternative option proposed to the consultation and the implications of changes beyond visual effects production of making changes to film tax relief.

**3.18** The changes the government is proposing follow engagement with interested parties and have been assessed against the criteria set out in Chapter 2. They seek to reflect the best

interests of the taxpayer whilst providing longer-term certainty and promoting investment in, and the production of, culturally relevant projects.

**3.19** Alongside the consultation on providing support to the visual effects industry, the government, with the British Film Institute (BFI), has also been working to ensure the modernisation of the Cinema Communication guidelines by the European Commission reflects the issues affecting the film sector. The revised guidelines continue to support the principles of UK film tax relief, and recognise the increased significance of co-production. The changes proposed by government below are consistent with these revised guidelines.

As announced at the Autumn Statement the government will:

- **make relief available at 25 per cent on the first £20 million of qualifying production expenditure and 20 per cent thereafter**, for small and large budget films, subject to state aid clearance. This will make the film tax relief easier to use and more attractive, as well as eradicate the 'cliff edge' between the 20 per cent and 25 per cent schemes;
- **reduce the minimum UK expenditure requirement from 25 per cent to 10 per cent** to encourage further investment in the UK and benefit visual effects and wider industry, helping UK independent production companies by encouraging minority co-productions where the UK spend is less than 25 per cent.
- **modernise the cultural test** – which will be expanded to allow for 'European' as well as 'British' films, in line with other creative content tax reliefs. (The test will also become a 35 point test with a pass mark of 18 and will include an increase in the points available for principal photography/special effects/visual effects and an EEA language) – details can be found in Annex B; and
- **invest £5 million in the National Film and Television School's Digital Village**, to expand and upgrade its existing facility into a world-class training centre to provide a sustainable supply of UK talent for the digital and creative industries.

The tax changes announced will be introduced from April 2014, subject to state aid clearance, and legislated at Finance Bill 2014.

In addition the government **will seek state aid clearance to increase the rate of relief to 25 per cent for all qualifying expenditure when re-notifying film tax relief in 2015**. The forward approach demonstrates the government's continued commitment to the sector and its cultural and economic contribution.



# 4

## Next steps

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**4.1** The measures announced at Autumn Statement 2013 will be introduced from April 2014, subject to state aid clearance. The measures will be included in Finance Bill 2014.

**4.2** Draft Finance Bill legislation was published on 10 December 2013 (and can be found at <https://www.gov.uk/government/collections/finance-bill-2014> where draft Explanatory Notes and Tax Information and Impact Notes are also available) and is open to technical consultation until 4 February 2014.

**4.3** Technical comments on draft legislation should be sent to:

Kerry Pope  
HMRC  
3<sup>rd</sup> Floor, 100 Parliament Street  
London SW1A 2BQ

[Kerry.Pope@hmrc.gsi.gov.uk](mailto:Kerry.Pope@hmrc.gsi.gov.uk)

Tel: 03000 585 740

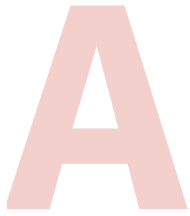
Or

Des Ryan  
HMRC  
3<sup>rd</sup> Floor, 100 Parliament Street  
London SW1A 2BQ

[Des.ryan@hmrc.gsi.gov.uk](mailto:Des.ryan@hmrc.gsi.gov.uk)

Tel: 03000 585 895





# Consultation respondents

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BBC Worldwide

BECTU

Bournemouth Borough Council

British Film Commission

British Film Institute

Chanel 4

Creative Scotland

Creative Skillset

Double Negative

Factory Picture

Film London

Framestore

Lucas Film

MMP Tax

PACT

Planetmirth

PwC

The Production Guild

Saffery Champness

Rocket Pictures

Viacom

A number of individuals



# B Cultural test and golden points rule

## Revised cultural test

**Table B.1: Revised cultural test**

<b>Section A – ‘Cultural Content’</b>		
A1	Set in the EEA	4
A2	Lead Characters EEA citizen or resident	4
A3	Based on EEA subject matter or underlying material	4
A4	Original dialogue mainly in a language of the EEA	6
		<b>Total</b>
		<b>18</b>
<b>Section B – ‘Cultural contribution’</b>		
B	Represents/Reflects a diverse British culture, British heritage or British creativity	4
		<b>Total</b>
		<b>4</b>
<b>Section C – Cultural Hubs</b>		
C1	Studio and/or location shooting/visual effects/special effects <sup>a</sup>	4
C2	Music recording/audio post production/picture post production	1
		<b>Total</b>
		<b>5</b>
<b>Section D – Cultural Practitioners</b>		
D1	Director	1
D2	Scriptwriter	1
D3	Producer	1
D4	Composer	1
D5	Lead actors	1
D6	Majority of cast	1
D7	Key Staff: (lead cinematographer, lead production designer, lead costume designer, lead editor, lead sound designer, lead VFX supervisor, lead hair and makeup supervisor)	1
D8	Majority of crew	1
		<b>Total</b>
		<b>8</b>
		<b>Total points available</b>
		<b>35</b>
		<b>Pass mark</b>
		<b>18</b>
<sup>a</sup> Maximum points awarded would be 4 points. - points can be awarded for principal photography/SFX if 50% or more takes place in the UK, and - for visual effects if 50% or more takes place in the UK. - an extra 2 points can be awarded if 80% or more of either VFX or PP/SFX takes place in the UK.		

## The Golden points rule

### Revised golden points rule

When a film scores 18 or more points in A4, C and D it must have scored:

- 1 at least an additional two points in one of the first two sections of the cultural content category because the film is set in the EEA or because the lead characters are EEA citizens or resident; **or**
- 2 all four points in the third section of the cultural content category because the film is based on EEA subject matter or underlying material.



# Consultation process

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## Consultation principles

**C.1** This consultation is being run in accordance with the government's consultation principles. The consultation principles are available at the following link:

<https://www.gov.uk/government/publications/consultation-principles-guidance>.

**C.2** If you have any comments or complaints about the consultation process please contact: Amy Burgess, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

**C.3** Email: [hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk](mailto:hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk).





## **HM Treasury contacts**

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[www.gov.uk](http://www.gov.uk)

If you require this information in another  
language, format or have general enquiries  
about HM Treasury and its work, contact:

Correspondence Team  
HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 5000

E-mail: [public.enquiries@hm-treasury.gov.uk](mailto:public.enquiries@hm-treasury.gov.uk)

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