The UK creative industry: reform of tax reliefs

Large Corporate

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We explore the impact that the recent reform of the rules for tax relief will have on the UK's creative industry.

Key Points

What is the issue?

The UK's creative industry tax reliefs play a key role in supporting the growth of the creative sector economy in the UK. However, developments in the creative industries and the international tax landscape have prompted the government to reform the rules to ensure they keep pace with change and continue to boost growth in the sector.

What does it mean for me?

Given the long lead times for production activity, the potential implications of the reforms for working capital and the extended transition period, it is important that companies involved in UK production activity consider the impact of the changes now.

What can I take away?

The reforms provide enhanced relief for animation, children's TV, UK independent films and visual effects, but there are also potential pitfalls that mean claimants need to understand the new rules well in advance of submitting a claim.

In recent years, the UK has cemented its reputation as a creative talent hub. From films such as Guardians of the Galaxy, hit dramas like The Crown, and West End shows such as Harry Potter and the Cursed Child, the UK's contribution to the creative sector has inspired a growing and dynamic industry.

Government statistics show that in 2022 the creative industries generated £125 billion of value for the UK economy and employed 2.4 million people in the UK, growing at over twice the rate of the wider economy over the previous decade. (See the Department for Culture, Media and Sport's Sectors Economics Estimates at tinyurl.com/2p9yys7y.)

The creative sector tax reliefs have played a key role in supporting the growth of the UK creative industries since the introduction of the film tax relief in 2007, with the value of claims increasing from £65 million for 60 claims in 2006-07 to £517 million for 770 claims in 2021-22 (slightly down from a pre-covid peak of £627 million for 950 claims in 2019-20) (see tinyurl.com/3h4982c8).

The popularity and success of the scheme led to its expansion over time to other parts of the sector, and the UK now offers a vast package of tax incentives for the creative industries spanning film, high end TV, animation, children's television, video games, theatre, orchestra, and museum and gallery exhibitions. An independent study commissioned by HMRC and published in November 2022 estimated that 38% of UK productions would not have taken place at all without the reliefs and 41% would have had a lower UK production budget (see tinyurl.com/mryvjw93). The 2022 study and others suggest that the impact for inward investment is even higher.

As the demand for UK productions is increasing, so is investment in infrastructure. The expansion at Shepperton Studios opened in March 2024 with both Amazon MGM Studios and Netflix taking studio space to support their ambitious content creation plans. Pinewood Studios, famous for filming James Bond and Star Wars, has approval for an £800 million expansion in its studio space and expects to create over 8,000 new jobs and contribute £640 million a year to the UK economy.

As well as the economic benefit, the creative industries contribute to the UK's 'soft power' by reaching worldwide audiences, showcasing British talent and strengthening the UK's global reputation. The creative sector tax reliefs support this through the 'cultural test' certification, which awards points to productions that have UK lead actors, UK directors or content that features or promotes the UK. This plays out in what we see on screen. When searching for tickets for the latest blockbuster film or browsing a streaming service for a gripping series, we are inundated with choices showcasing Britain.

Responding to the changing environment: a consultation on reform

In November 2022, the government launched a consultation on reform of the audio-visual reliefs (film, high-end TV, animation, children's TV and video games). The consultation notes that much has changed since the introduction of the film tax relief in 2007. The creative industries have evolved with new, cutting?edge technology, changes in viewing habits and distribution models, and demand from the public for higher quality content.

The international tax landscape has also changed, and the consultation document acknowledged the concerns of industry stakeholders, including those relating to the Pillar Two global minimum tax rules developed by the OECD Inclusive Framework. The OECD Inclusive Framework's Pillar Two rules ('model rules') are designed to ensure that large multinational groups (with annual consolidated group revenue of at least €750 million) pay a minimum effective tax rate of 15% on their profits in every country in which they operate.

The consultation document noted that, in calculating the effective tax rate, the model rules treat tax credits differently depending on their design. Certain tax credits are regarded as being equivalent to a grant so are treated as income in the calculation. The consultation acknowledged industry concerns that the creative sector reliefs in their original form may not fully meet the requirements to be considered as income for the purpose of the model rules.

To address these concerns, the consultation proposed reforming the reliefs into refundable expenditure credits, modelled on the UK's existing research and development expenditure credits.

Autumn Statement 2023: initial reforms

Following consultation, the reforms were confirmed at Autumn Statement 2023. From 1 January 2024, companies can opt into a new expenditure credit for either audio-visual productions (film, animation, high end

TV and children's TV) or video games, respectively known as the audio visual expenditure credit and video games expenditure credit.

One of the overwhelming comments by businesses in response to the consultation was around the stability of the regime. The mechanism, calculation and value of the relief was clear and as such it had become an integral part of the underlying economics of UK film production.

The government therefore sought to align the new reliefs with the existing reliefs as far as possible, maintaining the cultural test and rules around qualifying expenditure. However there are a number of fundamental changes.

Accounting treatment: The existing 'below the line', non-taxable credit is replaced by an 'above the line' taxable credit, intended to mirror the accounting treatment of the research and development expenditure credits.

Increased rate: As the new credit will be subject to tax, the headline rate of relief has been increased from 25% to 34%, providing a small increase in effective benefit.

Animation and children's TV: Additional support was granted to both animations and children's TV productions with the introduction of an enhanced rate of 39%, giving an effective benefit of 29%.

Timing: Recognising that budgets for creative productions are set well in advance, the rules include an extended transition period. Companies can opt in to the new audio visual expenditure credit and video games expenditure credit regimes for expenditure incurred from 1 January 2024. The rules become mandatory for *new* productions (those which have not yet started principal photography (for film and TV) or entered the production phase (for video games) from 1 April 2025. Existing productions can apply the current reliefs for expenditure incurred until 31 March 2027.

Payment mechanism: The repayment mechanism is closely aligned to the research and development expenditure credits regime but with some simplifications. In particular, the cap linked to payroll taxes will not apply. The new mechanism may have implications for quarterly instalment payments.

European expenditure: Companies may no longer claim for European expenditure on video game development. To qualify for relief, costs must be 'used and consumed in the UK'.

Anti-avoidance: The new rules limit the benefit available in respect of certain intra-group costs where the payment exceeds the arm's length amount.

Administration: Claim submissions must be accompanied by a new additional information form, providing full details of the claims, as well as registration numbers for VAT, corporation tax, employment tax and foreign entertainers, and details of the nature and quantum of intra-group transactions.

Impact of the changes

Although an intention of the reform was to ensure that the reliefs are straightforward to administer, the change in accounting treatment, the extended transition period and the new payment mechanism means there is no one size fits all solution for organisations looking to benefit from the new regime.

The creative sector credits are material to the businesses that claim them, and the reforms should be given a commensurate level of consideration by those affected.

Typically, budgets for production activity are agreed with a significant lead time before activity commences. The changes should be considered now, to ensure that the value of the credit is accurately recorded in the production budget before a project is greenlit, and that any impact on working capital requirements from the change in repayment mechanism is understood.

In particular, under the new mechanism companies may be required to make corporation tax payments in advance under the quarterly instalment payments regime and receive a refund after the audio visual expenditure credit or video games expenditure credit claim is submitted.

Large multinational groups will need to consider the impact of the changes on their Pillar Two calculations, and may see a benefit from early transition to the new expenditure credit regime. Some smaller business may also see a benefit from early transition due to the higher rates available, particularly where they are claiming for the enhanced relief for animation and children's TV.

On the other hand, international video game developers may prefer to defer their transition to continue benefiting from relief for European expenditure under the old video games tax relief.

Due to the mechanics of the historical regime, many businesses in the sector set up special purpose vehicle structures to optimise the reliefs. While these vehicles have become industry standard, they may no longer work as originally designed when the new accounting treatment, complexity around group relief claims for the notional tax deduction, anti-avoidance provisions and implications for quarterly instalment payments are all considered.

The new additional information form brings additional reporting and record keeping requirements. Timely information gathering is crucial as claims submitted without an additional investment form or with an incomplete additional investment form will be rejected by HMRC.

Spring Budget 2024: additional support for the creative sector

The 2024 Spring Budget brought more exciting news for the creative industries, with the announcement of additional support. As part of the consultation into the creative reliefs, the government identified that the 80% cap on qualifying expenditure meant that companies were incentivised to take the more portable elements of a production offshore, where foreign reliefs may be obtained. This is a particular issue for visual effects expenditure so the announcements included an enhanced relief for visual effects expenditure claimed under the new audio visual expenditure credit. The proposals include removing the 80% cap on qualifying expenditure for visual effects costs and increasing the rate of the tax credit to 39% for visual effects, and are expected to take effect from 1 April 2025. The changes have the effect of increasing the net benefit on visual effects costs from 20.4% to 29.3%.

A new UK independent film tax credit was also announced at a rate of 53%, significantly higher than the standard rate for film of 34%. This is restricted to films with a budget (or core expenditure) below £15 million, and a new test will be administered by the British Film Institute, including a requirement for the production to have a UK writer or director.

The rates of relief for theatres, orchestras, and museums and galleries will be permanently set at the higher rates of 40% (for non-touring productions) and 45% (for touring productions and all orchestra productions). Initially introduced to support these businesses in their covid recovery, the higher rates will become permanent. The sunset clause for museums and galleries will also be removed so that it becomes a permanent tax relief, with no expiry date.

Studio operators will enjoy a substantial 40% cut in business rates for eligible film studios for ten years from 1 April 2024, recognising the investment in key infrastructure required to support the expansion of the industry.

Finally, it was announced that the Tees Valley Investment Zone will focus on the creative and digital sectors. This is anticipated to bring in £175 million of additional investment alongside up to 2,000 jobs over the next 10 years.

Conclusion: what comes next?

The UK's programme of creative industry tax reliefs has played a key role in supporting the growth of the creative sector in the UK. Developments in the creative industries and the international tax landscape since the introduction of the film tax relief in 2007 prompted the government to reform the rules to ensure they keep pace with change and continue to boost growth in the sector.

Although the new regime is designed to retain as much character of the original regime as possible, the changes to the regime and extended transition period mean that businesses need to analyse the impact from the outset. HMRC has started to publish guidance on the new regime in the Creative Industries Expenditure Credit Manual, with further chapters expected in the coming weeks.

Further announcements in the Spring Budget 2024 demonstrated the government's commitment to the creative sector with new and extended reliefs targeting key areas to boost further growth. Legislation is required to implement some of the budget announcements so further change is possible, particularly with the recent change in government. However, the new government has highlighted the importance of the UK's creative industries and has committed to continue investing in the sector in statements made both pre- and post-election. In particular, the Budget 2024 announcements were warmly welcomed in the new government's 'Plan for the arts, culture and creative industries' launched in March 2024 (see tinyurl.com/yu72jb2v).

While the reliefs may continue to evolve over time, there is no doubt that they will continue to play an important role in encouraging growth in the UK creative industries and supporting the UK's status as a creative talent hub.

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