



Bord Scannán na hÉireann  
The Irish Film Board

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# Adapting to the changing competitive dynamics of the international film industry.

Report to the Department of Arts, Sport and Tourism

November 2005

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## Executive summary

Ireland has built a strong competitive position in the international film industry over the past decade. Film activity and the reputation of Irish cast, crews and producers overseas have thrived aided by continued government support. An average of 19 indigenous and 9 incoming films<sup>1</sup> have been produced in Ireland over the last three years representing annual Irish spend of €102 million and employing over 4,100 people each year. The Irish film industry's contribution to the broader cultural, social, economic and strategic development of Ireland has also been widely endorsed<sup>2</sup>. However, the future of the Irish film industry is now in jeopardy as a result of major changes in tax incentives across a number of key partner and competing territories. In the last 5 years, many territories including Australia, New Zealand, Canada, New York, Fiji and Hungary have increased their fiscal incentives to compete for lucrative Hollywood productions.

The success of the Irish film industry has been driven to a large extent by the combination of: availability of distinctive locations, established infrastructure, a strong cadre of crew and creative talent and a competitive financial incentive created by the ability to combine UK and Irish tax incentives on Irish expenditure<sup>3</sup>. This is about to change. The UK tax scheme for film production will expire in April 2006. The UK Treasury have made it clear that a new system will be introduced but will be limited to expenditure in the UK. Over 93% of Irish feature film activity<sup>4</sup> is currently co-produced with the UK. The elimination of the combined tax relief will have an immediate impact on all co-productions - significantly impacting the viability of indigenous and incoming productions in Ireland.

In the face of these changes, the Irish Film Board has estimated that activity levels will immediately fall to a level of 33% of average activity<sup>5</sup> experienced during the 2002 – 2004 period. This would result in a corresponding fall in direct employment and direct economic contribution. At this reduced level it is unlikely that the industry could carve out a viable future as talent, crew and ancillary service providers would likely emigrate or exit the industry and there would be no investment in infrastructure. This effectively would signal the loss of all the economic, strategic and cultural benefits associated with a national film industry.

If Ireland is to maintain competitiveness within the dynamics of the international film industry, a change to the tax incentive will be essential. The financial incentive available from Ireland

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<sup>1</sup> Feature films, television dramas and animation

<sup>2</sup> The 2003 PWC and Sheridan Reports identified the value in nurturing an indigenous industry capable of creating and exploiting Intellectual Property Rights, and creating and sustaining highly skilled, value added employment. These broader arguments in favour of government support for this are not re-visited

<sup>3</sup> The benefit offered by Section 481 to productions is below market level when considered on a stand-alone basis but under the current UK system, co-productions can combine UK and Irish incentives for the portions of the production spend incurred in Ireland, providing a minimum of 20% of total production budget is spent in the UK. Section 481 is restricted to Irish spend only.

<sup>4</sup> Based on an analysis number of feature films produced during the period 2000 - 2004, excludes feature films of less than €1 million (which are considered too small to justify co-production financing in most cases)

<sup>5</sup> As measured by total annual Irish expenditure

will have to be competitive on a stand-alone basis when compared with other territories. In order to achieve this, a minimum net benefit of 20% of the production budget to all films, regardless of budget size, is required. Providing Ireland can offer a competitive benefit on a stand-alone basis, the changing competitive landscape also provides opportunities to expand the scope of film production activity to promote the growth of the post-production sector which has been under-developed owing to current co-production arrangements with the UK. Changes to Section 481 will be required to enable this.

The Irish Film Board is recommending the following changes to the Section 481 system:

- **Remove the current 66% / 55% limitation** on eligible expenditure that qualifies for Section 481 to consider **all Irish expenditure as eligible**. The current limitation effectively limits activity to no more than 55% (on medium to larger scale projects) of a film's expenditure in Ireland. The removal of this limitation will increase the incentive for productions to base a larger proportion of spend in Ireland (to potentially include production and post production), while also increasing the available net benefit for productions as a percentage of total budget.
- **Remove the restriction on size of Section 481 funds that can be raised for films** with a budget greater than €27 million<sup>6</sup>. Given that the average Hollywood film has a budget of €53 million, the current cap excludes a significant amount of lucrative activity.
- **Restore tax relief for individual investors to 100%**. This change will further increase the benefit to productions in order to address the current market deficit. Market forces will ensure that this benefit flows to the production rather than to individual investors.
- **Consider a mechanism for maintaining the competitiveness of Section 481** in order to respond to the fast moving, competitive landscape.

The proposed changes to the film tax incentive should enable the continued development and expansion of the film industry while contributing positive economic benefits to Ireland. The incremental exchequer costs of €10.8 million are estimated to yield a 5:1 economic return. In order to address the major uncertainty that is constraining current industry activity, an announcement is required in the context of the forthcoming Finance Act. Ireland must be in a position to offer producers a viable package ahead of the expiration of the UK scheme in April 2006, in order to influence their location selection and financing viability decisions for 2006 and 2007 productions.

Without implementing proposed changes to the incentive immediately, Ireland's audio-visual sector will slide backwards, losing its international foothold with profound negative effects on employment (direct and indirect), talent development and retention and the growth and development of SME's. The industry is at a crucially vulnerable stage.

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<sup>6</sup> The current cap on Section 481 funds that can be raised of €15 million equates to a budget of €27 million applying the 55% limitation of qualifying funds

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## Chapter 1: Ireland's current competitive position

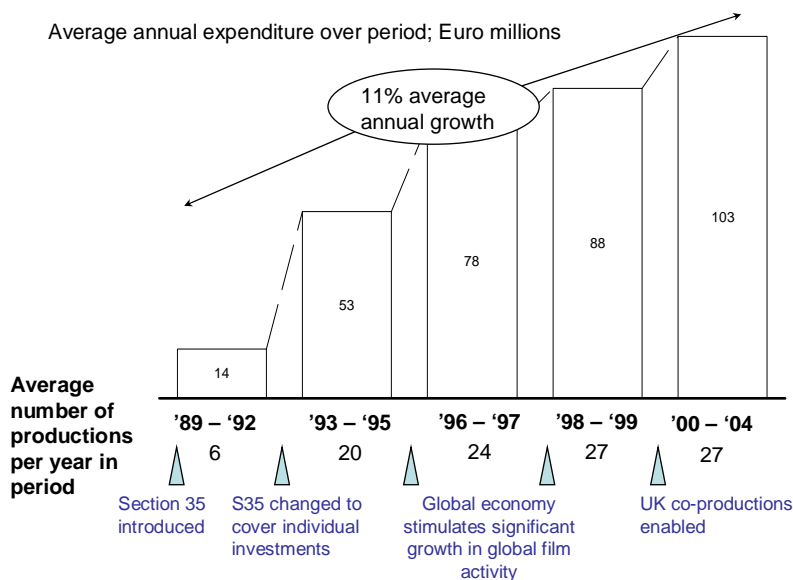
Ireland has built a strong competitive position in the international film industry since the introduction of a production tax incentive for individual investors, together with the reconstitution of the Irish Film Board, in 1993. Film activity and the reputation of Irish cast, crews and producers overseas have thrived for much of the last decade aided by continued government support. As a consequence the Irish economy has benefited from the direct expenditure attracted into Ireland by substantial international film productions locating in Ireland, together with a growing and positive international awareness of Ireland through the medium of high profile Film and Television projects that receive major worldwide distribution. This position is now under threat as imminent changes in international incentive structures will significantly impact Ireland's ability to offer a competitive package to international and indigenous producers.

### The Irish Film Industry's success in International Film industry

Ireland is recognised as a key player in the international film industry both for its role in producing high quality indigenous films and television drama and as a favoured location of choice for incoming productions. Over the past 12 years, since the introduction of the Government's tax incentive for films, over 345 films<sup>7</sup> have been produced in Ireland. Average annual expenditure has risen by 17% since 1989.

Exhibit 1

#### Annual Irish Expenditure by Film Industry



<sup>7</sup> Includes feature films, television drama and animation productions

The quality of Irish films and Irish film industry talent is well recognised. Irish films and television drama have achieved international acclaim through winning awards at the most prominent international film festivals over the past decade e.g. 3 Oscar nominations for *In America* (2004); Toronto Film Festival Discovery award for *Magdalene Sisters* (2002) and *Omagh* (2004) which also won the 2004 BAFTA; Edinburgh Film Festival Audience award and Sundance Film Festival Selection for *Inside I'm Dancing* (2004/2005); and Berlin Golden Bear and Sundance Audience Prize for *Bloody Sunday* (2002). In addition, many Irish cast and crew are now considered in the premiere league of film talent including actors (Colin Farrell, Cillian Murphy, Brenda Fricker and Gabriel Byrne) and directors (John Moore, Neil Jordan, Jim Sheridan and Damien O'Donnell). All of these key creatives received their initial exposure/experience on Irish productions, and their high profile in turn reflects back positively in terms of recognition, interest, and goodwill on Ireland generally.

An average of 4,100 people were directly employed in the film industry each year during the period 2002 – 2004<sup>8</sup>. Industry activity also resulted in additional employment in related industries including tourism, ancillary service providers and digital media.

### **Role of government support**

Sustained government support has been a key contributor to this success in the form of tax incentives and the funding of the Irish Film Board.

- Tax incentives: The introduction of a tax incentive specifically for individuals to invest in film and television production in 1993<sup>9</sup> (which formed the basis of current Section 481 legislation) has been of paramount importance to the industry. When the Government extended this scheme to individuals in 1993, Ireland was one of the few countries offering tax incentives for film production. Since then tax relief for film production has been adopted across the globe, in no small part stimulated by Ireland's well publicised success in this area.
- Irish Film Board: The Irish Film Board promotes the creative and commercial development of Irish filmmaking and promotes Ireland as a location. Total funding to the organisation for 2005 is €14.4 million.

The sustained nature of this support is essential and is mirrored in other countries competing for similar international film productions. This is also characteristic of Ireland's industrial development approach where the Government has been proactive in creating a rich network of support agencies and financial incentives to address the multi-faceted needs required to create a sustainable and competitive industrial sector including low corporation tax, Enterprise Ireland and IDA development support, Science Foundation Ireland R&D investment and Fás training incentives.

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<sup>8</sup> Extrapolated from Screen Producers Ireland 2003 employment survey

<sup>9</sup> Section 35 film production relief was introduced in 1987 however was limited to companies. It did not gain widespread use until 1993 when it was extended to individuals.

The dual strategy of promoting indigenous activity and attracting incoming international activity is also the key foundation of the Irish Film industry – recognising that a vibrant industry requires sustained high activity levels and international and local relationship building across the industry through experience. Inward production activity allows the indigenous sector to flourish as big budget production supports the variable activity level and significantly lower budget indigenous sector.

### **Role of co-productions**

Ireland's success in the international production industry has been inextricably linked to its ability to partner and work with the UK film industry. Over 93% of Irish feature film activity<sup>10</sup> is co-produced in the UK (21% of these also involve additional EU country participation)<sup>11</sup>.

An official co-production is a production by producers from two or more countries which is made under the aegis of an international co-production treaty. A production that is eligible to be deemed a 'qualifying' film under the terms of the relevant treaty in each of the co-producing countries is then able to access the national and regional supports and taxation based incentives in each country. In order to qualify, projects must meet specific cultural and economic criteria in each country. Co-productions in Ireland are governed by bilateral agreements / treaties and the European Convention on Cinematographic Co-production. Co-productions are a commonly used structure across the international film industry driven by two key factors:

1. The industry is an extremely mobile industry where financing decisions, made very rapidly, have a major impact on where activity is located – both at an individual film level and for components of an individual film's production (e.g. principal photography, post production). The emergence of government incentives to support activity has further fuelled this and has resulted in producers shopping around for the best financial package to support the specific needs of each and every production.
2. Outside of the Hollywood Studio system, no other single geographical area has the critical mass to deliver the creative, distribution, marketing and financial resources to produce a slate of blockbuster English language films. The critical mass can only be achieved when multiple territories work together to contribute creative and financial resources through co-productions. This market failure is recognised at the WTO where the EU and other trading blocks preserve their right to subsidise indigenous audiovisual industry development.

Over the past 5 years, 90% of indigenous films and 100% of incoming films in Ireland have been structured as co-productions<sup>12</sup>. In each case the UK has been a co-production partner. In 21% of the cases additional partners have worked together through multi-lateral co-productions.

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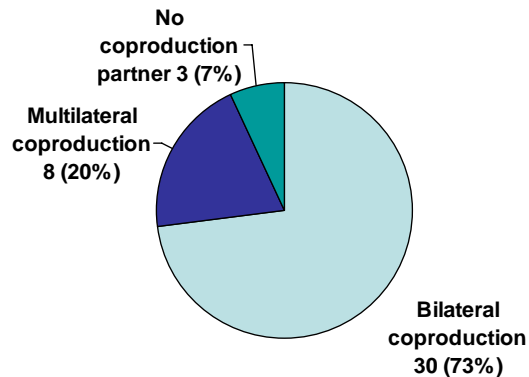
<sup>10</sup> Based on an analysis of the number of feature films produced during the period 2000 - 2004, excludes feature films of less than €1 million (which are considered too small to justify co-production financing in most cases)

<sup>11</sup> Since Ireland ratified the European Convention on Cinematographic Co-Production in June 2000, a treaty of the Council of Europe.

## Exhibit 2

### Co-production activity

Total number of Irish feature film productions '02 – '04 (%)\*



\* Excludes films < €1 million  
Source: IBEC data and IFB analysis

The UK has been a strong co-production partner for many territories as a result of its tax incentive structure. Film productions have been able to avail of UK tax incentives for all eligible spend (regardless of where the money is spent) provided a minimum of 20% of the expenditure is incurred in the UK<sup>13</sup>, and the film is deemed to qualify as an official co-production film. The Irish tax incentive is limited to eligible expenditure incurred in Ireland only. Thus, it has been possible to combine UK and Irish tax incentives for the portions of the production spend incurred in Ireland so long as the minimum 20% UK spend has been satisfied. In addition, UK private equity partnership structures based on Generally Agreed Accounting Principles 'GAAP' which were also able to finance film have emerged, providing further incentives to the UK and Irish industries. Typically, this has resulted in productions shooting in Ireland and conducting post-production in the UK.

Uncertainties and proposed changes to the UK system have directly contributed to a downturn in Irish activity levels in 2004 and 2005, evidencing the dependency on the UK. During 2004, the UK government announced a number of changes to the system to address UK Treasury concerns regarding tax avoidance loopholes in the system under 'GAAP' partnerships and made it clear that further changes were being considered. This uncertainty and instability had an immediate impact where small changes to incentives can change the economic viability of film production. Decisions on where to locate a film require a level of certainty around

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<sup>12</sup> Of the 3 feature films (> €1 million budget) that did not avail of co-production structures, **Honeymooners** was a Hollywood production that shot in Ireland as a result of favourable previous experiences of the producer and could not qualify for UK relief due to high US cast involvement and 2 low budget films (**Dead Bodies** and **Bloom**) where the budget was deemed to be too low to entice multiple investors through a co-production structure.

<sup>13</sup> And subject to the points system as per the European Convention on Cinematographic Co-Production

financing structures for a guaranteed period. Production investment in UK features has slumped by 43% in the first nine months of 2005 which film observers have linked to the uncertainty over the UK tax regime coupled with the strength of the pound against the dollar<sup>14</sup>. This downturn in UK activity levels has been mirrored in Ireland where production levels in 2004 / 2005 decreased by 50% compared with the previous two years as concerns about financing viability caused international studios to consider alternative locations with more stable and therefore more attractive incentives or indigenous Irish productions believed the financing conditions too tight and risky to pursue<sup>15</sup>.

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<sup>14</sup> Screen Finance October 5, 2005

<sup>15</sup> Exchange rate concerns and the impact of new tax incentives in New York, Louisiana, Hungary and New Zealand have also contributed to this decline.

## Chapter 2: Changing competitive landscape

The competitiveness of the international film industry is, like most industries, based on a dynamic landscape impacted by changes in national and local government support, international exchange rates and consumer taste and spending characteristics. The poor performance of the Dollar against the Euro and Sterling over the past 3 years has weakened the competitive position of all European countries reliant on US investment. However, Ireland's position is likely to come under significantly greater threat as a result of a change in tax incentives across many territories, favouring greater focus on maintaining film expenditure within the tax jurisdiction offering the incentive.

### Change in UK tax incentive structure

The changes to UK tax regimes announced in 2004 were a temporary measure to address tax avoidance loopholes under GAAP and prompted a major review of the industry. Following a detailed economic and cultural assessment of the value of the UK film industry to the UK economy, the UK Treasury announced a renewed and strengthened commitment to the industry coupled with preliminary guidelines for a significantly new tax incentive structure to be introduced in early 2006.

The new tax incentive scheme will be finalised shortly and legislated post industry consultation; however the published guidelines and feedback from the industry indicate that the scheme will incorporate the following fundamental changes:

- Tax relief will be limited to qualifying UK production expenditure - rather than global budget in current system
- The minimum expenditure incurred in the UK required to qualify for UK tax relief is likely to increase from the current 20% - the consultation document specifies a target 40%.
- The incentive will result in a net benefit to producers of an estimated 20% depending on the size and structure of the film<sup>16</sup>. This compares to 8% – 15% offered today. It would therefore seem that purely UK indigenous productions will receive the maximum benefit by maximising local spend.

If, post consultation, the proposed changes are maintained, co-producers will be forced to re-think the current UK / Irish co-production model. The proposed 40% minimum UK spend will change the way producers think about splitting activities across territories. In the past, to avail of both incentives, producers have tended to shoot films in Ireland and conduct post production in the UK. A 40% minimum spend effectively requires the producer to shoot part of the film in the UK. Only 19% of UK / Irish co-productions over the period 2000 - 2004 would have met this new 40% criteria. A change in the structure to locate 40% of spend in the UK is not simple. It is rarely cost effective to split shooting between two countries unless the script requires this. The

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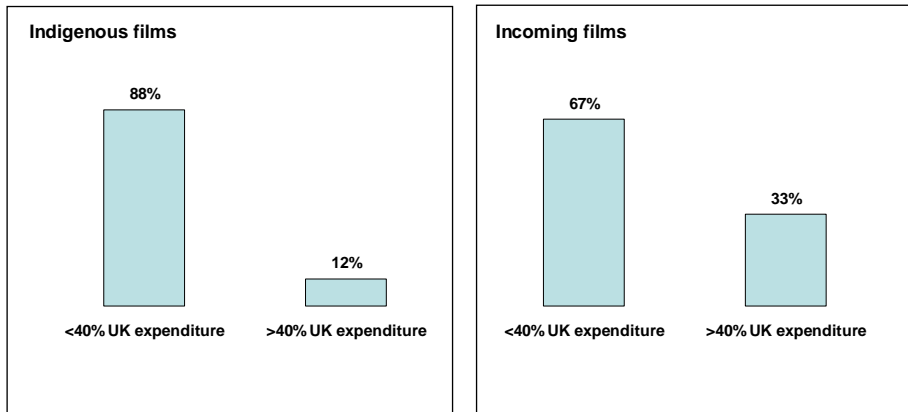
<sup>16</sup> See Appendix 1 for full details of the proposed incentive and calculations of net benefit.

proposed changes also inhibit the ability to combine UK and Irish incentives on Irish spend<sup>17</sup>. Given the strength of the UK post production sector and the limitation of UK tax incentive to UK spend, there will be limited benefits to an Irish or International producer in structuring a UK / Irish co-production for the vast majority of films.

**Exhibit 3**

**Coproduction structure**

% of all Irish film coproductions '01 – '04



**Changes underway in other territories**

The international competition for film production is also being affected by introduction of new tax relief in other territories. For the first time, a number of US states (e.g. New York, Louisiana and Texas) have recently introduced state and city incentives and a number of additional states (including California - the home of Hollywood and Governor Arnold Schwarzenegger) are now considering further incentives to attempt to stem the tide of US production leaving Hollywood. Since Louisiana (pre Hurricane Katrina), introduced tax incentives worth up to 20% of a budget in 2002, production spend in the state has increased from US\$30 million to more than US\$400 million in 2004<sup>18</sup>.

Meanwhile, the low cost of labour, investment in infrastructure and diverse locations has boosted the attractiveness of Eastern European countries to international producers. Hungary, Romania and the Czech Republic in particular are serious competitors in the international film industry. In addition to low labour rates<sup>19</sup>, they are able to offer a strong cadre of experienced crew and a sophisticated infrastructure. Several jurisdictions have or are considering

<sup>17</sup> As currently permitted for UK / Irish coproductions where UK tax incentives are available for total EU spend providing a minimum 20% expenditure in the UK

<sup>18</sup> Source Screen Daily 27 April 2005

<sup>19</sup> Hungary's production costs are 50 – 60% lower than the UK and anything between 30 –70% lower than the US with Romanian costs 40% lower than the Czech Republic and Hungary according to a Screen International article How the East is being won"

introducing tax incentives for film. Since Hungary introduced a 20% rebate on foreign productions in 2004 (based on local spend), levels of production have increased ten fold from one film in 2003 to an estimated ten films in 2005<sup>20</sup>. Simultaneously, work to improve infrastructure such as building a new purpose built studio and the provision of additional governmental support is improving conditions and competitiveness for filmmaking in Hungary.

Belgium, New Zealand, and Malta have also changed their incentives to improve their competitiveness. All of these territories have tied incentives to local spend.

### *Case Study: New York City*



*Historically, New York was a highly favoured location for film production as a result of its wealth of city locations and the availability of crews. However, over the past decade it had experienced a significant decrease in activity as a result of productions moving to territories with specific financial incentives. Ireland has gained significantly by attracting a number of films that would historically have been New York productions (e.g. **In America, Laws of Attraction and Honeymooners**). Recognising the loss of economic benefits, Mayor Bloomberg has introduced a series of new incentives to improve the competitive proposition for film productions. This includes a 5% production city tax credit (which can be combined with a 10% state tax credit), a 1% of production cost marketing incentive, NY State sales tax exemption on below the line costs, support of the NY Mayor's Office of Film in selecting and preparing locations.*

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<sup>20</sup> Source: The Budapest Times, 30<sup>th</sup> May 2005

### Chapter 3: Implications for Irish competitiveness

The appeal of the Irish film industry has been driven to a large extent by the combination of: availability of distinctive locations, established infrastructure, a strong cadre of crew and creative talent and a competitive financial incentive created by the ability to combine UK and Irish incentives. When the UK's current system expires in April 2006 resulting in the likely removal of this UK / Irish combined effect, Ireland's proposition will no longer be internationally competitive as it will be uncompetitive as a stand alone incentive.

Ireland must now reinforce its competitiveness in its own right and must look at all aspects of the competitive offering – working arrangements, infrastructure and financial incentives.

**Talent:** The talent proposition is defined by quality and skills of available talent, labour rates, flexibility, transparency and stability. Ireland's film crew and creative talent are widely regarded as world-class. The flexibility and stability of labour relationships are currently the subject of an ongoing industry negotiation. Resolution of this will be important for the industry. Labour rates in Ireland have steadily increased and are now considerably higher than in competing territories such as Czech Republic and Hungary. As a result, Ireland is no longer a location of choice for highly labour intensive films (such as any film where major set construction and support is required). However, the labour rates in Ireland are still lower than in the US and are not considered an obstacle for films where quality of crew and location and relative ease of production (i.e. proximity to US and UK and English speaking) are key drivers.

**Infrastructure:** Ireland currently has one purpose built production studio for major films (Ardmore Studios) and three small studios. None of these have been upgraded over the past 2 years and future upgrades of Ardmore are on hold amidst uncertainty of large budget film activity. As a result, facilities are increasingly falling behind world class standards. The Irish industry will have to address this area in order to bolster its proposition.

**Financial support:** Film finance for indigenous productions relies on three key sources: tax incentives, public funding and market support. Together with assessing real costs of production (goods and labour), incoming Hollywood productions typically base decisions on tax incentives as public funding is not normally available to them and market support is within their own control. Ireland's financing sources can be assessed as follows:

**Tax incentives:** Section 481 has been widely recognised as a strong incentive structure much admired due to the timeliness of decision-making and payment. However, the most important aspect is the net benefit offered to producers. The current incentive provides a maximum net benefit of 12% of the total production budget for films less than €5 million and 10% for films between €6.35 million and

€27 million<sup>21</sup>. The table below illustrates how this is considerably lower than the net benefit offered by competing territories. However, Ireland’s proposition has in the past been bolstered by the potential to combine with the UK to offer a combined net benefit of up to 25%. Without this, Ireland’s incentive will be compared on a stand-alone basis and is uncompetitive and below market levels.

**Exhibit 4**  
**Comparison of tax benefits available for local production expenditure**

Theoretical example – 15m Euro film with local spend optimised to maximise benefit

Country	Net contribution to producer (% production budget)	Constraints on spend
Ireland	10%	<ul style="list-style-type: none"> <li>• €15 m cap</li> </ul>
UK anticipated	20% est.	<ul style="list-style-type: none"> <li>• Requires min. 40% UK spend</li> </ul>
UK (expiring 4/'06)	15%	<ul style="list-style-type: none"> <li>• Requires minimum 20% UK spend</li> </ul>
Ireland / UK co-production (expiring 4 / '06)	25%	<ul style="list-style-type: none"> <li>• Specific co-production guidelines</li> </ul>
Isle of Man	25%	<ul style="list-style-type: none"> <li>• Requires min. 50% local spend, linked to recoupment</li> </ul>
Hungary	20%	<ul style="list-style-type: none"> <li>• Based on certified Hungarian spend</li> </ul>
Australia	12.5%	<ul style="list-style-type: none"> <li>• Min spend of €9.3m, require 70% of budget spend in Australia for films with budget &lt;€30m</li> </ul>
Canada	10 – 25%	<ul style="list-style-type: none"> <li>• Calculated on local labour spend</li> </ul>
New York	15%	<ul style="list-style-type: none"> <li>• Requires 75% spend in NY. Only on labour costs</li> </ul>

Source: Interviews

**Irish Film Board funding:** The Irish Film Board funding is focused on indigenous films of recognised cultural merit. For projects with budgets above €3 million, the Irish Film Board can invest up to 25% of the production budget in a qualifying film through its production fund (approx. €5.5million in 2005). In practise this figure rarely exceeds €750,000 and typically makes up no more than 10% to 15% of the production budget for a mid-sized budgeted film. This support plays a vital role in the financing of indigenous films.

**Market funding:** Ireland is severely constrained in this area as it has no strong market fund sources for feature films. The UK, and most other territories can access domestic funding from distributors and national broadcasters. Ireland is viewed as a region within the UK for international distributors and is not considered a viable stand-alone geography for allocation of rights and funding. On occasion, indigenous films with specific perceived audience appeal have been able to attain domestic minimum guarantees but only for a very small portion of the production budgets. TV3 have invested in a small number of Irish films over

<sup>21</sup> €15 million is the maximum cap on eligible expenditure Section 481 funds that can be raised which translates into €27 million budget based on 55% limit to qualifying budget, films with expenditure greater than this will therefore receive proportionately lower net benefits.

the past 3 years. The stated policy of the Irish public broadcaster RTÉ, is not to invest in feature film.

Combined Irish sources can therefore only finance up to 35%<sup>22</sup> of a film's budget. This is in contrast to the UK where 100% funding is possible. This creates an additional hurdle for financing indigenous films. It also restricts the nature of market support available for Irish indigenous films as international distributors neither have the understanding of the Irish market or the interest to invest heavily in promoting Irish films to an Irish audience.

**Other government support:** Further government support in the form of informal political support also plays a key role in the film industry. The Irish government has a strong reputation for weighing in to address specific industry issues as required. The importance of government support has recently been elevated as evidenced by the UK Deputy PM's role in lobbying Walden Media to locate the production of the multi-million dollar period epic budget 'Wilberforce' in the UK, rather than in Ireland.

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<sup>22</sup> 10% from Section 481 and 25% from the Irish Film Board for films with greater than \$2 million budget

## Chapter 4: Required change to tax incentive

If Ireland is to compete on a stand-alone basis in the international film industry, a change to the tax incentive will be an essential component. The financial incentive available from Ireland will have to be adjusted to maintain Ireland’s competitiveness in response to the changing competitive landscape. As illustrated in Exhibit 4, the benefit offered by Ireland’s incentive is currently considerably lower than that offered by key competitors. A minimum net benefit of 20% of local spend (UK Treasury target for new incentive) will be an essential component of a viable tax incentive for indigenous and incoming productions. The Irish Film Board proposes the following structure:

### Exhibit 5

#### Proposed changes to Section 481 tax incentive

Proposed changes	Net contribution to producer (% production budget)	Other implications
Remove 55 / 66% threshold	18% for films up to €27m	<ul style="list-style-type: none"> <li>Clear incentive to incur greater proportion of spending in Ireland with particular benefits for post-production sector</li> </ul>
Lift write-off from 80% to 100%	13 – 15.5% for films up to €27m	
Remove cap on eligible expenditure	Maintain benefit for all budgets	<ul style="list-style-type: none"> <li>Provide incentive for larger budget films</li> </ul>
Combined effect of above	22.5% for all budgets	<ul style="list-style-type: none"> <li>Provide competitive benefit that puts the emphasis on maximising Irish expenditure for all budget sizes</li> </ul>

### Maintain the Section 481 framework.

The current Section 481 structure is widely accepted as being a strong tax incentive system. It works well for all stakeholders. The PWC analysis and SPI reports<sup>23</sup> of 2003 both examined the structure and favoured it due to the timely receipt of funds, ease of administration, close links between incentive and budget and the ability of financiers to ascertain fundability ahead of production decision-making. The one area of concern was from the Revenue Commissioners who had some concerns about the potential for abuses. To address this concern, control has increased with Revenue taking direct responsibility for the financial administration of the scheme from January 2005.

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<sup>23</sup> 'The Sheridan Report - Realising the potential of the Irish Film and Television Industry – a unique national asset' Screen Producers Ireland 2003; 'Review of Section 481 of the Taxes Consolidation Act 1997' PWC 2003

**1. Remove the current 66 % / 55% limitation and restrict solely to amount of Irish spend**

Under current Section 481 legislation, production companies qualifying for assistance may raise up to 66% of the total cost of production of a film with a budget of €5,080,000 or less (and no more than 55% of the total cost of production of a film with a budget greater than €6,350,000) with Section 481 funds not allowed to exceed the lower of Irish spend or €15,000,000. This creates a situation where there is no incentive to spend more than 55% / 66% of the production budget in Ireland. An analysis of previous co-productions in Exhibit 4 bears this out as on average 47% of an Irish co-production film expenditure is incurred in Ireland. A removal of this limitation would potentially have the dual benefit of extending the net benefit available to all productions to 18% of the total budget and creating an incentive to conduct a greater proportion of production activity in Ireland thus making a greater contribution to the Irish economy.

This change could be particularly beneficial to the post production sector in Ireland which has been curtailed due to the practice of basing post-production in the UK in order to ensure that a film qualifies for the combined UK / Irish incentives. The post production sector has been identified by Enterprise Ireland as a particularly attractive sector of the film industry for Irish growth given its profile as a digital media sector with strong synergies with the Irish software industry. It is unlikely that this sector will flourish in Ireland without an incentive to increase the proportion of a film's expenditure in Ireland.

Concerns regarding potential contravention of State Aid guidelines of risk are not considered to be valid in relation to this proposal and informal feedback from the EU Commission supports our view on this. EU state aid legislation does state that 'The producer must be free to spend at least 20% of the film budget in other Member States without suffering any reduction in the aid provided for under the scheme.'<sup>24</sup> This 20% of budget is likely to be achieved in all Irish produced films through salaries of non-Irish personnel, and is not impacted by the proposed removal of the 66 / 55 % limitation. In addition, any elimination of this restriction would still mean that over 80% of a film's finance must be raised from other sources and would not significantly alter the risk profile of any investment in film or violate State Aid intensity restrictions.

**2. Remove / raise cap on overall spend**

Section 481 eligible expenditure is currently restricted to €15 million. Therefore the net benefit (as a percent of total expenditure) available to films with budgets greater than €27 million decreases with increasing budgets. Given that the average Hollywood film has a budget of €51 million<sup>25</sup>, the Irish incentive does not address this critical market need. Effectively the net benefit for a €50 million budget film offered by Section 481 is 5.4% compared with 12.5% in

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<sup>24</sup> 'Legal Aspects in relation to Cinematographic and other Audiovisual Works 2001'

<sup>25</sup> According to Focus 2005 World Film Market Trends published by the European AudioVisual Observatory

New Zealand or Australia, 15% from New York, 28% from Canada, 25% from the Isle of Man<sup>26</sup>. By removing the cap, Ireland would be able to maintain competitiveness for all budget sizes.

### **3. Restore tax relief to 100%**

By restoring the tax relief for individual investors from 80% to 100%, the net benefit to productions could increase by 25%. This additional measure is essential if the industry is to offer a competitive proposition to indigenous and incoming producers. There have been concerns about such a measure unnecessarily increasing the benefit to individual investors and/or financial advisors. However, the experience of the industry has demonstrated that market forces have established a minimum return that is necessary to entice individual investors and that any increase in overall net benefit will flow to producers rather than any other party. This is also supported by the fact that there is demand from investors for Section 481 projects. When the film tax relief scheme was originally introduced to individual investors in 1993, investors were able to claim tax relief on 100% of their investment. In 1997 this was reduced to 80% when the investment period was reduced from 3 years to 1 year. At that stage personal taxation rates were 14% higher than current rates. This change will partially address the decline in net benefit that resulted from reduced personal taxation rates but most importantly is required to address the changing competitive landscape.

### **4. Consider a mechanism for maintaining the competitiveness of Section 481.**

As this report illustrates, the Irish film industry's competitiveness is heavily influenced by international factors which are by their nature highly dynamic. The proposed changes to Section 481 outlined above should ensure that the industry maintains competitiveness in the face of the expected changes to the UK, and other international incentives in 2006/ 2007. It will be advisable however to monitor the industry's competitiveness on an on-going basis, as is the case with the constant monitoring undertaken by Forfas, ESRI, Enterprise Ireland and IDA of the industrial sector generally

In the 2004 budget, the Government announced an extension of Section 481 relief to 2008. Uncertainty regarding the future of the incentive beyond this date is already impacting infrastructure investment decisions and by early 2007 will further impact on planning for major production locations that are in the decision pipeline for the year 2009.

The Irish Film Board therefore recommends that the effectiveness of Section 481 is subject to a review mechanism as international circumstances change. The administrative costs would be low given that the Irish film industry already operates in a very transparent environment<sup>27</sup>.

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<sup>26</sup> Note this 5.4% can be combined with UK benefit to offer combined 14% benefit today. However with anticipated changes in UK legislation. Ireland must offer stand-alone benefit

<sup>27</sup> DAST and IBEC are required by S481 legislation to prepare an annual report on productions availing of S481 funding with very detailed figures on numbers employed and breakdown of the eligible and non-eligible spend together with other relevant fiscal information (PAYE and PRSI totals etc). Revenue also has a view on future activity given their role in approving all Section 481 projects.

## Chapter 5: Economic impact of proposed changes

The proposed changes to the Film Tax incentive would have an estimated 5:1 return on investment for the Irish economy. This is based on a comparative analysis of two future scenarios:

1. Section 481 remains as is and activity levels decrease significantly as a result of reduced competitiveness
2. Proposed Section 481 changes are adopted and the industry builds on this reinforced competitiveness

Given that the Section 481 tax incentive is activity-based, all costs and benefits will be dependent on future activity levels.

Exhibit 6 summarises the anticipated changes in activity levels for the two future scenarios analysed.

### Exhibit 6

#### Forecasted future activity levels\*

Film category	Ave. # films '02 – '04	Estimated changes in future activity levels	
		S481 remains unchanged	Proposed changes adopted
Indigenous films <€2 million	5	-12.5%	Maintain current levels
Indigenous films >€2 million	10	-50%	Maintain current levels
Incoming films <€27 million	7	-75%	+50%
Incoming films >€27 million	1.3	-100%	+100%

\* All feature films, TV dramas and animation projects funded by Section 481

#### Future scenario where Section 481 remains unchanged

Given the changing competitive landscape, a future where the industry continues to rely on current Section 481 support levels will create major challenges for indigenous and incoming productions. Activity levels will decrease in each category of film:

##### Small indigenous films (< €2 million)

Small indigenous films are in some ways protected from a changing international landscape. Only 25% of these films avail of coproduction financing. Therefore it is assumed it is only this small percentage that will be impacted in the future. This analysis assumes a 50% drop in these coproductions as the ability to combine UK and

Irish tax incentives disappears. This will have a net impact of a 12.5% decrease in overall small indigenous film activity.

**Mid to large indigenous films (>€2 million)**

Large indigenous films depend heavily on UK / Irish coproduction financing to finance their projects; 100% of projects during '02 – '04 were structured as UK / Irish coproductions. Given that sourcing finance is a major struggle for most of these films, with only a few films generating attractive returns for their producers, the removal of the UK tax incentive combination will have a major impact. A drop in activity of at least 50% would be likely without the proposed changes in the tax incentive. Whilst it is possible that some of these films that are developed in Ireland could be produced in UK / other territories, it is likely that this would be a short-term measure before Irish producers relocate productions completely to an environment more supportive of film production.

**Incoming productions <€27million:** An average of 7 incoming productions of less than €27 million were shot in Ireland during the period '02 – '04. Given that tax incentive financing is such a major driver for location choice for this category of film, Ireland would suffer significantly with a below market level support. Without a competitive tax benefit on offer, production levels would likely fall by 75%. This is highly credible given the experience in 2005 to date, where Ireland has succeeded in attracting only 4 incoming films of modest budgets in the face of pressure from uncertainty in UK legislation.

**Incoming productions >€27million:** This category of film is already struggling in Ireland given the cap on the amount of Section 481 funds that can be raised with Ireland averaging only 1.3 films per year over the period 2002 – 2004. The additional impact of the loss of UK combined tax incentive would effectively rule Ireland out of this category of film.

In total these activity levels represent only 33% of average activity<sup>28</sup> experienced during the 2002 – 2004 period. This loss in activity levels would result in a corresponding fall in direct employment and direct economic contribution. At this low level it is unlikely that the industry could carve out a viable future as talent would likely emigrate or exit the industry and there would be no investment in infrastructure resulting in the loss of all the economic, strategic and cultural benefits associated with a national film industry.

**Future scenario where proposed changes in Section 481 are adopted**

The proposed changes in Section 481 should enable the industry to continue to thrive within this changing landscape. These changes should enable increased film activity levels both in

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<sup>28</sup> As measured by total annual Irish expenditure

terms of number of films produced in Ireland and the percentage of overall budget spent in Ireland.

**Small indigenous films (< €2 million)**

As discussed above, the immediate impact on the small indigenous sector of a changing competitive environment is not considerable. Therefore the changes proposed will have relatively little impact but should enable the sector to continue to operate at '02 – '04 activity levels.

**Mid to large indigenous films (> €2 million)**

By increasing the net benefit to market levels, indigenous producers should be able to maintain '02 – '04 production levels. A removal of the 55 / 66% limitation on the proportion of budget that can be raised should encourage producers to spend an increasing percentage of the budget in Ireland on production and post production. This analysis assumed a 20% increase in this percentage.

**Incoming films < €27 million**

The improved net benefit enabled by the proposed changes should be similar to that offered by the new UK tax incentive. Ireland could then compete in the market potentially gaining a greater proportion of business currently going to the UK/ Eastern Europe or remaining in North America. This is expected to increase activity levels by 50% with the additional impact of higher percentage of budgets being spent in Ireland. This was evidenced during recent negotiations for the BBC 'Robin Hood' production where the UK producers, Tiger Aspect, clearly indicated that their €70 million projected 5 year production would have come to Ireland if the 55% restriction did not exist. This was based on the fact that they were prepared to spend 80% of their budget in Ireland but would only receive a benefit on 55% of that 80% under current rules. They ultimately opted to move the production to Hungary where the tax incentive is available on the entire Hungarian spend without any limit or cap.

**Incoming films > €27 million**

A removal of the cap and increased net benefit could dramatically alter Ireland's competitiveness in this sector. This could effectively increase the net benefit on offer for a €50 million production from 4.5% to 22.5%. This should, at a minimum, double current activity levels in the short-term with additional growth over time as Ireland's reputation and infrastructure improves over time.

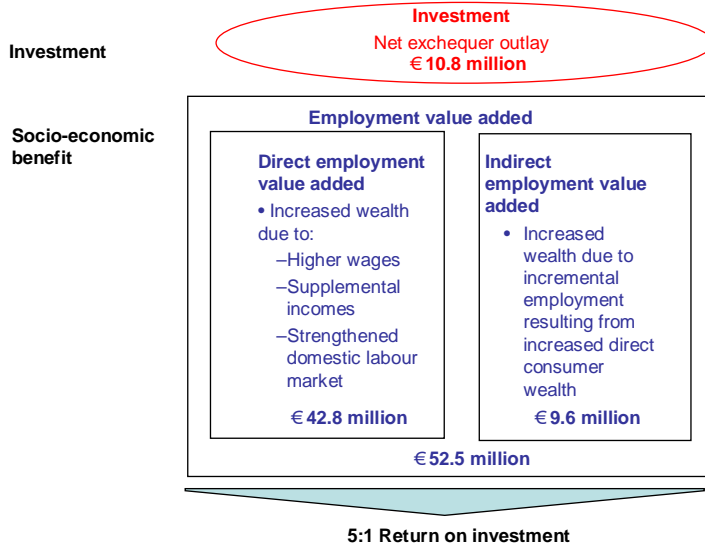
**Economic impact assessment**

The proposed changes to Section 481 would offer an estimated 5:1 return on investment for the Irish economy. Based on an assessment of the difference in net tax foregone under the two scenarios, it is estimated that the proposed changes would result in an additional €10.8 million net exchequer costs. This investment would deliver a €52.5 million socio-economic benefit as a result of incremental wages from direct and indirect jobs. There will also be significant

unquantified benefits of incremental tourism activity, regional development and impact on related sectors such as digital media.

**Exhibit 7**  
**Economic contribution of changes to Section 481**

Average annual estimated impact based on forecasted activity levels with and without proposed changes



**Net exchequer costs**

The effect of changes to Section 481 tax legislation will result in increased tax foregone for each film produced in Ireland. These costs will be partially offset by increases in taxes from direct employment, incremental expenditure taxes from employee earnings and goods and purchase spending and capital duty. The methodology used is based on the methodology developed by PWC in the 2003 Report to the Irish Film Board and the Department of Arts, Sport and Tourism<sup>29</sup>. The incremental cost of administration has been considered negligible. Social welfare savings have also been excluded as the impact of Ireland’s current economy is considered. The net impact is an estimated €10.8 million euro.

<sup>29</sup> Explained in Appendix 2

## Exhibit 8

### Net exchequer cost calculation inputs

#### Exchequer costs

S481 tax foregone

#### Exchequer returns

Incremental tax on direct employment  
Taxes raised on incremental employee expenditure  
Taxes raised on incremental film production expenditure  
Capital duty

#### Net exchequer cost

### Socio-economic benefit

The average annual socio-economic contribution of incremental film activity enabled by the proposed changes to Section 481 is estimated at €52.5 million. An estimated €42.8 million would be contributed by the difference in direct employment value between the two scenarios. This is a true incremental value corrected for displacement (the degree that the industry can be replaced by employment in other industries)<sup>30</sup>. The increased consumer wealth from direct employment is estimated to contribute an additional €9.6 million in additional indirect employment.<sup>31</sup>

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<sup>30</sup> Assumed to be 36% as estimated in The Sheridan Report 2003 'Realising the Potential Value of the Irish Film and Television Industry' and PWC in 'Report to the Irish Film Board and the Department of Arts, Sport and Tourism 2003'.

<sup>31</sup> This effect was calculated using a multiplier of 1.748 as calculated by Eamon Henry (ESRI) and the generally accepted displacement factor of 70% for general employment. This multiplier was applied only to the incremental direct incomes and not to total direct income value.

## Recommendations

Ireland's current competitive position in the international film industry is under significant threat as a result of impending changes in UK tax legislation and changes already underway in other competing territories. The future of the indigenous film industry and the ability of Ireland to attract incoming productions will both be severely impacted if the current Section 481 tax incentive remains as is. The benefits offered by this incentive are below market level today unless combined with UK incentives. With the proposed changes in UK legislation combining incentives will no longer be possible. If the Irish industry is to sustain its current competitiveness changes will be required in Section 481 support. This report recommends the following changes:

- Remove the current 66% / 55% limitation on eligible expenditure that qualifies for Section 481 to consider all Irish expenditure as eligible. Removal of this limitation will increase the incentive for productions to base a larger proportion of spend in Ireland while also increasing the available benefit for productions
- Remove the restriction on size of Section 481 funds that can be raised for films with a budget greater than €27 million. Given that the average Hollywood film has a budget of €53 million, the current restriction excludes a significant amount of lucrative activity.
- Restore tax relief for individual investors to 100%. This will further increase the benefit to productions to address the current market deficit. Market forces will ensure that this benefit flows to the production rather than to individual investors.
- Consider a mechanism for maintaining the competitiveness of Section 481, in order to respond to the fast moving, competitive landscape.

The proposed changes would need to be incorporated into the forthcoming Finance Act in order to address the major uncertainty that is constraining current industry activity. Ireland's ability to compete is now challenged by the uncertainty affecting future viability of Irish / UK co-productions as a mechanism to finance indigenous films and attract incoming productions. The current UK scheme expires in April 2006. Ireland must be in a position to offer producers a viable package now in order to influence their location selection and financing viability decisions for 2006 and 2007 productions.

## Appendix

1. Overview of Section 481
2. Economic analysis methodology

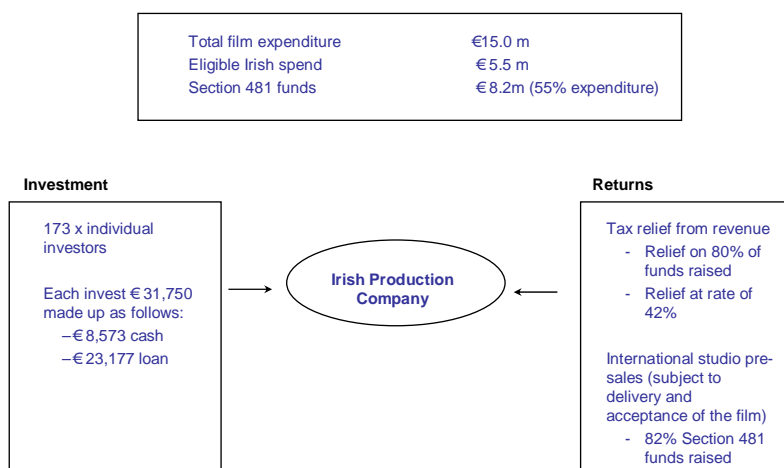
## Appendix 1: Overview of Section 481

Tax relief for investments in the film industry was introduced in 1987 under Section 35. This scheme has been revised in several subsequent Finance Acts. Section 481 in its current form works as follows:

- Qualifying companies (Irish incorporated and resident companies established for the production of one and only one qualifying film) can raise funds which are subject to tax relief on all Irish expenditure up to the following maximum amounts:
  - Up to 66% of the total expenditure costs for a budget of €5.08 million or less
  - Up to 55% of the total expenditure of a film with a budget of between €6.35m and €27m
  - Up to €15m maximum for films with a budget over €27m
- Funds are raised from individual investors who can claim tax relief on 80% of their investments. Individual investors can invest up to €31,750 under the scheme in any one year.
- Producers typically put in place conditional pre-sales agreements representing approximately 82% of funds raised for successfully completed films (films completed within agreed timing, budget to agreed specification). The pre-sales usually represent advanced international market sales and/or estimates for the specific project in question. These proceeds form the return to Section 481 investors subject to delivery and acceptance of the film by a third party, usually a distributor or sales agent.

### Exhibit A-1

#### Section 481 Cashflow – Example



## Appendix 2 - Economic Analysis Methodology

The economic assessment of the proposed changes in Section 481 has been based on methodologies used in film industry reports in 2003<sup>32</sup>. The economic assessment examines the difference in net exchequer costs between the two future scenarios for the industry and investigates the return in the form of socio-economic benefit from the increased activity forecasted by adopting the proposed Section 481 changes.

### Net exchequer calculations

The net exchequer costs are based on assessment of forecasted cash flows related to changes proposed in Section 481. The impact of these changes varies considerably across category of film<sup>33</sup>, therefore this entire analysis was completed at a category level and then aggregated.

### Estimated exchequer costs

The exchequer bears two costs to service Section 481 – tax foregone and administrative costs. The difference in tax foregone between the two scenarios required an assessment of the impact of changes in activity and changes in S481 tax relief restrictions. These were analysed for the 4 key categories of film

- Section 481 funds raised:

The Section 481 funds raised is a data point available for historical productions. However for future scenarios these require an analysis of following factors:

- Changes in activity levels. Section 481 is an activity-based incentive – no tax will be foregone without activity. A detailed assessment of activity levels under the two scenarios was conducted and is described in the main report.
- Amount of Section 481 funds raised / film. Without any changes to Section 481 the amount raised per film for each category should not be impacted and the base scenario assumed the '02 – '04 average / film is maintained. The proposed changes to eliminate the 55/ 66% limitation of proportion of the budget that can be raised would mean that the amount of Section 481 funds raised per film would increase and would no longer be driven off total budget estimates but would equal the total Irish spend. Therefore the proposed S481 changes scenario assumed Section 481 funds raised equal to Irish spend.

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<sup>32</sup> 'Realising the potential of the Irish Film and Television Industry – a unique national asset' Screen Producers Ireland 2003; 'Review of Section 481 of the Taxes Consolidation Act 1997' PWC 2003

<sup>33</sup> Small indigenous, mid / large indigenous, incoming < €27 million, incoming > €27 million

- % eligible for relief: Without any changes Section 481 tax foregone is estimated as Section 481 funds raised x 80% investor relief x 42% (higher rate for personal taxation. With the proposed changes the % eligible for relief will increase to 100%

The overall administrative costs for Section 481 were estimated in 2003 as less than €200,000<sup>34</sup> by the PWC report. The two future scenarios may result in some changes to administrative requirements as a result of changes in activity levels and the potential reduced costs of driving Section 481 funds off Irish expenditure rather than overall budgets. However, the overall impact of these changes in the context of overall costs was considered negligible.

### Estimated exchequer returns

The exchequer will benefit from film production activity as a result of direct and indirect tax flows.

**Incremental tax on direct employment:** The activity level differences between the two scenarios will result in significant differences in employment levels and direct tax on employee earnings. Tax on direct employment is based on the product of the following inputs:

- **Irish labour spend corrected for nonrecouped IFB investment:** Across the 4 categories of film analysed the changes in anticipated activity levels will result in changes to total Irish labour spend. The portion of this spend driven by the government's investment through IFB cannot be considered incremental and was corrected for using the '02 – '04 data.
- **Average tax paid on marginal income** The analysis applied the current accepted economic practice rate of 30% for average tax paid on marginal incomes
- **Displacement** Not all incremental labour spend can be considered incremental to Irish economy. A correction for displacement is required. The 36% displacement figure calculated in 2003 reports was used for this purpose.

**Social welfare savings:** The 2003 PWC report apportioned some savings to the exchequer to social welfare savings. The incremental social welfare savings of the increased activity levels arising from proposed Section 481 changes have however been considered to be negligible. In this relatively full employment economy it is difficult to forecast any significant impact on social welfare drawings.

**Taxes raised on incremental employee expenditure:** The incremental earnings of employees will result in increased expenditure resulting in additional tax

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<sup>34</sup> PWC report.

income through VAT. The incremental taxes were estimated using the following inputs:

- **Irish labour spend corrected for nonrecouped IFB investment less displacement and taxes** – as calculated above
- **Assumed savings rate** - Use the PWC assumed rate of 15%
- **Tax multiplier** - PWC adjusted the E Henry tax multiplier to reflect the unique attributes of the film industry. This report adopted this adjusted multiplier of 41%

**Taxes raised on incremental film production spend:** The incremental spend on Irish goods and services will also result in increased expenditure taxes. These were calculated using the following inputs:

- **Irish goods and services corrected for nonrecouped IFB investment** – as discussed above the additional spend enabled from IFB investment cannot be considered as incremental to the exchequer. Using the '02 – '04 recoupment date from IFB this has been corrected
- **Tax multiplier** – This report adopted the PWC adjusted multiplier for company expenditure of 32%

**Capital duty:** All funds raised for Section 481 are subject to a 0.5% capital duty which flows directly to the exchequer.

**Deadweight effect:** Deadweight is accounted for by calculating net impact as the difference between two future scenarios. Therefore there are no exchequer benefits assumed from the activity that would take place in the future without any changes to Section 481.

### **Socio-economic benefit**

The Irish economy benefits from the value added from the wealth derived by incremental film activity as a result of higher wages, supplemental incomes and avoidance of emigration. This benefit as calculated as the combination of direct and indirect incomes

**Direct employment value added:** The increased Irish labour spend corrected for non recouped IFB investments and displacement represents incremental wealth to the economy.

**Indirect employment value added:** The incremental wealth derived from direct employment does in turn create additional indirect employment. This is estimated using the tax multipliers calculated by E Henry<sup>35</sup>.

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<sup>35</sup> This effect was calculated using a multiplier of 1.748 as calculated by Eamon Henry (ESRI) and the accepted displacement factor of 70% for general employment. This multiplier was applied only to the incremental direct incomes and not to total direct income value.