

BFI RESPONSE TO HM TREASURY VISUAL EFFECTS CONSULTATION

Executive Summary

The BFI sees merit in both options, with some amendments, and as such we recommend both options for implementation. We also recommend an increase in the value of points within the Cultural Test for shooting and/or VFX. In addition, the BFI would urge the scope of VFX to be defined as widely as possible to support as much of the sector as possible. We recommend the definition of VFX as provided in the Cultural Test guidance notes for film is used to determine the scope of the sector.

There are three key areas where we would like to offer detailed feedback:

- Showing how the VFX industry has benefited the UK economy and British film since 2007 and why there is now a need to prevent the loss of the sector to internationally territories
- Offering alternative solutions which build upon the proposed options and benefit the whole sector
- Identifying the need to introduce targeted skills area in higher and further education relating to the VFX industries to ensure a diverse and expert British workforce for the future.

The Visual Effects (VFX) sector is a significant part of the global film economy and represents an increasingly substantial proportion of film budgets. It has a highly skilled workforce and the UK sector is highly regarded for its expertise and the quality of its output. However, the UK is losing work to territories elsewhere who offer specifically targeted tax incentives, largely because, under European Union State Aid rules, the UK's Film Tax Relief (FTR) is calculated on 80% of spend so producers are actively incentivised to look elsewhere for 20% of their budgets and VFX is one of the most portable.

This has an impact both economically and culturally. VFX is increasingly influential in shaping the look and feel of films – even generating individual characters - and it is important to ensure that British sensibilities and cultural influence continues to play their part.

There is also a significant concern regarding skills and education. This was initially raised in in the UK Facilities Sector report in 2009 commissioned by UK Screen Association in partnership with the UK Film Council and Ascent Media and again in the NEXT GEN report published in 2011 and commissioned by NESTA. The loss of VFX work in the UK impacts across all the creative sectors and needs to be addressed.

The government's commitment to support the VFX industry is vital but it must be delivered with a commitment to consider all aspects of the VFX and film production agenda from the economic value through to education, skills and diversity.

We welcome the criteria set out by the Government in the consultation document, particularly in that it acknowledges a need to support this important sector. We also see this as an opportunity to consider how to maximise opportunities for other elements of the film production value chain such as skills, education and employment.

Introduction

The British Film Institute (BFI) is the lead organisation for film in the UK. Since 2011, it has combined a creative, cultural and industrial role as a Government arm's length body and distributor of National Lottery funds. Its key priorities are to support a vibrant UK film culture by investing in film education, audience access, filmmaking and film heritage. Founded in 1933, the BFI is a registered charity governed by Royal Charter.

In October 2012, the BFI published 'Film Forever, Supporting UK Film 2012-2017', which set out its strategy for the next five years, following an extensive industry consultation. It described the activities underpinning the BFI's three strategic priorities:

- Expanding education and learning opportunities and boosting audience choice across the UK;
- Supporting the future success of British film; and
- Unlocking film heritage for everyone in the UK to enjoy.

To that end, the BFI helps ensure public policy supports film, especially British film. It follows that we support HM Treasury's recognition that support for the UK visual effects industry is important to sustain film production in the UK and encourage future production in the UK in a competitive international market to the benefit of audiences for culturally British films at home and abroad.

The Options

Bearing in mind the causes of the decline in VFX in the UK, the most logical option to solve the problem would be to offer film tax relief on 100% of the budget. However, the recent draft Cinema Communication from the EU means that this is not compatible with State Aid rules. Our response to the European Commission has called for this to be changed though it is probable that the rules will remain as drafted.

Therefore the two options put forward by the Government seem like sensible attempts to address the problem. We will discuss each of them in turn, but we see no reason why they should be mutually exclusive.

We see merit in both options, with some amendments, and as such we recommend both options for implementation. We also recommend an increase in the value of points within the Cultural Test for shooting and/or VFX. In addition, the BFI would urge the scope of VFX to be defined as widely as possible to support as much of the sector as possible. We recommend the definition of VFX as provided in the Cultural Test guidance notes for film is used to determine the scope of the sector:

"Visual effects mean digital alterations to a film's images. That is, where individual frames of the film are created, recorded or manipulated digitally in a digital environment. Visual effects activity includes, but is not limited to: Pre-visualisation, Concept Design, Data Acquisition (motion capture, cyber scans, lidar scanning, set surveys, photogrammetry shoots), Computer Generated Images (CGI), Character/Creature Animation, Colour Correction, 2D Compositing, 3D Animation, 3D Modelling, Digital Intermediate, Virtual Sets/Studios, Digital Matte Painting, Lighting and Rendering. However, it does not include the editing of a film."

Option 1:

The evidence suggests that the most significant failure in the VFX field relates to large budget films when the producer moves elements of the production to secure the best deals; however we must be mindful that VFX is increasingly important to independent filmmaking as well.

Bringing the rate of relief for large budget films in line with the same rate as lower budget films is a positive move as it brings a level of consistency with the new tax reliefs for high-end TV and Animation (as well as the video games relief which we would like to see approved by the Commission). However, we do not think this amendment should be coupled to a requirement for 80% of the VFX cost to be spent in the UK.

However, this is a zero sum game as producers may still look to move another area of up to 20% of the total spend outside the UK to claim relief elsewhere. In some cases, therefore, the incentive would still not result in the whole production being shot in the UK. We would advocate removing the 80% restriction as a general condition of the tax relief and instead offer it as 1 of 2 options to claim for points in the Cultural Test. This could include awarding points for studio filming and VFX. We think one way of mitigating this would be to amend the Cultural Test for film so that an additional 2 points may be awarded if at least 80% of the VFX budget is spent in the UK, or 2 points are awarded if at least 50% of the VFX is spent in the UK and 2 points are awarded if at least 50% of the principal photography takes place in the UK.

Introducing additional points into the Cultural Test will increase the total to 33 and the pass mark will be increased to 17.

We understand that any amendments to the Cultural Test would need European Commission (EC) clearance but we believe that these proposals are consistent with the EC definition of a culturally British film. Whilst introducing extra points to the cultural hubs section will decrease the proportion of cultural content points in section A from 51% to 48%, it is still the most generous section of the Cultural Test and we feel that it will not impact on the cultural value of British films overall. If there was a concern from the EC that the value of the cultural content in section A was diminished, then one option would be to add a further 2 points for English language (including regionally recognised languages) in section A4. This would bring the total points value to 35 and pass mark to 18 but importantly would mean that the overall points weighting of cultural content in section A remained at 51%.

Option 2:

We are unclear as to why the level of 20% has been selected and are not sure that the evidence points to that having any meaningful impact. However, if reduced to 10% we think that this could help encourage production overall in two ways. It might increase the number of productions that come to the UK in total, notably in the co-production sector and it might also encourage the VFX expenditure on some productions that are not taking place in the UK to be spent here. We do not think it will be significant in its own right, but combined with Option 1 and additional points in the Cultural Test it might help deliver a net benefit to the UK.

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

The BFI agrees with the criteria as laid out in the consultation document and is pleased to see the Government has acknowledged the need for further support in this sector of UK film production. We think it is important to include in the criteria a clause which ensures that the impact of these changes reflects a positive change to the film industry economy. We welcome the options that have been laid out and have considered each in consultation with key stakeholders.

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

The most recent study of the creative industries *The UK Facilities Sector* report published in 2010 reviewed the size and scope of the broadcast, film and advertising sectors up to 2008. The authors of the report observed that whilst the UK's tax relief incentive was competitive in the international market, the film sector was vulnerable to increasing competition from those international territories offering targeted tax incentives for post production services including VFX, particularly as the relief is capped at 80%.

The latest Creative Skillset report demonstrates the effect of the decline in VFX and the current position of the VFX industry moving more work outside the UK. This has had a detrimental effect on employment in the VFX sector which has decreased by 23%. Notably there is also a significant decrease of Black Asian Minority Ethnicity (BAME) employees in the sector - down from 7.9% to 1%.

We have reviewed the VFX spend of 29 of the 46 large budget films that have received final certification under the Cultural Test since the introduction of the FTR in 2007. We would stress that this data is approximate and confidential. The data indicates that the approximate spend on VFX on culturally British films is in excess of £530m, with at least £287m being spent in the UK. However, there is a notable decline since 2007 in the amount of VFX which is now taking place in the UK. Not least due to the UK's 80% cap on claiming tax credit and the ability to take the VFX element of a production to another international territory which offers tax credits for VFX. As the VFX spend is often 10% to 14% of the total budget, it is the most portable element of the production. Significantly, to lose such a valuable contribution both economically and in terms of employment and skills is a serious concern that must be addressed.

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

The UK visual effects industry is a world leader and is well known for having highly competitive levels of skills and experience, expertise, cultural hubs and technology. However, as the figures indicate we are losing our talent and skills to the competition.

We also need to address the skills and education being offered in schools and higher education to engage with the employees of the future and ensure we retain the talent, the skills and knowledge in the UK and remain as a world leader in this sector. Notably, the government recognised and acknowledged the loss of skills and expertise in the animation sector by introducing tax reliefs for

animation programmes. Whilst we acknowledge that state aid requirements prevent a targeted VFX tax relief, it is vital that measures are taken to prevent further losses in the VFX sector.

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

- **Changes in overall levels of activity and employment within the UK visual effects industry;**

As noted previously, employment in the sector has decreased since 2009 by nearly a quarter. This is a significant downturn and is a consequence of employees and their skills and experience following the work outside the UK and has had a significant impact on the diversity of the VFX workforce.

- **Trends in visual effects activity on culturally British films;**

Due to the 80% cap on FTR, there has been a decline in the amount of VFX taking place in the UK. Large budget films which aim to spend the majority of the budget in the UK, will take the VFX work to another country to maximise the incentives available specifically for VFX.

- **Examples of visual effects activity, companies or employment moving overseas, and estimates of the value of this activity; and**

The majority of companies in the UK are based in London but they have also identified the value in opening offices in territories such as Canada, India, the US and Australia where they can offer the skills and talent of the UK but in another country. MPC, Framestore, Prime Focus and Double Negative have all opened branches in international territories.

- **Details of British films (particularly large budget films) choosing to spend their visual effects budgets outside the UK.**

See appendix – this is confidential data

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

- Ability to qualify as British under the Cultural Test to access the UK's film tax relief (FTR).
- The 80% cap of FTR available means applicants will look to spend 20% elsewhere where they can still get relief.
- More competitive targeted VFX tax reliefs available outside the member states. e.g. Canada
- Portability of the VFX sector to take the work overseas

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

It will have an adverse impact by reducing the number of projects coming to the UK which in turn may result in entire productions going elsewhere and having a further impact on the contribution of UK film production to the GDP.

Question 7: Overall, would pursuing this proposed option be an effective way to provide further support for the visual effects industry through the tax system?

We welcome the options HM Treasury has proposed and see the benefits that each could offer but not as an “either or” option. Option 1 (offering an enhanced 25% tax credit for large budget films with at least 80% VFX spend) will benefit large budget films but the 80% spend as a tax requirement is restrictive. We recommend that the 80% VFX spend is removed but offered within an amended film cultural test as 1 of 2 options to achieve further points for shooting and/or VFX.

Whilst there is obviously a higher visual effects spend for larger budget productions, this option does not benefit lower budget film production and could be seen as only supporting one part of the film production sector.

We strongly recommend that the rate of relief for large budget films is brought in line with the high-end television; animation and proposed video games relief regardless of the VFX spend.

As the new creative sector reliefs for high-end television, animation and the proposed video games do not have a limitation for larger budget productions, we feel that this should be a consideration outside of the visual effects consultation thereby delivering greater consistency across all the reliefs onto a level playing field.

The second option of reducing the core expenditure threshold from 25% to 20% is a positive move but we think that the 5% reduction is not significant enough to make an impact. We recommend that the threshold is reduced to 10%. This would benefit all budget levels in the film production sector but importantly could encourage further work to take place in the UK and equally could encourage further official co-production with EU member states. We also think an amendment to the Cultural Test which gives higher budget films the option to achieve points specifically for visual effects could have a beneficial effect, if combined with the reduced core expenditure threshold. An outline proposal is attached at Annex A.

Question 8: What are the likely economic impacts of introducing this option?

The impacts of both options that we have recommended would be a rise in the FTR being given to the applicant. However in a wider context this would be offset by the increase in visual effects and potentially other production work taking place in the UK. This will further add value to the economy and generate employment. It will also help maintain the UK as an attractive prospect for inward investment and co-production.

Question 9: How far would this option support or increase visual effects activity on culturally British films?

We consider that the options we have proposed, with an enhanced points system in the cultural test, would potentially increase and support the UK VFX sector and production activity on culturally British films. It could also potentially encourage new inward investment in the UK. But to gain significant information on the impact of these proposals a monitoring exercise across the industry should be undertaken over the next three years. The consultation has demonstrated the need to evaluate consistently the levels of activity, employment, education and size of the film and creative sector industries across all parts of the sector on a regular basis.

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

Whilst the support for the visual effects industry is welcomed, this could lead to a decrease in music recording and audio work at the post-production stage taking place in the UK due to the cap of 80% of the FTR. Therefore balance and consideration of these cultural industries also needs to be addressed and all areas of film production should be closely monitored in the next three years.

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

The VFX spend on large budget films may depend on the genre and style of the film. The range varies from 5% to 20% but averages between 10% to 14% for those films which have significant VFX content. The spend can be at least 1- 2% of the total core expenditure, or in the region of at least £500k to £1m.

The producers of animated films may spend at least 50% of the budget spent on visual effects.

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

Almost all larger budget film will have some visual effects spend. The genre and style of the film may dictate a less significant spend (e.g. *Mamma Mia*) but the general trend would be for at least 1% to spent on digital intermediate activity. All large budget films will have part of their VFX spend on digital intermediate work. Digital intermediate work is the finishing process and includes digitally refining and enhancing elements of the film such as colour.

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

If it is reduced to 10% we believe that it would have a significant positive effect by encouraging and increasing the VFX work to take place in the UK. We also believe that a 10% threshold will increase official co-production with partner countries and Member States of the European Union.

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

The legislation for the Cultural Test for film recommends that points will be awarded for significant spend for VFX, SFX, music recording, audio post production and picture post production. This is measured at 1% of the total budget. However, where the amount is a significant spend but is lower than 1%, discretion may be granted to award the points.

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

As above, we understand that these measures are intended to benefit all budget levels of film production. As such we would recommend that a 1% threshold of the total budget, which is the current level for cultural hub spends in the film cultural test, is a reasonable figure. The test does allow for discretion if the amount is less than 1% but still deemed to be significant in relation to the work and we recommend that this discretion is also maintained.

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

It's unlikely that our recommended options would cause an extra burden. It is already a requirement for applicants or their representatives, who claim the VFX points in the Cultural Test to provide a breakdown of the VFX costs.

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

Yes, as the cultural test is limited to only British content in Section A, it can be difficult for some inward investment projects to qualify and mean that the whole project may go elsewhere. As such an amended cultural test option is provided at Annex A.

We would also recommend that the European Economic Area (EEA) sections of A1, A2 and A3 of the Cultural Tests for high-end television and animation programmes are introduced into the film Cultural Test, thereby putting the UK on a level playing field with other member states cultural tests which allow European content.

We also believe that introducing the 'unidentified location and citizens of an unidentified location' elements in A1 and A2 of the animation programme and proposed video games cultural tests would be significantly beneficial to the film Cultural Test, notably for the visual effects sector. Films with fantasy landscapes or set on other planets struggle to pass the film cultural test yet are likely to have a significant visual effects spend.

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

As outlined in our previous answers we recommend the introduction of both options, with recommended amendments, will benefit all parts of the sector. We further recommend that option 1 includes an enhanced cultural test proposal which awards points where a significant level of VFX takes place in the UK.

A	Cultural Content	
A1	Film set in the UK	4
A2	Lead characters British citizens or residents	4
A3	Film based on British subject matter or underlying material	4
A4	Original dialogue recorded mainly in English language	4
	Total Section A	16
B	Cultural Contribution	
	Film represents/reflects a diverse British culture, British heritage or British creativity	4
	Total Section B	4
C	Cultural Hubs	
C1	At least 50% of principal photography or SFX	2
	At least 50% of VFX	2
C2	At least 50% of Music Recording or Audio Post Production or Picture Post Production	1
	Total Section C	5
D	Cultural Practitioners	
D1	Director	1
D2	Scriptwriter	1
D3	Producer	1
D4	Composer	1
D5	Lead Actors	1
D6	Majority of Cast	1
D7	Key Staff (lead cinematographer, lead production designer, lead costume designer, lead editor, lead sound designer, lead visual effects supervisor, lead hair and makeup)	1
D8	Majority of Crew	1
	TOTAL ALL SECTIONS (pass mark 17)	33

A	Cultural Content	
A1	Film set in the UK	4
A2	Lead characters British citizens or residents	4
A3	Film based on British subject matter or underlying material	4
A4	Original dialogue recorded mainly in English language	4
	Total Section A	16
B	Cultural Contribution	
	Film represents/reflects a diverse British culture, British heritage or British creativity	4
	Total Section B	4
C	Cultural Hubs	
C1	At least 50% principal photography or VFX or SFX	2
And	At least 80% of principal photography or VFX	2
C2	Music Recording/Audio Post Production/Picture Post Production	1
	Total Section C	5
D	Cultural Practitioners	
D1	Director	1
D2	Scriptwriter	1
D3	Producer	1
D4	Composer	1
D5	Lead Actors	1
D6	Majority of Cast	1
D7	Key Staff (lead cinematographer, lead production designer, lead costume designer, lead editor, lead sound designer, lead visual effects supervisor, lead hair and makeup)	1
D8	Majority of Crew	1
	TOTAL ALL SECTIONS (pass mark 17)	33

