

**EXPLANATORY MEMORANDUM TO  
THE FILMS (DEFINITION OF “BRITISH FILM”) (NO. 2) ORDER 2006**

**2006 No. 3430**

**1.** This explanatory memorandum has been prepared by the Department for Culture, Media and Sport and is laid before Parliament by Command of Her Majesty.

**2. Description**

2.1 This Order modifies the definition of a British film in Schedule 1 to the Films Act 1985 by amending the points-based cultural test inserted by the Films (Definition of “British Film”) Order 2006.

**3. Matters of special interest to the Joint Committee on Statutory Instruments**

3.1 None.

**4. Legislative Background**

4.1 Schedule 1 to the Films Act 1985 sets out the requirements to be satisfied for a film to be a British film for the purposes of that Schedule. A film that is certified as British under paragraph 3 of that Schedule will be eligible for the new film tax relief to be introduced by Chapter 3 of Part 3 of the Finance Act 2006. Schedule 1 will also be amended by that Act with effect from the date this Order comes into force, 1<sup>st</sup> January 2007. Similarly, the new film tax relief will take effect from that date.

4.2 Paragraph 10(2) of Schedule 1 provides that the Secretary of State, with the approval of the Treasury, may make modifications to paragraphs 1 and 4 to 5 of that Schedule. This power is subject to the affirmative resolution procedure.

**5. Extent**

5.1 This instrument applies to all of the United Kingdom.

**6. European Convention on Human Rights**

The Minister for Creative Industries and Tourism has made the following statement regarding Human Rights:

In my view the provisions of the Films (Definition of “British Film”) (No. 2) Order 2006 are compatible with the Convention rights.

**7. Policy background**

7.1 The explanatory memorandum for the Films (Definition of “British Film”) Order 2006 (S.I. 2006/643) sets out the policy background for the introduction of the points-based cultural test in April 2006.

7.2 The full implementation of the new film tax relief has always been subject to approval by the European Commission of the film tax relief state aid notification. Article 87 of the EC Treaty prohibits Member States from providing aid, such as tax relief, to selected industries or businesses if such aid has the potential distort competition and affect trade between Member States. However, there is an exemption for aid to promote culture. The European Commission may approve such aid if such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest.

7.3 Given that public subsidy of film production is common throughout Europe the Commission has issued a specific communication<sup>1</sup> setting out how it intends to deal with notifications of film support schemes. One of the eligibility requirements is that the aid is direct to a cultural product. Each Member State must ensure that the content of the aided production is cultural according to verifiable national criteria.

7.4 In September 2005 the Government submitted a state aid notification to obtain approval from the Commission for the new film tax relief. The existing cultural test was notified in December 2005. This test had been developed with the UK Film Council and following a public consultation with the British film industry and we were confident that this met the requirement that the aid was directed to a cultural product.

7.5 However, in September 2006 the Commission indicated that they had concerns about the existing cultural test in that it placed too much emphasis on the economic elements of film-making i.e. where the film was made and the persons employed to make it, and therefore had the capability of affecting intra-Community trade. Since then the Government has been in discussions with the Commission and have revised the cultural test. The Commission formally approved the state aid notification, including the revised test, on 22 November 2006.

7.6 The main changes to the revised test are: an increase in the amount of points awarded in relation to the content of the film from 4 to 16 points; a decrease in relation to where the film is made from 15 to 3 points; a decrease in relation to who makes the film from 13 to 8 points; and a new 4 point section has been introduced to reflect the contribution a film makes to British culture. The guidance on how the Department will assess the test is available from [www.culture.gov.uk](http://www.culture.gov.uk).

7.7 The Department carried out a full 12 week consultation on the existing cultural test. Unfortunately, given the need to introduce the new relief quickly and the confidential nature of our discussions with the Commission it was not possible to carry out a similar consultation on the revised test prior to introduction. The revised test was devised in consultation with HM Treasury, HM Revenue and Customs and the UK Film Council. Responses from the original consultation were borne in mind throughout the discussions with the Commission and consultees' views have been reflected in the final test. For example the need for certainty and clarity offered by interim certification.

## **8. Impact**

8.1 A Regulatory Impact Assessment is attached to this memorandum.

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<sup>1</sup> Communication on Certain Legal Aspects relating to Cinematographic and Other Audiovisual Works, COM(2001) 534.

## **9. Contact**

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## REGULATORY IMPACT ASSESSMENT

### Revised revisions to Schedule 1 to the Films Act 1985

#### *Title of Proposal*

1. Revised Cultural Test for British Films (Schedule 1 to the Films Act 1985)

#### *Objective*

2. Film plays an important role in British culture. The Government's core aim in providing tax relief is to promote the sustainable production of culturally British films. This aim is supported through:
  - a.) Encouraging the production of films that might not otherwise be made;
  - b.) Promoting sustainability in British film production; and
  - c.) Maintaining a critical mass of UK infrastructure, creative and technical expertise, to facilitate the production of culturally British films.
3. The Department for Culture, Media and Sport's proposals are for a new cultural test to better identify culturally British films that might be considered eligible to claim the new tax relief in line with the European Commission's rules on State Aid. We are aiming for the new Cultural Test to be in place by 1 January 2007.
4. Government intervention at this stage will help the development of a sustainable UK film industry whose public value has been recognised, and the export of Culturally British films which will further establish the image of the UK abroad.

#### *Background*

5. To be effective, the qualifying criteria for a British film must be clearly understood and easily implemented. Currently a film certified as a British film by DCMS, must fulfil either:
  - a.) The terms of Schedule 1 to the Films Act 1985; or
  - b.) The terms of an international co-production agreement to which the UK is party (including the European Convention).

Only proposed revisions to Schedule 1 to the Films Act are the subject of this RIA. Proposed revisions of international co-production agreements will, over time, be handled separately.

6. Under Schedule 1, the Secretary of State currently certifies a film - and opens the gateway to claim the

existing film tax reliefs - when satisfied that the following criteria are met:

- a) The Maker Test (Who makes the film) - A film must be made by a maker of the UK or another member state of the EEA. "Maker" means the person ordinarily resident in a member state or a company registered, centrally managed and controlled in a member state making arrangements for filmmaking throughout the time the film is made;
  - b) Moving Pictures created specially for the film (content of the film) - Moving pictures from a film by another maker (or from a previously certified film) should comprise no more than 10% of the playing time of the film. In the case of documentary films and in the light of their subject matter, this limit may be extended at the discretion of the Secretary of State;
  - c) The film must pass the points-based cultural test reflecting the content of the film, where it was made and who made it. Separate cultural tests exist for animations and documentaries.
7. It is proposed that the first test (a) be amended by the definition of a 'Maker' that will be set out in the HMT's revision to the Finance Act. The second test (b) will be retained and (c) will be amended by a revised cultural test.
  8. We want to ensure that the cultural test is compatible with the European Commission's rules for providing state aid.
  9. Some of the selection criteria for the current Lottery Funding Programmes include the requirement for a film to wholly or substantially qualify as British. It provides a discretionary grant with recoupment provisions.

### ***The Need for Government Intervention***

10. Cinematic film provides a universal and readily accessible medium for the expression and representation of British culture and national identity. As the Minister for Culture stated in her speech on Government and the Value of Culture, there is a distinction to be made between entertainment and cultural engagement. Where cultural contribution goes beyond providing entertainment in this sense, the social benefits often fail to be captured in the transactions that people undertake in the market. In this regard culturally British films can be regarded as merit goods that the market often fails to provide at the optimum level.
11. The social benefits that attach to cultural production suggest that there is a public interest in ensuring greater supply than the market would otherwise provide. Without Government intervention, a richer, more diverse and more representative range of voices may not emerge, resulting in a more impoverished and limited

range of choices for the public. The aim of support is to address the market failure in the supply of culturally British films by way of an incentive for specific behaviour - the production of culturally British films.

12. The introduction of a revised cultural test will ensure that Government support is directed to only culturally British films. This is in line with the Commission's state aid requirements.

### **Consultation**

13. The Cultural Test was first published for consultation in July 2005, the final framework was then published in December 2005. DCMS made clear throughout this process that the Cultural test was subject to State Aid approval.
14. Consequently, following further consultation between the UK Government and the European Commission further revisions to the Cultural Test have been made. The revised Cultural Test is now available from the DCMS website at [www.culture.gov.uk](http://www.culture.gov.uk).
15. DCMS has been working with the European commission to make sure that the revised test is rigorous enough to meet the requirements that allow EU member states to subsidise films for cultural purposes and that it does not distort competition between member states.
16. The revised cultural test will still offer alternative options for animation and documentary films so as not to exclude these films from passing the test as many of the elements of the main cultural test did not apply to these specific types of film. As a result the draft Order provides for varied cultural tests for these types of films.

### **Options**

**Option 1** - Do nothing: allow the criteria in Schedule 1 to the Films Act 1985 to remain unchanged.

- a) Leaving the current tests to run in their current form would not fulfill the Government's objective to ensure that support is directed to the production of culturally British films.
- b) In addition, there is the risk that the European Commission may not consider the current test compatible with State Aid rules.
- c) Implementation and delivery plans would not be applicable to this option.

**Option 2** - Review some of the criteria in Schedule 1 to the Films Act 1985 to incorporate a revised cultural test.

- a) The introduction of a revised cultural test will ensure that films are genuinely culturally British. This test will be administered by the Department for Culture, Media and Sport in a similar way to the current certification process based on the 1985 Films Act. This will meet the requirements of the State Aid rules for support to film production. This will facilitate the centering of the gateway for film tax reliefs within HMRC, whilst guaranteeing HMT that only culturally British films may approach HMRC's gateway.
- b) The revised test is designed to be very straightforward to comply with and therefore minimises the risk of non-compliance and the need to exercise administratively burdensome compliance and enforcement regimes.
- c) A system of pre-certification for the Cultural Test was unanimously called for through the original consultation in 2005 and this will continue. It is agreed that pre-certification offers the certainty film producers need in order to begin work on production.
- d) The revised cultural test aims to establish a positive affect on the UK economy and film industry by reflecting and emphasizing the cultural value of British films.
- e) Option 2 would need to be in place by 01 January 2007.

### ***Sectors and groups affected***

17. The revised cultural test is targeted directly at the UK film production sector and in addition to individual casts and crews, there are currently between 4000 to 5000 UK companies either directly involved in film production or who provide the necessary services to film producers (such as studio facilities, sound, lighting, post production and special effects). All will be directly affected by the revised cultural test.
18. Indirectly affected will be the film financing sectors, in particular banks lending money to producers, and sectors that market and exploit the film once it is completed.

### ***Benefits***

19. The introduction of the revised cultural test will benefit the UK film industry and film culture in the UK by encouraging the use of British content, British film making facilities and practitioners. A thriving sustainable British Film Industry should also have the long term impact of utilising the wealth of talent emerging from training courses in media and film, who will make up the film industry of tomorrow.
20. In terms of the monetary value of the benefits, the revised Cultural Test has been designed to ensure that films passing the test reflect British culture on screen...

21. Film production spending in the UK totalled more than £559 million in 2005, this was lower than 2004 spending levels, due largely to the industry's uncertainty about the new tax relief's. The film industry has widely welcomed the new tax credit system which was announced by the Chancellor at the Budget announcement 2006, therefore we are confident that production spend in the UK will reach even higher levels once the new system is fully up and running.
22. The revised Cultural Test still offers an objective system through which to qualify as a British film. The test has been developed in partnership with UK Government, the UK Film Council and the EU Commission and offers producers the certainty they require to make their films in the UK.
23. A system of pre certification will continue to allow producers certainty that they need in order to release the funds to begin making their films.

#### ***Policy costs***

24. None identified.

#### ***Administrative costs***

25. The DCMS will continue to administer a system of pre-certification. No further administrative costs have been identified and, as before in the long term the simplicity and objectivity of the revised Cultural Test will be less administratively and financially burdensome.

#### ***Implementation and Compliance costs***

26. The revised cultural test remains based primarily on objective criteria to determine the cultural content of a film. The current test has already proved to be less burdensome than the previous certification tests and it is expected that the revised cultural test will be the same.
27. As for compliance, the current cultural test has already reflected how it has lightened the administrative burden of using Schedule 1 to the Films Act 1985, as film businesses no longer have to plan their expenditure to meet a 70% threshold for "activity in the UK". This costs saving may be offset through the introduction of a new test about expenditure to be administered by HMRC with a lower threshold and a different way of assessing British expenditure.
28. The DCMS and HMRC are working closely to ensure that the information required of a film maker for application to both the DCMS Cultural Test and the HMRC expenditure



test for tax relief can be as closely aligned as possible. Joined up working across the two departments will help us to avoid placing unnecessary administrative burdens on the film maker to produce extra and duplicate documents at different stages.

29. It is proposed that film businesses will be required to keep records of the nationality and country of residence of all cast and crew, and some of the budget heads for particular activities, such as visual effects work. However, this is no more than what is already required under the current rules and so does not represent an increased burden.

### ***Small firms Impact Test***

30. A large proportion of businesses in the film industry are small (250 employees or less). The views of small businesses were taken account of in 2005 and during the initial formal consultation period through stakeholder meetings and written responses. We consulted with the Small Business Service during the consultation period, who were satisfied that the original Cultural Test has had little impact on small businesses, and any impact resulting from initial procedural changes, would not be disproportionate to that of other businesses. To ease the transition to the new system, a transitional period will be set out by the HMT. It is not expected that the revised cultural test would have any further impact on small businesses.
31. Some films may score too few points and so fail the revised cultural test, but in this case the Government/industry consensus is that there is not sufficient justification for the associated benefits.

### ***Competition Assessment***

32. There will be no impact on competition from the revised test. The revised test is designed to be equally accessible to all sectors of the market. The test does not dictate to film makers their choice of content, hubs and practitioners but it does awards a good number of points for films demonstrating British culture through their content.

### **Enforcement and Sanctions**

33. The Department for Culture, Media and Sport (DCMS) will manage the effective enforcement of the revised test and thereafter ensure compliance. Non-compliance would result in a film not qualifying as British, or having its British certificate withdrawn, which in turn would prevent it from being eligible to apply for benefits available to British films. The new test has been drafted to avoid loop-holes which could lead to abuse of the test.

## **Monitoring and Evaluation**

34. The revised tests will be kept under continuous review. This information will also be linked with data from HMRC and UKFC and from other sources on the distribution and performance of British films at the box office and through other channels. This will allow the performance of the test against its wider objectives to be assessed and a judgement made about the effectiveness of the tests.

## **Implementation and Delivery Plan**

35. The DCMS will implement and deliver the revised Cultural Test. The key milestone will be 1 January 2007 when we expect the revised Cultural Test to begin to apply. The implementation of the revised test, as mentioned above, will not in itself be burdensome on staff or financial resources. Central to the implementation and delivery plan is communication with stakeholders. Seminars and workshops for the industry will be considered in order to effectively deliver the new system.

## **Post-implementation Review**

36. A Post-implementation review will be conducted two years after the cultural test has been introduced. The success of the revised cultural test will be measured against the objectives set out in this RIA as well as against performance results of British films, including box office admissions, number of certified films (British and co-productions) and the use of British content in films. It would be difficult to do a reasonable assessment within less than two years as initial take-up of the new system for films is anticipated to be slow, time is needed for films to be released, and box office figures over a reasonable period need to be considered.

## **Summary and Recommendation**

<b>Option</b>	<b>Total benefit per annum</b>	<b>Total cost per annum</b>
1	No additional benefits	No additional costs
2	Ensuring that films are culturally British and create a sustainable, thriving British film industry by encouraging British cultural content to be displayed on screen and investment into Britain's cultural practitioners and	Following the initial period of 'bedding in' the revised test will ultimately be less costly than the existing structure, as it will be easier to make certification decisions and therefore a more efficient use of staff time.

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### **Conclusion**

37. Based on the evidence provided in this RIA, the recommendation is to proceed with Option 2. As illustrated above, this option offers the most benefits to the British film industry and the smallest cost to the Exchequer.

### **DECLARATION**

I have read these Regulatory Impact Assessments and I am satisfied that the benefits of each justify the costs.

**Shaun Woodward MP  
Minister for Creative Industries and Tourism  
Department for Culture, Media and Sport  
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