HM TREASURY

Creative sector tax reliefs:

response to consultation

December 2012

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Foreword

As announced at Budget 2012, the Government is introducing targeted tax reliefs for the animation, high-end television and video games industries from April next year. These new targeted incentives support the Government's ambition to make the UK the technology centre of Europe.

These reliefs look to build on the success of the film tax relief, which has supported over £5 billion of investment into British films and seen a 70 per cent increase in the film production workforce since its introduction in 2007. It is notable that 2011-12 was a record year for the scheme, with 320 films receiving over £200 million of support.

The Government is keen to foster similar investment into these highly skilled and innovative industries through the new creative sector tax reliefs. With this in mind, the Government conducted a consultation on the design of these new reliefs over the summer. The consultation document published in June emphasised the Government's commitment to introduce reliefs that are among the most generous in the world and set out proposals to design each new relief along the lines of the existing film tax relief.

I am grateful to the large number of interested parties – particularly those from within the relevant industries – who participated in the consultation and submitted detailed and considered responses.

The Government's response to the consultation sets out the key decisions made on the design of these reliefs. I am confident that they will not only provide the necessary support for these industries to continue making a valuable cultural contribution to the UK, but will also promote new economic growth and employment opportunities within the UK.

Responses to the consultation also set out a clear case for the need to support skills development within these creative industries. As announced at the Autumn Statement, the Government will introduce additional support for skills and talent development within the film, television and video games sectors, to come into effect alongside the new creative sector tax reliefs in April 2013.

We have today also published draft legislation to implement these reliefs. Again, I hope all those with an interest in this policy are able to contribute their views to ensure that the legislation introduced is high quality and fit for purpose.

David Gauke

Exchequer Secretary

1 Introduction

1.1 The Government announced at Budget 2012 that it would introduce corporation tax reliefs for the animation, high-end television and video games industries. A consultation on the design of the new reliefs – *Consultation on creative sector tax reliefs* – was published on 18 June and closed on 10 September.

1.2 The aim of this document is to summarise views received during the consultation (from individuals, companies, representative and other bodies) and to set out the Government response. This document also reflects the views expressed through the industry-focussed working groups that convened to discuss the design of each new relief. The Government is grateful to all those who contributed to the consultation process.

Policy aims

1.3 The animation, high-end television and video games industries make a significant economic and cultural contribution to the UK. The Government is introducing these targeted tax incentives with the aim of supporting strong and sustainable private-sector led growth within these industries to ensure the continued production of these valuable cultural products in the UK.

1.4 Operating within the Government's wider growth and tax agendas, and building on the successful film tax relief (FTR) model, the policy aims of these new reliefs are:

- to promote the sustainable production of culturally relevant productions in the UK through a tax relief that provides support directly to producers;
- to incentivise investment into UK productions that would otherwise take place outside the UK or that would not be economical without relief; and
- to create the necessary critical mass of infrastructure and skills to enable and support production in the UK both today and in the longer term.

Scope of the response

1.5 Chapter 2 summarises the key proposals and comments put forward by interested parties in response to the questions outlined in the June consultation document, together with the Government response.

1.6 Chapter 2 also sets out the Government's decision on what rates of relief to apply to each new relief.

1.7 The proposals set out in this document are at stage 3 (drafting legislation to effect the proposed change) of the Government's approach to tax policy making. The consultation document was at stages 1 and 2.

Next steps

1.8 Draft legislation will be published for consultation on 11 December. This consultation will close on 6 February 2013. Following this the Government will include final legislation in Finance Bill 2013, which will then be subject to parliamentary scrutiny.

1.9 Like the FTR, the creative sector tax reliefs will need State aid approval from the European Commission (EC) on the basis that they will address an identifiable cultural market failure. The Government is currently in the process of notifying the schemes with the EC and will provide an update to interested parties when it is appropriate to do so in the New Year. The final design and implementation of the new tax reliefs is subject to confirmation with the EC.

1.10 In order to qualify for tax relief it is expected that productions will need to qualify as culturally British via a cultural test. A Department for Culture, Media and Sport (DCMS) consultation on the design of the cultural tests for each new relief opened on 1 October and closed on 29 October. Guidance on the cultural tests will be provided in due course.

2 Summary of responses

Introduction

2.1 The Government received 56 responses to the consultation. These included responses (including several joint responses) from SME and large production companies, legal and financial advisers, local and regional governments and representative bodies. A list of respondent organisations is provided in Annex A, along with a list of the members of the three industry-focussed working groups.

2.2 All respondents to the consultation welcomed the introduction of the new creative sector tax reliefs, stating that the reliefs would support greater UK competitiveness, enable more production within these sectors and encourage overseas production to return to the UK. Several respondents made reference to the positive impact that the reliefs could have in supporting greater investment both within the UK and from overseas into these industries, resulting in higher levels of economic growth and job creation. Others also referenced the significant cultural opportunity that the reliefs present.

2.3 Several respondents referred to the potential for the reliefs to foster greater skills and infrastructure development within these industries, although concerns were also raised that greater levels of production could result – at least in the short term – in greater demands on available skills and infrastructure.

Summary of key decisions on design

2.4 The Government is committed to introducing effective tax reliefs for the animation, high-end television and video games sectors to ensure they are among the most generous available in the world. It therefore intends to adopt the following key design features for all three reliefs:

- Applying generous rates of relief: Production companies in all three industries will be able to claim an additional deduction worth 100 per cent of UK qualifying production expenditure and, where this results in a loss, they will be able to surrender such losses for **a payable tax credit worth 25 per cent of UK qualifying production expenditure**.
- Adopting the film tax relief model: **Each new relief will be modelled on the existing film tax relief** and adapted as necessary to meet the relevant characteristics of each industry.

Questions relevant to all three sectors

2.5 This section provides the Government's response to views expressed on questions relevant to all three tax reliefs, including how to evaluate design proposals and the Government's proposal to adopt the film tax relief model for all three new reliefs.

2.6 The criteria that the Government proposed to use in evaluating proposals for the creative industries tax reliefs are included in the box below.

Box 2.A: Criteria for the creative sector tax reliefs[1]

- Effectiveness
- Affordability
- Simple and straightforward to administer
- Sustainable and not open to abuse
- Compliance with EU State aid rules

Question 1: Do you agree with the proposed criteria for assessing the animation, high-end television and video games tax reliefs? Please provide any comments as appropriate.

2.7 Respondents who answered this question were generally in agreement that the criteria chosen to assess the new reliefs were sensible, though a number also emphasised the need to design the reliefs in a way that ensures they are attractive and competitive when compared with other incentives available internationally.

Using the film tax relief model

2.8 The consultation document asked a number of questions relating to its proposal to use the film tax relief as the basis for designing each new relief. This section summarises the responses received on these questions and sets out the Government's response.

Question 2, 15 and 26: Would adopting a similar model to the film tax relief be an effective way of meeting the Government's objective to support animation/high-end television/video games production?

Question 3, 15 and 26: What alternative models for an animation/high-end television/video games tax relief could the Government consider? Please describe and explain how this would better meet the criteria in Chapter 2.

Question 13, 24 and 38: Does the requirement that each production operates as a separate trade within the production company – with a separate, identifiable production budget – create any issues?

Question 27: Would adopting one of these models be more appropriate than the proposed model to design a video games tax relief? Please describe and explain how this would better meet the criteria in Chapter 2.

Question 28: What alternative models for a video games tax relief could the Government consider? Please describe and explain how this would better meet the criteria in Chapter 2.

2.9 In general, respondents welcomed the Government's proposal to use the FTR model as the basis for designing the new reliefs, although across the three industries respondents also emphasised the need to adapt the model to their particular working practices.

[1] Further detail on these design criteria is contained in the consultation document, available at: http://www.hm-treasury.gov.uk/consult_creative_sector_tax_reliefs.htm.

2.10 Support for using the FTR model was less clear-cut in the responses relating to the video games industry compared with the animation and high-end television industries. Concerns were raised that model was less appropriate for the way video games tend to be developed, especially where significant amounts of development expenditure takes place after the release of the video game. Nevertheless, the majority of respondents to questions 26, 27 and 28 – including the two representative bodies for video games developers – endorsed the Government's proposals to use the FTR model for the video games tax relief. They did so on the basis that having a consistent model across the creative sector tax reliefs would make implementation and administration more straightforward and that the FTR model appears to have the necessary flexibility to be adapted to the way all parts of the video games industry operate.

2.11 In addition, a small number of respondents asked for the design of the reliefs to be monitored and reviewed after an appropriate period. Specifically, a few of these respondents also asked that the Government consider making the relief 'Above the Line' to support multinational companies.

2.12 The consultation set out a proposal to use the concept of separate trades – whereby the profits and losses of each separate production within a company are calculated separately – in the design of each new relief. Nearly all respondents felt that a requirement that each production has a separate, identifiable budget would not create issues for companies using the reliefs. Most felt that it was already standard practice to do so and, particularly in the case of high-end television, the use of a single purpose vehicle for larger productions would mean this requirement would be met in any case. Some respondents commented that the accountancy requirements of the reliefs should be kept as straightforward as possible in order to ensure the administrative burdens on smaller producers are kept to a minimum.

Government response

2.13 In light of consultation responses **the Government has concluded that the FTR model – including its requirement that each qualifying production operates as a separate trade – offers an appropriate basis on which to design the tax reliefs for the animation, high-end television and video games sectors**. The Government commits to monitor the uptake and operation of the new reliefs once they come into force to ensure their effectiveness.

2.14 In particular, the Government believes that the FTR model has sufficient flexibility to be applied to all sections of the video games industry. The Government considered alternative options, but has concluded that any alternative would be likely to require a similar process to be undertaken by businesses (i.e. companies would need to track and record development expenditure linked to specific projects). On balance the Government believes the FTR model will benefit more companies, ensure consistency across the reliefs and provide the certainty of a payable tax credit.

Animation

2.15 This section covers the Government's response to the consultation questions specific to the design of the animation television tax relief. These include how the Government intends to define animation (including relevant exclusions), the treatment of co-productions and which 'core production costs' will be eligible for relief.

Defining animation

2.16 The consultation document proposed to define animation as '*a sequence of images in 2 or 3 dimensions created by recording still images or objects, one frame at a time with incremental changes in position, form or appearance between frames to create the impression of movement*'. It also proposed to limit relief to productions that are 'intended for broadcast' and to specifically exclude certain categories such as animation produced for advertising purposes, news or weather, or for games shows.

Question 4: Would adopting a definition of animation on this basis exclude any content that might reasonably be included?

Question 5: Is there an alternative definition of animation that would more accurately reflect the nature of the content being produced? If so, please provide one.

Question 6: What would be an appropriate way of removing animated programmes which are pornographic in content? For example, is there an appropriate classification used in the industry that could be adopted?

2.17 Respondents to these questions broadly agreed with the definition proposed in the consultation document, though alternative definitions and adaptations to the original definition were provided. Several respondents highlighted the need to ensure that the definition included all methods of animating programmes, including computer generated animation and motion capture sequences. One respondent noted that the Film Act 1985 includes a similar definition.

2.18 A small number of respondents raised concerns that the 'intended for broadcast' requirement could act as a constraint on the ongoing development of the industry, emphasising the need to allow forms of broadcast other than television to be included within this definition. A minority felt that the definition should be broadened to include animation for advertising and other purposes.

2.19 On the issue of excluding pornographic content, all respondents to this question were supportive of the aim to exclude pornographic content from the relief. Several respondents pointed out that television programming is covered by the Ofcom Broadcasting Code. Others identified a range of options to exclude pornographic content, including imposing a classification regime similar to that operated for films by the British Board of Film Classification or allowing producers to self-certify that the production contains no pornographic content.

Government response

2.20 Having considered the responses **the Government has concluded that it will be sufficient to allow 'animation' to take its ordinary meaning in legislation**. The Government believes this approach represents the most straightforward way of defining animation that will effectively target the relief on all forms of animation (including computer generated and motion capture animation).

2.21 In addition, the Government will introduce the proposed requirement that programmes are 'intended for broadcast', which is consistent with the 'intended for theatrical release' used under the film tax relief, and exclude specific categories – including advertisements or other promotional programme; news, current affairs or discussion programmes; competitions; and training programmes – to ensure the effective targeting and positive economic and cultural impact of the relief.

2.22 On the issue of excluding pornographic content, **the Government is satisfied that the existing media regulatory safeguards mean that additional measures to specifically exclude pornographic content are not necessary**.

Mixed content productions

2.23 The consultation document set out a proposal to allow productions where the costs of animation make up 75 per cent or more of the total production costs to be classed as animation productions for the purposes of the relief.

> **Question 7:** Are there alternative approaches to determine whether a mixed content production should be treated as an animated production for the purposes of this relief that the Government should consider? Please describe and explain how this would better meet the criteria in Chapter 2.

2.24 All respondents to this question supported the Government's proposal to allow some mixed content programmes to qualify as animated programmes for the purpose of the relief. However, the majority of respondents felt that the proposed 75 per cent threshold was too high, with very few mixed content productions made with expenditure on animation accounting for 75 per cent or more of the total production costs. Several respondents proposed that the threshold should be lowered, with the consensus that 51 per cent would be more appropriate.

Government response

2.25 In light of the considered views and evidence presented by respondents and by industry, the Government agrees that the proposed 75 per cent threshold is unlikely to be sufficiently effective in promoting the production of mixed content animated programmes. **The Government will therefore lower the threshold to allow productions where animation makes up 51 per cent or more of the total production costs to be classified as animation productions for the purpose of the relief**.

Co-productions

2.26 Respondents to this question identified some specific examples where two or more companies were involved in the production of an animation programme or series. However, it appears that for many of these productions the driving force behind the formation of the co-production was to access incentives available overseas. In addition, it was not always clear that respondents were referring to genuine co-production cases (i.e. where two companies are directly involved in actually producing animated content for a single production) or were referring to co-financing relationships (where one or more companies provides financing, but does not produce any animated content).

Government response

2.27 As under the film tax relief, the Government intends that all co-productions made under an internationally agreed co-production treaty will be eligible for relief. The Government does not intend to legislate for other forms of co-production to be eligible for relief as doing so risks introducing complexity and opening the relief to abuse without significantly increasing its overall effectiveness in terms of economic and cultural impacts. The Government is aware that companies looking to undertake genuine co-productions may look to structure their business relationships in order to access the relief.

Identifying core production costs

Question 9: Which costs are integral to the production process itself and should therefore be eligible for relief? Please explain your choices.

Question 10: Are the core production costs in animation similar to those in film? If not, please explain how the animation industry differs.

Question 11: Are one or both of the proposed rules for separating speculative expenditure from early stage expenditure on a project with an identifiable end product workable?

Question 12: Is there an alternative rule that would be simpler or more effective to ensure that speculative expenditure does not qualify for relief?

2.28 Respondents commented that the production process for animation was broadly similar to that of film, constituting development, pre-production, production and post-production stages. However, most respondents also felt that a higher proportion of the total production costs fell earlier on in the production process for animation than for film productions. Several respondents also made the point that production expenditure in animation is typically lower than for films.

2.29 In addition, respondents emphasised that certain production costs of animation (e.g. costs of directors, scriptwriting and music composition) are similar to film, but other expenditure is different or more prominent for animation (e.g. costs of art directors, animators and recording studios). Respondents typically agreed with the Government's aim to support the direct costs of production, although a small number of respondents argued that the costs of financing should be eligible for relief.

2.30 Respondents also confirmed the Government's view that significant proportion of the costs of producing an animated programme can be early stage. Respondents generally accepted the need for a rule to distinguish between speculative and other early stage costs. However, respondents were split on the best approach to achieving this. Most, including a number of larger producers, advocated allowing all early stage costs of a production to be eligible for relief once the production is formally accepted or commissioned by a broadcaster. In contrast, a small number of respondents argued that not all animation productions are commissioned by a broadcaster and that a more flexible option should be introduced that does not rely on a production being commissioned by a broadcaster. Several respondents also highlighted the need for pilots to be eligible for relief.

Government response

2.31 Consistent with the proposals set out in the consultation document, **the Government will allow all direct production expenditure to be eligible for relief in line with the existing treatment available under the film tax relief** (under which animated films are also able to claim relief). The Government believes this is consistent with its aims to introduce effective, sustainable reliefs that are not open to abuse.

2.32 The Government accepts the need to ensure the effectiveness of the animation tax relief by allowing early stage costs that are integral to the production process to be eligible for relief. Provided that a programme passes the cultural test and is intended for broadcast, production expenditure (including early stage costs) on programmes such as pilots will be eligible for relief. Detailed information on the administration and operation of the tax relief will be included in guidance to be provided in due course by HMRC.

Other design points

> **Question 14:** Are there any other specific design points which need to be addressed?

2.33 Respondents to this question raised a number of different points. In many cases these related to issues covered by other specific questions in the consultation. For example, several respondents emphasised that any requirement for productions to be 'intended for broadcast' should not be limited to traditional broadcasters or raised the issue of Government support for industry skills.

2.34 Respondents also made general points about the need for a simple and effective relief that meets the need of animation companies – including the need to introduce generous rates of relief. A number of respondents also provided points on the design of cultural test, which has been consulted on separately by DCMS.

Government response

2.35 The Government's response to a number of points made – e.g. on the 'intended for broadcast' requirement and on the need for sector-specific skills support – are covered elsewhere in this consultation response. In addition, a number of responses to this question raised issues outside the scope of this consultation, such as what rates of relief to apply and views on the design of the cultural tests. The Government notes the points made and, where relevant, has considered them in the context of other work relating to the creative sector tax reliefs (e.g. comments on the design of the cultural test were passed to DCMS). Detailed information on the administration and operation of the tax relief will be included in guidance to be provided in due course by HM Revenue & Customs (HMRC).

High-end television tax relief

2.36 This section covers the Government's response to the consultation questions specific to the design of the high-end television tax relief. These include how the Government intends to define high-end television (including relevant exclusions), the treatment of co-productions and which 'core production costs' will be eligible for relief.

Defining high-end television

2.37 The consultation document proposed to target the high-end television tax relief on drama and comedy productions intended for broadcast with a per hour of programme running time expenditure of £1 million of more – excluding programmes with a running time below 30 minutes and excluding specific genres (including advertising, discussion programmes, news or current affairs programmes, quiz or panel shows, and training purposes).

> **Question 17:** Does this definition of an average expenditure of £1 million per hour of running time create any issues in terms of monitoring and reporting?
>
> **Question 18:** Do you agree that the production expenditure that qualifies towards the £1 million per hour threshold should only relate to direct production costs? If not, what types of expenditure should also qualify towards the £1 million threshold? Please justify your choices.

2.38 Respondents to these questions covered a number of points about the definition of high-end television that will be considered here. Overall respondents to these questions largely agreed with the proposed definition. A small number of respondents felt that the £1 million per programme hour threshold was set too high. In particular, two respondents argued that incentivising this type of production would be unlikely to benefit regions other than London and the South East. A small minority also felt that programmes with running times below 30 minutes should be eligible for relief on the basis that some significant activity takes place at this level. Several respondents also called for documentaries to be explicitly included within the scope of the relief alongside drama and comedy programmes.

2.39 The majority of respondents also raised the issue of how to define a 'programme hour', with some agreeing with the Government's proposal to use a 'running time' definition (i.e. the running time excluding commercial breaks). However, most respondents agreed that using 'slot time' (i.e. the 'slot' into which a programme is commissioned) would be preferable on the basis that it fits more closely with industry working practices.

2.40 On the question of which costs should qualify towards the £1 million threshold, respondents generally agreed with the Government's proposal to limit this to direct production expenditure (i.e. excluding indirect expenditure on raising and servicing of finance, advertising and marketing costs and income received through grants or other public subsidies). Several respondents felt that production fees paid to producers by commissioning bodies should qualify for the £1 million threshold, although some also emphasised the need to limit this to avoid abuse.

Government response

2.41 As the consultation document set out, the Government's aim is to introduce a high-end television tax relief to support high-end television production in a way that is straightforward for business and that represents good value for money for the taxpayer. The Government will therefore define the relief as set out in paragraph 2.37. However, having considered the responses received, the **Government has decided to define a 'programme hour' on the basis of slot time instead of running time** (and therefore to exclude programmes made to a 30 minute slot rather than programmes with less than 30 minutes running time). The Government believes this position is consistent with the general consensus within the sector whilst meeting its criteria to design a relief that is effective, affordable and simple to administer.

2.42 On the basis of views and evidence received, the **Government will also allow high-end documentaries to be eligible for relief** where they meet the remaining qualifying criteria of the high-end television tax relief. The Government believes that including documentaries will open the relief to a number of culturally and economically significant productions that would otherwise not be made in the UK.

2.43 To ensure a relief that is sustainable and not open to abuse, the Government will limit the £1 million threshold to costs incurred directly on production. The Government will, however, consider how to legislate to allow a production fee of no more than 10 per cent of the pre-production budget to count towards the threshold.

Co-productions

Question 19: Please provide examples and relevant details of co-productions that currently take place to produce high-end television programmes.

2.44 Respondents to this question identified several specific examples where two or more companies were involved in the production of a high-end television production, in many cases to access incentives available overseas. In particular, several respondents to this question identified situations where international co-productions take place and called for additional international co-production treaties to be introduced.

2.45 Nevertheless, it was not always clear that respondents were referring to genuine co-production cases (i.e. where two companies are directly involved in actually producing high-end content for a single production) or were referring to co-financing relationships (where one or more companies provides financing, but does not produce any content).

Government response

2.46 As under the film tax relief, the Government intends that all co-productions made under an internationally agreed co-production treaty will be eligible for relief. The Government does not intend to legislate for other forms of co-production to be eligible for relief as doing so risks introducing complexity and opening the relief to abuse without significantly increasing its overall effectiveness in terms of economic and cultural impacts. Nevertheless, the Government is aware that companies looking to undertake genuine co-productions may look to structure their business relationships in order to access the relief.

2.47 The issue of introducing new internationally agreed co-production treaties is outside the scope of this consultation. The Government will continue to look to develop new co-production opportunities for film and television, in line with relevant strategic priorities.

Identifying core production costs

Question 20: Which costs are integral to the production process itself and should therefore be eligible for relief? Please explain your choices.

Question 21: Are the core production costs in high-end television similar to those in film? If not, please explain how the high-end television industry differs.

Question 22: Are one or both of the proposed rules for separating speculative expenditure from early stage expenditure on a project with an identifiable end product workable?

Question 23: Is there an alternative rule that would be simpler or more effective to ensure that speculative expenditure does not qualify for relief?

2.48 Respondents commented that the production process for high-end television is similar to film, broadly constituting development, pre-production, production and post-production stages. Respondents emphasised the need for all direct expenditure on production to be eligible for relief for to ensure its effectiveness.

2.49 The majority of respondents to these questions noted that high-end television productions costs are likely to include a higher proportion of in-house costs than for films (e.g. of in-house lawyers, script editors, administration etc.). In addition, a small number of respondents also made the point that a higher proportion of costs were likely to fall at an earlier stage than for film productions.

2.50 Respondents generally accepted the need for a rule to distinguish between speculative and other early stage costs. However, respondents were split on the best approach to achieving this with some advocating the proposed approach where all early stage costs become eligible for relief once the production is formally commissioned and others advocating alternatives on the basis that the first approach relies too strongly on broadcasters as part of the process. There was, nevertheless, a general consensus that high-end television differs from film in the fact that high-end television producers often make a pilot before committing to produce longer series, which should be reflected in the design of the relief to ensure its effectiveness and long-term sustainability.

Government response

2.51 Consistent with the proposals set out in the consultation document, **the Government will allow all direct production expenditure to be eligible for relief in line with the existing treatment available under the film tax relief**. The Government believes this is consistent with its aims to introduce effective, sustainable reliefs that are not open to abuse.

2.52 The Government accepts the need to support the effectiveness of the high-end television relief by allowing early stage costs that are integral to the production process to be eligible for relief. Provided that a programme passes the cultural test and is intended for broadcast, production expenditure (including such early stage costs) on programmes such as pilots will be eligible for relief. Detailed information on the administration and operation of the tax relief will be included in guidance to be provided in due course by HMRC.

Other design points

Question 25: Are there any other specific design points which need to be addressed?

2.53 Respondents to this question raised a number of different points. In many cases these related to issues covered by other specific questions in the consultation. For example, several respondents raised the issue of Government support for sector skills.

2.54 Respondents also made general points about the need for a simple and effective relief that meets the need of high-end television companies – including the need to introduce generous rates of relief. A number of respondents also provided points on the design of cultural test, which has been consulted on separately by DCMS.

Government response

2.55 The Government's responses to a number of points – e.g. on the need for sector-specific skills support – are covered elsewhere in this consultation response. In addition, a number of responses to this question raised issues outside the scope of this consultation, such as what rates of relief to apply and views on the design of the cultural tests. The Government notes the points made and, where relevant, has considered them in the context of other work relating to the creative sector tax reliefs (e.g. comments on the design of the cultural test were passed to DCMS). Detailed information on the administration and operation of the tax relief will be included in guidance to be provided in due course by HM Revenue & Customs.

Video games

2.56 This section covers the Government's response to the consultation questions specific to the design of the video games tax relief. These include how the Government intends to define video games (including relevant exclusions), which 'core production costs' will be eligible for relief and whether to apply a minimum spend threshold.

Defining video games

2.57 The consultation document asked for comments on defining a video game according to the definition used under the French tax incentive[2]. It also proposed to limit relief to video games 'intended for commercial release' and to exclude games made with the primary purpose of advertising or gambling.

> **Question 29:** Would adopting a similar definition of a video game exclude any content that might reasonably be included?
>
> **Question 30:** Is there an alternative definition of a video game that would more accurately reflect the nature of the content being produced? If so, please provide one.
>
> **Question 31:** Would a workable solution be to require games to be classified in order to qualify for the tax relief and for BBFC R18[3] games to be specifically excluded from the scheme? If not, what other solutions would you propose to exclude pornographic products from relief?

2.58 Respondents generally felt that the proposed definition might be workable, but as currently drafted would most likely to be too restrictive and not necessarily reflective of the way the sector has developed in recent years (for example, several respondents commented that CD-ROMs are now a largely obsolete technology). Several respondents provided alternative definitions or proposed changes to the definition set out in the consultation document.

2.59 Whilst most respondents on this point agreed that games with a primary purpose of gambling should be excluded from the relief, a small number of respondents felt that games made for the purposes of advertising or that contain advertisements and product placement should be eligible for relief.

2.60 The consultation document also set out the Government's aim to exclude games which are pornographic or contain material that would be refused an age rating certificate and asked for views on how this could be administered. Respondents to this question all agreed that pornographic and extremely violent content should be excluded from the relief. However, respondents were also unanimous that the Government should not be imposing a requirement that video games must gain an official age rating in order to qualify for relief on the basis that doing so would introduce significant burdens on smaller companies. Respondents generally felt that a self-certification process would be sufficient to address what was felt to be a relatively low risk of pornographic or other extreme material receiving tax relief.

Government response

2.61 The Government is grateful to respondents for providing alternative definitions of a video game. Having considered the responses received, **the Government has concluded that that it will be sufficient to allow a 'video game' to take its ordinary meaning in legislation**. The Government believes this approach represents a straightforward approach to defining a video game in a way that does not limit the relief to particular parts of the sector.

2.62 In addition, the Government will introduce the proposed requirement that products are 'intended for commercial release'. This is aimed at ensuring that the relief is targeted at

[2] 'Leisure software made available to the public on a physical medium or online and incorporating elements of artistic and technological creation; the latter cover not only PC and console video games but also mobile games, on-line games for one or more players, educational or edutainment software and, provided that they incorporate sufficient interactivity and creativity, cultural CD-ROMs'.

[3] BBFC R18 classifications are for products that can only be supplied in licensed sex shops.

commercial developers and provides consistency with the 'intended for theatrical release' used under the film tax relief. The Government will also exclude games made with a primary purpose of advertising and gambling to support the targeting of the relief on culturally British video games in line with EU State aid rules, but will allow games with some product placement or in-game advertising to be eligible for relief. Further details on the operation of these design characteristics will be provided in guidance

2.63 **On the issue of excluding pornographic and other extreme material, the Government agrees with the industry consensus that companies applying for the relief should not be required to have received an age rating** from a designated ratings body as this would not meet the criteria to keep the relief simple for businesses to use and there may be practical problems given that age classification certificates are only formally issued to finished products[4]. Instead, the Government will include a requirement that companies must self-certify during the application process that a game does not contain pornographic or other extreme material.

Identifying core production costs

2.64 The consultation document set out the Government's intention to limit relief to the direct costs of development, excluding the costs of financing, marketing etc. and netting off other public grants and subsidies.

Question 32: Does this proposed definition capture the appropriate integral costs of producing a video game? If not, please explain why.

Question 33: Are the core production costs in video games similar to those in film? If not, please explain how the video games industry differs.

Question 34: Are one or both of the proposed rules for separating speculative expenditure from early stage expenditure on a project with an identifiable end product workable?

Question 35: Is there an alternative rule that would be simpler or more effective to ensure that speculative expenditure does not qualify for relief?

Question 36: Does the proposed approach to debugging and maintenance costs ensure that the costs integral to the production of a video game can qualify for relief? Please explain your view.

Question 37: Does the flexibility offered by the FTR model, that allows further relief for qualifying costs after the product has been completed, provide sufficient scope to accommodate costs that arise in both the video games' business models?

2.65 Respondents to these questions generally agreed with the Government's intention to limit relief to the direct costs of development. Many respondents did, however, make the point that the integral costs of production and the production process itself are different for the video games sector compared with the film sector.

2.66 In particular, respondents felt that while film productions are generally made up of development, pre-production, production and post-production stages, this is not the same for video games. Several respondents provided useful explanations of typical production processes for video games, though it was apparent that there is no industry consensus on this point. It was also noted that unlike films it is possible for a significant amount, potentially the majority,

[4] It is noted that many games will, in any case, apply for age ratings and games that are unsuitable for younger children must obtain PEGI 12, 16 or 18 (or BBFC R18) age ratings before they can be legally marketed as physical products in the UK.

of production costs to take place after the video game has been released publically. Finally, respondents also felt that video games development costs are likely to include a higher proportion of in-house costs than for films, with one respondent noting that it is possible for a single company to commit to develop an entire game without any external input.

2.67 On the Government's proposals to separate speculative expenditure from early stage development expenditure, the majority of respondents felt that any requirement that a game had to be commissioned by a publisher before early stage costs became eligible for relief would be too restrictive and not reflect the fact that increasingly developers are self-publishing games. The alternative proposal in the consultation document – that only costs incurred in producing a video game with the potential to be approved for commercial release to be eligible for relief – received support from a minority of respondents, but was generally seen as too subjective. In both cases it was felt that any rule should provide as much certainty to users as possible. One respondent put forward a proposal that only early stage costs once a company 'has begun coding to create a playable game' should be eligible for relief.

2.68 A number of respondents raised concerns in regards to the Government's proposals to exclude certain costs of debugging and maintenance. Many responses argued that debugging forms an essential part of the video games development process and should be eligible for relief whether it occurs before or after the release of a game. Respondents did, however, tend to agree that the costs of service maintenance (e.g. of maintaining servers or monitoring usage) should not be eligible for relief as they are not integral to the development of the game itself.

2.69 The consultation document also asked respondents for their views on whether the FTR model's treatment of post-release costs is sufficiently flexible, particularly for video games where significant development costs fall post-release of a game. Respondents to this question typically emphasised the importance of post-release costs, for example of developing new levels or add-ons to a game, but generally felt that the FTR model would be sufficiently flexible to enable this.

Government response

2.70 Consistent with the proposals set out in the consultation document, **the Government will allow all direct production expenditure to be eligible for relief in line with the existing treatment available under the film tax relief**. The Government believes this is consistent with its aims to introduce effective, sustainable reliefs that are not open to abuse.

2.71 The Government accepts the need to ensure the effectiveness of the video games tax relief by allowing early stage costs that are integral to the production process to be eligible for relief. The Government believes that early stage expenditure incurred should be eligible for relief once a commercial decision to develop a complete game has been made. HMRC will provide guidance on the application of this principle in due course.

2.72 In light of consultation responses received, **the Government intends to allow all direct development expenditure (including relevant quality assurance) incurred after the release of a qualifying game to be eligible for relief**, but to exclude all service maintenance costs. This will ensure the effectiveness of the relief in supporting the entire production process.

Minimum spend threshold

2.73 The consultation set out the Government's intention to consider whether a minimum spend threshold would be necessary to ensure that the relief targets genuine commercial activity.

Question 39: Should there be a minimum spend threshold and if so at what level?

2.74 Respondents generally opposed introducing a minimum threshold on the basis that doing so would introduce uncertainty for companies over their eligibility (especially if development expenditure is spread over more than one year) and on the basis that doing so could exclude a potentially significant number of economically and culturally significant games.

Government response

2.75 **The Government agrees not to introduce a minimum spend threshold** in order to keep the relief as simple as possible for users. It considers that existing design characteristics of the relief (for example the requirements that applicants must be companies and the need to pass a cultural test) represent sufficient obstacles to non-commercial games accessing the relief.

Other design points

Question 40: Are there any other specific design points which need to be addressed?

2.76 Respondents to this question raised a number of different points relating to issues covered by other specific questions in the consultation or issues outside the scope of the consultation (for example, on what rates of relief to apply and points on the design of cultural test that has been consulted on separately by DCMS).

Government response

2.77 The Government's responses to a number of points are covered elsewhere in this consultation response. In addition, a number of responses to this question raised issues outside the scope of this consultation, such as what rates of relief to apply and views on the design of the cultural tests. The Government notes the points made and, where relevant, has considered them in the context of other work relating to the creative sector tax reliefs (e.g. comments on the design of the cultural test were passed to DCMS). Detailed information on the administration and operation of the tax relief will be included in guidance to be provided in due course by HM Revenue & Customs.

Other issues

2.78 This section covers the Government's response to the 'Other issues' chapter of the consultation document, which included questions relevant to all three sectors. These include questions on the proposed claims process, the treatment of unpaid costs, anti-abuse measures and a question on supporting skills development.

Claims process

Question 41: Are there any issues for the animation, high-end television and video games industries in applying the same process to make claims under the new tax reliefs?

2.79 The majority of the responses found that the current claims system for film tax relief was straightforward and appropriate, although some respondents felt that they should be able to make claims at an earlier point in the cycle for cash flow purposes. Most responses emphasised clarity and certainty was required to streamline the claims procedure and wanted guidance available for what could be claimed as core expenditure.

Government response

2.80 **The Government intends to set up arrangements for HMRC to administer the new creative sector tax reliefs in line with the current administration of the film tax relief**. HMRC intends to publish comprehensive guidance on the new regime in 2013 and will, with DCMS, embark on a programme to educate taxpayers and explain the new creative industry tax reliefs to both large and small businesses. The Government believes that guidance and a programme of education will enable the majority of customers to confidently self-assess their claims for relief.

Treatment of unpaid costs

2.81 The consultation document proposed that any amount of costs incurred but unpaid within four months of the end of a period of account will not qualify for the tax relief.

> **Question 42:** Do respondents think that this is an acceptable time scale to exclude unpaid costs?

2.82 Although there were some calls for a longer time period most responses agreed that the proposed time scale was acceptable provided that genuine production costs paid outside this limit were eligible for claims in later accounting periods

Government response

2.83 **On this point the Government proposes to keep the rule consistent with the film tax relief**. Any costs paid outside this period will be eligible for claims if paid in later accounting periods.

> **Question 43:** Can respondents suggest ways to prevent abuse of the new tax reliefs to ensure that they remain effective? Are there specific areas in addition to those mentioned above?

Anti-abuse measures

2.84 Most responses agreed that the reliefs needed to be sustainable and not open to abuse. It was noted in most responses to this question that the introduction of the new film tax relief in 2007, on which the creative industry tax reliefs are based, has not resulted in abuse on the basis that it is well targeted. There were some suggestions that a targeted anti-abuse rule might be helpful but that this should be not be at the cost of overcomplicating the creative sector tax reliefs regime.

Government response

2.85 The Government considers that effective anti-avoidance rules are critical to the long term success and stability of the creative industry regimes. **The Government will include rules similar to those applied under the film tax relief to prevent artificial inflation of claims**. HMRC will continue to monitor for abuse once the regime has been introduced.

Skills and talent

Question 44: What systems and measures could be developed or enhanced to ensure that the animation, high-end television, and video game industries have a world class skills and talent base capable of supporting the growth that the new measures will be designed to support?

2.86 Many respondents to this question raised concerns that the new tax reliefs would produce or exacerbate a skills shortage within the relevant industries. Respondents typically made reference to the existing Skills Investment Fund (made up of voluntary contributions from film productions either based in the UK or in receipt of UK public funding and administered by Creative Skillset) as a model that could be extended to the new creative sector tax reliefs. Some respondents put forward alternative proposals, including attaching requirements that companies invest in skills or training in order to be eligible for relief. Whilst some respondents felt that the Government should contribute financing to any skills initiative, others felt that it was best left to market forces.

Government response

2.87 Responses to the consultation set out a clear case for supporting further skills development within these creative industries. The Chancellor therefore announced at the Autumn Statement that the Government will match fund voluntary industry contributions of up to £6 million over the next two years into the existing Skills Investment Fund administered by Creative Skillset, expanding its scope to include support for skills provision in the film, television, animation and video games sectors.

A List of respondents and working group members

Respondent organisations

A Productions Ltd
Aardman Animations
Abertay University
Adastra Creative
Aiglon Consulting
Animation UK
British Broadcasting Corporation
British Film Commission
British Film Institute
British Screen Advisory Council
BSkyB
Burnside Chartered Accountants
Confederation of British Industry
Channel 4
CharacterShop
Cornwall Arts Centre Trust
Creative Skillset
Creative Scotland
Dehns
Deloitte
Directors UK
Discovery
Dundee City East/West
Electronic Arts
Equity
Film London
Gateshead Council
Grant Thornton
Institute of Chartered Accountants of Scotland
Ingenious Media
Institute of Practitioners in Advertising
Lupus Films
Machine Productions
Mayor of London's Office
Mike Kidd Associates
MMP Tax Ltd
Northern Ireland Screen
Olswang LLP
Producers Alliance for Cinema and Television
Pinewood Shepperton plc
PricewaterhouseCoopers
Sarassin Ltd
Scott Free Films
Sixteen South
Sony
Spider Eye Ltd
TAC (Wlsh Independent Producers)
Tait Walker LLP
Trade Industry Games Association (TIGA)
TV Coalition
UK Music
UK Screen Association
UK Interactive Entertainment (UKIE)
Union Media Ltd
UKTV
The Walt Disney Company
Welsh Government

Working group members

Animation

Emily Davidson, PACT

Tim Searle, Baby Cow Productions

Kerry Lock, Aardman Animations

Ruth Fielding, Lupus Films

Daniel Isman, Blue-Zoo Animation Studio

Alex Slade, Nickelodeon UK

Teresa Rogers, The Walt Disney Company

Tony Collingwood, Collingwood O'Hare Entertainment

Michael Carrington, Turner Broadcasting

High-end television

John McVay, PACT

Helen Flint, Company Pictures

Jay Roewe, HBO

Daniel Isaacs, Kudos Productions

Mary-Ann Hughes, The Walt Disney Company

Richard Williams, Northern Ireland Screen

Nigel Stafford Clark, Deep Indigo Productions

Sheryl Trinh, Impossible Pictures

Video games

Jason Kinglsey, Rebellion

Andy Payne, Mastertronic

Sarah Fahy, Sony

Ian Mattingly, Activision Blizzard

Clare Stobbs, Square Enix Europe

Martin Servante, Creative Assembly

Colin Anderson, Denki

Patrick O'Luanaigh, nDreams

Riaan Hodgson, Jagex

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This document can be found in full on our website: http://www.hm-treasury.gov.uk

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