Subsidy Advice Unit Report on the Business Rates Relief for Film Studios scheme

Referred by HM Treasury

28 January 2025

Subsidy Advice Unit

Part of the Competition and Markets Authority

CONTENTS

1. The Referral

1.1 On 6 December 2024, HM Treasury (HMT) requested a report from the Subsidy Advice Unit (the SAU)[1] in relation to the Business Rates Relief for Film Studios scheme (the Scheme) under section 52 of the Subsidy Control Act 2022 (the Act).[2]

1.2 This report evaluates HMT's assessment of compliance (the Assessment) of the Scheme with the requirements of Chapters 1 and 2 of Part 2 of the Act.[3] It is based on the information and evidence included in the Assessment, and third-party submissions from two interested parties.

1.3 This report is provided as non-binding advice to HMT. It does not consider whether the Scheme should be implemented, or directly assess whether it complies with the subsidy control requirements.

Summary

1.4 The Assessment uses the four-step structure described in the Statutory Guidance for the United Kingdom Subsidy Control Regime (the Statutory Guidance) and as reflected in the SAU's Guidance on the operation of the subsidy control functions of the Subsidy Advice Unit (the SAU Guidance).

1.5 In our view, HMT has considered in detail the compliance of the Scheme with the subsidy control principles. In particular:

(a) The Assessment sets out a clear policy objective, helpfully articulated with the desired outcome of the Scheme (Principle A).

(b) The counterfactual assessment is clear and well-evidenced, and benefits from separate consideration of the impact on new and existing film studios (Principles C and D).

(c) the Assessment clearly considers and evidences the effect of the Scheme on competition and investment, in line with Annex 3 of the Statutory Guidance (Principle F).

(d) The Assessment clearly sets out the positive effects of the Scheme in relation to the policy objectives, its geographic impacts, as well as potential

[1] The SAU is part of the Competition and Markets Authority.
[2] Referral of the proposed Business Rates Relief for Film Studios scheme by HM Treasury - GOV.UK
[3] Chapter 1 of Part 2 of the Act requires a public authority to consider the subsidy control principles and energy and environment principles before deciding to give a subsidy. The public authority must not award the subsidy unless it is of the view that it is consistent with those principles. Chapter 2 of Part 2 of the Act prohibits the giving of certain kinds of subsidies and, in relation to certain other categories of subsidy creates a number of requirements with which public authorities must comply.

negative impacts, and conducts a balancing exercise between them in line with the Statutory Guidance (Principle G).

1.6 However, the Assessment should discuss each of the non-subsidy options which HMT considered, or confirm and justify that only one option was considered (Principle E).

1.7 We discuss these areas below, along with other issues, for consideration by HMT in finalising its assessment.

The referred scheme

1.8 HMT proposes to create the Business Rates Relief for Film Studios scheme (the Scheme), which will provide a 40% relief on English film studios' business rates bills until 2034. It will be administered by local authorities who will apply the relief against business rates bills. The Scheme will be backdated to 1 April 2024.

1.9 Business rates are an annual tax on non-domestic properties, determined by the ratable value of the property. The ratable value of non-domestic properties is assessed by the Valuation Office Agency (VOA) in England, independently of central government. The VOA carry out a revaluation every three years. At the 2023 revaluation, business rates liabilities for film studios increased significantly. The level of increase was unforeseen, and significantly higher than the average increase seen by other sectors. These increases mean that, without government intervention, film studios in England will need to pass on the costs through increased fees to productions.

1.10 The Scheme will operate alongside the Audio-Visual Expenditure Credit (AVEC), which was introduced by the UK Government in 2006 to support film production companies (who are film studios' customers) in the production of 'culturally British' film. It provides companies with a tax credits worth between 34% and 39% of their UK production costs. To ensure the beneficiaries are 'culturally British', AVEC contains a 'cultural test' which stipulates that a certain proportion of the spending and crew must be in the UK.

1.11 The Scheme will be available to any properties assessed as 'film studios' for valuation purposes by the VOA. The government estimates that around 40 properties will be eligible for this Scheme.

1.12 The Scheme does not have a maximum award amount, but the estimated costs are that this Scheme would cost £5 million in its first year (2024 to 2025), rising to £50 million by 2028 to 2029[4].

[4] Published at Spring Budget 2024 and certified by the Office for Budget Responsibility (OBR).

1.13 HMT explained that the Scheme is a Scheme of Particular Interest because it allows for the provision of one or more Subsidies of Particular Interest to be given.[5] In particular, the Scheme is highly likely to allow for individual subsidies of more than £1 million, which would cumulatively total more than £10 million over three financial years.

[5] Within the meaning of regulation 3 of The Subsidy Control (Subsidies and Schemes of Interest or Particular Interest) Regulations 2022 which sets out the conditions under which a subsidy or scheme is considered to be of particular interest.

2. The SAU's Evaluation

2.1 This section sets out our evaluation of the Assessment, following the four-step structure used by HMT.

Step 1: Identifying the policy objective, ensuring it addresses a market failure or equity concern, and determining whether a subsidy is the right tool to use

2.2 Under Step 1, public authorities should consider compliance of a subsidy with:

(a) Principle A: Subsidies should pursue a specific policy objective in order to remedy an identified market failure or address an equity rationale (such as local or regional disadvantage, social difficulties or distributional concerns); and

(b) Principle E: Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other, less distortive, means.[6]

Policy objectives

2.3 The Assessment states that the policy objective of the Scheme is to address a market failure for film studios in England, by bringing business rate bills back to a manageable level in England. This will in turn ensure that the positive externalities generated through the use of film studios in England continue to be generated, and the market failure continues to be corrected. This overarching policy objective can be split into two complementary outcome objectives: (1) that films continue to be produced in studios in England, and (2) that new investments in high-spec studio space are unlocked.

2.4 The Assessment explains that the Scheme will ensure that film studios do not need to significantly pass on costs linked to the business rate increase to productions which use their facilities, as the passing on of costs would weaken incentives which AVEC currently supplies to film production in the UK.

2.5 The Assessment explains that the Scheme is being established alongside the AVEC. The aim of the AVEC is to provide an incentive for the production of 'culturally British' films, and to grow the English film sector through investment. AVEC was thus designed to (1) encourage the production of films that might not otherwise be made, (2) promote sustainability in British film production, and (3) maintain a critical mass of UK infrastructure, and creative and technical expertise

[6] See Statutory Guidance, paragraphs 3.32-3.56 and the SAU Guidance, paragraphs 4.7-4.11 for further detail.

to facilitate the production of 'culturally British' films. The Scheme would return business rates liabilities to a level closer to that before the revaluation, which means that AVEC will continue to work as intended.

2.6 In our view, the Assessment clearly sets out and evidences the policy objective of the Scheme. In particular, it helpfully articulates it with the desired outcome of the Scheme, making clear what the Scheme aims to accomplish. It could however clarify whether it is linked exclusively with the production of 'culturally British' films, like AVEC, or to the production of films in England more generally.

Market failure

2.7 Market failures arise where market forces alone do not produce an efficient outcome. When this arises, businesses may make investments that are financially rational for themselves, but not socially desirable.[7]

2.8 The Assessment identifies the following as positive externalities associated with UK film production[8] which, in the absence of direct evidence, it argues can reasonably be considered as a relatively accurate proxy for the impact of 'culturally British' film:[9]

(a) social benefits that attach to cultural production; and

(b) economic goods which arise from film and TV production.

2.9 HMT states that this market failure is not specific to the UK; the existence of more than 100 incentives offered worldwide by national and regional governments for the production of film[10] shows this and highlights the expense of film production to need such incentives.

2.10 The Assessment references a report from the British Film Institute (BFI) which identifies three main spillover effects arising from UK film production: merchandise sales, tourism and UK brand promotion.[11] It gives examples of films which have a strong sense of place, explains that tourists are willing to travel to locations which appear on camera, and that these visits have a positive economic impact. It sets out that global consumption of UK film can stimulate interest in the UK and enhance its image and reputation.

2.11 The Assessment explains that 'it is widely accepted that the production of film and TV has cultural benefits for its audiences, and for the places where it is produced'

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[7] Statutory Guidance, paragraphs 3.35-3.48.
[8] Of which, as stated in the Assessment, a significant proportion of output arises from London and the South-East.
[9] This is because 90% of films made in the UK are 'culturally British'.
[10] British Film Commission (2023): *British Film Commission response to the Culture, Media and Sport Committee inquiry into challenges faced by the British film and high-end television industry*: p. 6.
[11] BFI, Olsberg SPI/Nordicity (2021): *Screen Business: How screen sector tax reliefs power economic growth across the UK 2017-2019*. p. 72.

and gives examples of this effect, setting out that films can: 'act as a crystallisation of a particular time', 'offer a platform for representation of ethnic minority communities', and 'reflect and affect social change'. It explains that the representation of the UK's geography will help to reflect and project a sense of national identity.

2.12 Under Step 4, the Assessment explains that film production in the UK gives opportunities to actors, producers and crew from the UK to learn their craft and pave the way for the UK's continued success in the film and TV sectors. It sets out that the Scheme has diplomatic benefits, explaining that the continued success of UK filmmaking worldwide is important to the UK's soft power, and that UK film can act as a cultural hook to build and strengthen diplomatic relationships. It states that 'culturally British' film has an international appeal which strengthens the pull which the UK has for business and trade.

2.13 Through this Scheme, HMT aims to bring business rates bills back down to a manageable level, ensuring that the present amount of positive externalities 'continue to be generated'. This will result in films continuing to be produced.

2.14 It explains that the AVEC has been efficient at correcting the market failures of film production in the UK, but that the significant increase in business rates liabilities for film studios in England will result in the positive externalities which arise from the use of film studios being realised at a lower level than previously.

2.15 In our view, while the cultural, diplomatic and soft power market failure rationales are explained and evidenced, it is not clear that all the benefits that the Assessment identifies are market failures. It could more clearly explain the economic benefits it identifies, and how they meet the definition of market failure positive externalities as set out in the Statutory Guidance.[12]

Appropriateness

2.16 Public authorities must determine whether a subsidy is the most appropriate instrument for achieving the policy objective. As part of this, they should consider other ways for achieving the policy objective.[13]

2.17 The Assessment explains that multiple ways of achieving the policy objective which did not involve a subsidy were considered, but were deemed unsuitable given that the increase in business rates liabilities resulted in immediate cost pressures for film studios.

[12] Statutory Guidance, paragraph 3.40
[13] Statutory Guidance, paragraphs 3.54-3.56.

2.18 It states that business rates are set by the VOA[14], and as the VOA values properties independent of central government, HMT does not have the power to change the way in which film studios are valued.

2.19 The Assessment does not set out any other means of achieving the policy objective that were considered by HMT.

2.20 In our view, the Assessment should explain in more detail why the Scheme is the most appropriate instrument for addressing the policy objective. It should discuss each of the non-subsidy options which HMT considered, or confirm and justify that only one option was considered.

Step 2: Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change

2.21 Under Step 2, public authorities should consider compliance of a subsidy with:

(a) Principle C: Subsidies should be designed to bring about a change of economic behaviour of the beneficiary. That change should be something that would not happen without the subsidy and be conducive to achieving its specific policy objective; and

(b) Principle D: Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.[15]

Counterfactual

2.22 In assessing the counterfactual, public authorities should consider what would likely happen in the future – over both the long and short term – if no subsidy were awarded (the 'do nothing' scenario).[16]

2.23 The Assessment states that the film sector is price-sensitive and operates with narrow profit margins and therefore productions are often willing to move abroad to film where it is cheapest. The Assessment outlines the counterfactual for existing and new studios separately.

Existing studios

2.24 The Assessment explains that, even before the 2023 revaluation, business rates represented a significantly higher proportion of operating costs for film studios

[14] The VOA provides independent and impartial valuation, and for this purpose acts independently of central government.
[15] See Statutory Guidance, paragraphs 3.57-3.71 and the SAU Guidance, paragraphs 4.12-4.14 for further detail.
[16] Statutory Guidance, paragraphs 3.60-3.62.

(compared to other businesses) and following the revaluation this has increased further.

2.25 The Assessment sets out that, absent government intervention, to retain a manageable profit margin, studios would need to pass on costs to the film productions which use their premises by charging higher fees. Productions may be unable to afford the higher rates, so would film outside England where it may be cheaper. It explains that the reduction in productions coming to film in England due to higher costs would likely lead to some film studios becoming financially unviable.

New studios

2.26 The Assessment explains that eight advanced studio developments (with planning permission, and construction either underway or due to commence) were put on hold and a further 12 developments (at the planning stage) were put at risk of being cancelled, which the Assessment states is due to the financial viability of such projects being damaged by the increase in business rates.

2.27 The Assessment states that, absent the Scheme, it is expected that studio investment would become less viable, leading to a shrinking of the anticipated pipeline of growth in studio space in England. It goes on to state that this would mean that the projected growth in the UK's film output could not be realised, along with the accompanying positive externalities.

2.28 In our view, the Assessment clearly describes and evidences what would be likely to happen if the Scheme was not implemented.

Changes in economic behaviour of the beneficiary and additionality

2.29 Subsidies must bring about something that would not have occurred without the subsidy.[17] They should not be used to finance a project or activity that the beneficiary would have undertaken in a similar form, manner, and timeframe without the subsidy ('additionality').[18]

2.30 The Assessment states that the Scheme will bring two changes in the economic behaviour of film studios, compared to the counterfactual, which will assist with achieving the policy objective:

(a) The Scheme will reduce business rates liabilities for eligible film studios, which will mean that film studio operators will not need to significantly pass on their increased liabilities to occupiers. The Assessment concludes that this

[17] Statutory Guidance, paragraph 3.64.
[18] Statutory Guidance, paragraphs 3.63-3.67.

will result in producers continuing to film in England, rather than moving to other, cheaper countries.

(b) The Scheme will give investors sufficient confidence in the UK film sector to unblock the investments which were paused following the 2023 revaluation.

2.31 The Assessment acknowledges that the Scheme will reduce 'business as usual' costs for film studios. However, it states that this is justified as the level of business rates would otherwise be unmanageable for film studios. In this scenario, the Assessment explains that productions would likely move to filming abroad to lower costs which would result in the policy objective not being achieved.

2.32 In our view, the Assessment clearly explains and evidences how the Scheme would change the beneficiaries' economic behaviour and that the Scheme brings about changes that would not have occurred otherwise.

Step 3: Considering the distortive impacts that the subsidy may have and keeping them as low as possible

2.33 Under Step 3, public authorities should consider compliance of a subsidy with:

(a) Principle B: Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it; and

(b) Principle F: Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the United Kingdom.[19]

Proportionality

2.34 The Assessment explains that the relief will work to bring studio liabilities down to a more 'manageable level'. It states that HMT worked extensively with film studios to understand what level of bills would be manageable, and what scale of reduction would help to achieve its policy objectives. The Assessment states that HMT/British Film Commission analysis indicates that a 40% relief reduces:

(a) the average increase in bills to a level which broadly tallies with what studios indicated was a manageable level of increase (the scale of increase that could be absorbed by studios without having to increase prices); and

(b) the share of businesses rates of film studio operating costs back down to a comparable situation to before the 2023 revaluation.

[19] See Statutory Guidance, paragraphs 3.72-3.108 and the SAU Guidance, paragraphs 4.15-4.19 for further detail.

2.35 The Assessment states that the Scheme is targeted at film studios, which directly experienced cost pressure caused by increased business rates (rather than, for instance, film producers). The Assessment explains that relief is targeted only at those types of studios which saw significant increases at the 2023 revaluation, and that this should mitigate the risk that any studio receives relief when it might have otherwise been able to fund the business rates increases. It acknowledges that a 40% relief will, by its nature, have a different impact on each beneficiary, but a flat relief was chosen because it treats existing and new studios equitably, and is straightforward to understand and administer. The relief contains a clawback mechanism, which means that any studio that sees a rateable value reduction following a successful challenge of the VOA's valuation will have their level of relief proportionately tapered away, to ensure that only studios which need support will continue to benefit.

2.36 The Assessment acknowledges the risk that the Scheme benefits some films which are not 'culturally British'. However, it explains that data supplied by the BFI shows that 90% of productions in the UK are considered to be 'culturally British' and, as a result, the number of films that are not ‘culturally British’ which will benefit is expected to be very small.

2.37 In our view, the Assessment clearly explains that the Scheme ensures that business rates for affected film studios will be at a ‘manageable level’, whereby film studios would not need to pass on increases in business rates to film producers, consistent with the policy objective. However, it could better draw on available evidence to more clearly explain how this level of relief to the film industry, in addition to that already granted through AVEC, is required to address the identified market failure, and why film studios passing on any of the business rate increase would negatively impact the volume of film production.[20]

Design of subsidy to minimise negative effects on competition and investment

2.38 The Assessment discusses a number of aspects of the Scheme’s design and their impact on competition and investment including the breadth of beneficiaries and selection process, the nature of the subsidy, the timespan of the Scheme, the nature of the costs being covered, and monitoring and evaluation.

2.39 In our view, the Assessment demonstrates and evidences how design features of the Scheme contribute to minimising any negative effects of the Scheme on competition and investment within the United Kingdom.

[20] This could be achieved by, for example, drawing on evidence of film studio costs and profitability set out in Step 2, and evaluations of the impact of AVEC on the decisions of film producers on whether to make films in the UK.

Assessment of effects on competition or investment

2.40 The Assessment states that the Scheme will have some impact on competition, both domestically and internationally.

2.41 Domestically, lowering the costs of those studios which are eligible for the relief may have a negative impact on those which are ineligible. However, the Assessment argues that the relief has been designed so that only studios which saw significant increases at the 2023 revaluation are eligible, that the studios ineligible for the relief differ significantly from those which are eligible, and that the Scheme will bring the eligible studios in line with the ineligible ones.[21] Ineligible studios, the Assessment states, are 'unimproved industrial properties', and so are much more likely to be used by lower-budget films, as opposed to the higher-spec, eligible studios that tend to be occupied by high-end productions. The Assessment therefore argues the competition distortions between the two will be limited.

2.42 The Assessment acknowledges that the Scheme may cause distortions within the United Kingdom, noting that whilst Scotland and Northern Ireland did not see the same levels of increase as England, some studios in Wales did. However, it explains that the devolved administrations will receive a block grant adjustment that would allow them to provide a similar relief should they choose to do so.

2.43 The Assessment acknowledges that the Scheme may cause regional distortion, as most studios are around London and the South-East of England. However, it notes that there is a growing trend for studios to be constructed outside these areas.

2.44 The Assessment acknowledges a potential risk of investment being targeted towards film studios instead of other types of property development. This, it suggests, may lead to underinvestment in sectors which would benefit from additional investment in their property/infrastructure. However, the Assessment argues that this is unlikely, as film studios currently represent an unattractive investment prospect when compared to other types of property investment. As such, the Scheme is unlikely to significantly distort investment decisions.

2.45 In our view, the Assessment clearly considers and evidences the effect of the Scheme on competition and investment, in line with Annex 3 of the Statutory Guidance.

Step 4: Carrying out the balancing exercise

2.46 Public authorities should establish that the benefits of the subsidy (in relation to the specific policy objective) outweigh its negative effects, in particular negative

[21] We note that in our view, even where circumstances mean that some parties are disproportionately impacted by a market wide change (such as an underlying change in the calculation of business rates), granting those parties relief can still constitute an economic advantage with the potential to distort competition.

effects on competition or investment within the United Kingdom and on international trade or investment.

2.47 The Assessment first sets out the benefits that will stem from achieving the Scheme's desired outcomes of facilitating the continued production of 'culturally British' film and TV and growing film infrastructure to meet future demand, including cultural, economic, and diplomatic benefits (see Step 1).

2.48 The Assessment considers several anticipated negative effects of the Scheme on competition and investment, both domestic, regional, and international. It suggests that the highly mobile nature of the film studio sector means the Scheme could encourage productions to film in the UK rather than abroad. However, under Step 3, the Assessment argues that the aim of the Scheme would ensure that production costs in England remain at a comparable level to other countries, rather than pricing studios in England out of the market altogether.

2.49 The Assessment also explains that reduced business rates liabilities will increase return on investment for investors, who may choose to invest in England rather than abroad, and in film studio developments over other kinds of investment. The Assessment suggests this could lead to the weakening of overseas film markets; underinvestment in sectors which would benefit from additional investment in their property or infrastructure; and the possibility that prospective studio developments ineligible for the Scheme are cancelled.

2.50 Overall, the Assessment explains that these negative effects are significantly outweighed by the benefits. It argues that, while the relief will be targeted at London and the South-East, the cultural, diplomatic and economic benefits arising from the continued production of 'culturally British' film will be felt across the country. Finally, it notes that potential distortions will also be mitigated by ongoing review of the relief.[22]

2.51 In our view, the Assessment clearly sets out the positive effects of the Scheme in relation to the policy objective, its geographic impacts, as well as potential negative impacts, and conducts a balancing exercise between them in line with the Statutory Guidance.

Other Requirements of the Act

2.52 HMT confirmed that no other requirements or prohibitions set out in Chapter 2 of Part 2 of the Act applies to the Scheme.

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[22] Both through the clawback mechanism and 'active' government review.