BRITISH SCREEN FORUM

FRAME THE DEBATE

CONSULTATION SUBMISSION

To HM Treasury and HMRC

R&D Tax Reliefs

FRAME THE DEBATE

CONTENTS

A. INTRODUCTION

About British Screen Forum

This submission is being made by British Screen Forum, a membership organisation through which many of the best informed and most influential people in the UK screen sectors convene to interrogate issues of importance and influence policy and the thinking around policy.

We provide a unique and trusted space for key players from the screen sectors to come together to debate the implications of the evolving landscape and the policy and regulatory environment, and to gain unrivalled insight into emerging themes and innovative technologies.

Members are senior figures drawn from a wide range of businesses and organisations operating in the film, TV, video game and/or online sectors. We aim to cover the whole value chain as well as the full range of means of distribution, so include members who can speak for writers, technicians, independent producers, directors, studio operators, distributors, exhibitors, broadcasters, games publishers, games developers, pay TV platforms and online platforms. It is a unique cross-sectoral mix, with a balance of creative, policy and business specialists. Further details are available on our website[1].

Scope of the response

This response has been prepared in consultation with our Members. Whilst it touches on a number of the issues raised, it is primarily concerned with those covered in Chapter 4, and the question of *"whether the definition of R&D and the scope of what qualifies for relief remain fit for purpose"* [2]. This submission argues in favour of a widening of the current definition to incorporate legitimate R&D activity undertaken in the Creative Industries (CIs). The current definition is largely focused on the development of tangible goods relating to science and technology. The development and exploitation of intangibles, e.g., Intellectual Property (IP), is of increasing importance to the UK economy, which is 80% services based. Arguments in support of this position are set out in Section D of this response.

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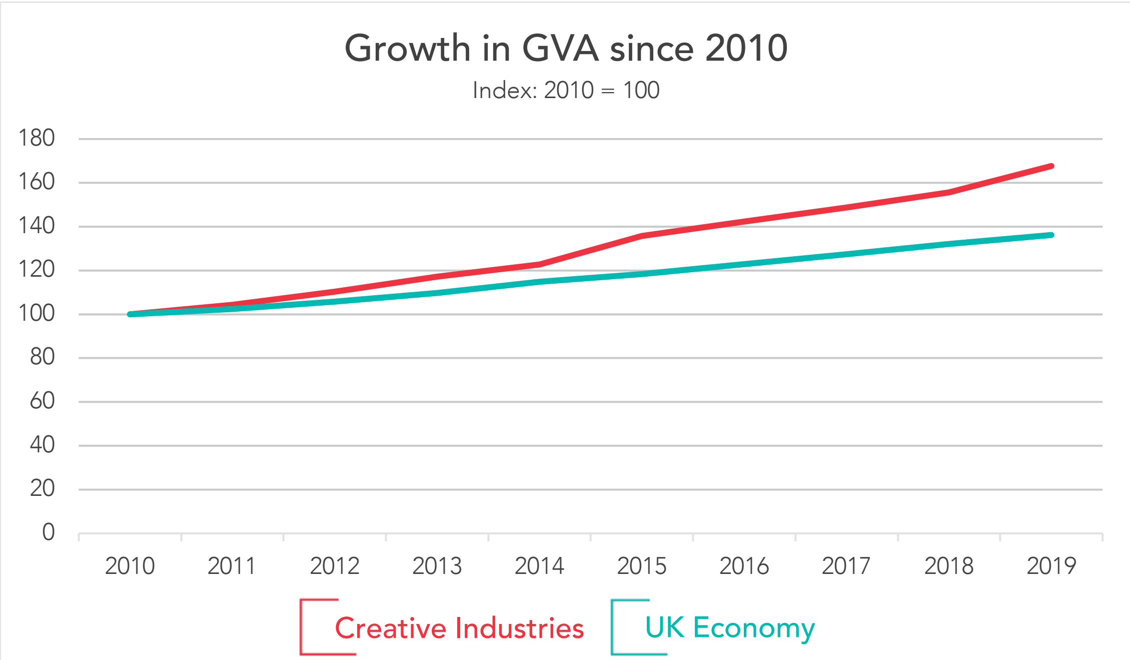
[1] https://britishscreenforum.co.uk/

[2] Scope of Consultation, 2.5, page 5

B. ECONOMIC GROWTH AND THE SCREEN SECTORS

The screen sectors are a key part of the Creative Industries which represent a global economic success story for the UK. The ability of the screen sectors to play such an important part in that success has been founded on, and supported by, a range of highly successful public policy interventions remedying market failures. These vitally important strategic interventions are discussed further in Section C, below.

The Creative Industries contributed £115.9bn to the UK economy in 2019, accounting for 5.9% of UK GVA. The GVA of the Creative Industries increased by 5.6% between 2018 and 2019 and by 43.6% between 2010 and 2019 in real terms[3], significantly outperforming the economy as a whole.



Data source: DCMS

Much of this growth is export led, with exports growing to £37.9bn in 2019[4], more than doubling in value since 2010 and accelerating particularly strongly since 2015.[5]
During the most recent four years for which figures are available, Creative Industries exports increased by 78%, growing at nearly twice the rate of services across the economy as a whole over that period.

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[3] Source: DCMS Sectors Economic Estimates 2019 (Provisional): GVA, December 2020
[4] Source: DCMS Sectors Economic Estimates 2019 Trade In Services, page 7
[5] Creative Industries exports were worth £14.7bn in 2010 and had grown by 158% by 2019. Over the same period the total value of services exported by the UK rose by 82% (from £174.1bn to £317.7bn). Source: DCMS Sectors Economic Estimates 2017 Trade In Services, Table 1 and DCMS Sectors Economic Estimates 2019 Trade in Services, Table 10

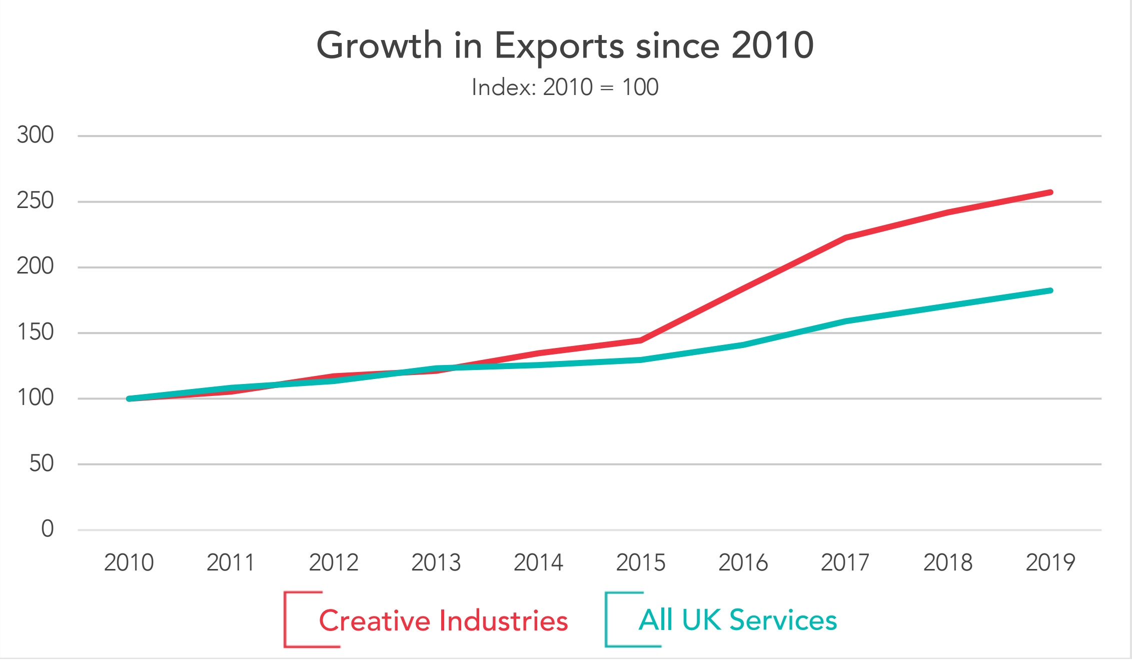
Continuing international demand for screen sector content and services is not in doubt and the UK is well placed to supply it, boasting an exceptional record of success in creating screen content for audiences right around the world:

- The UK is the world's second most successful exporter of TV content after the USA, and therefore punches well above its weight[6] with TV exports alone worth £1.48bn in 2019/20, up 6% year on year and a record high.

- UK films earned a record worldwide gross of $10.3 billion in 2019, a 25% share of the global box office, which also hit a new record of $41.7 billion.[7]

- There are more than 2,200 active games companies in the UK, including the creator of Grand Theft Auto V, the best-selling entertainment product of all time, selling 140 million units worldwide and generating over $6 billion in global revenue[8].

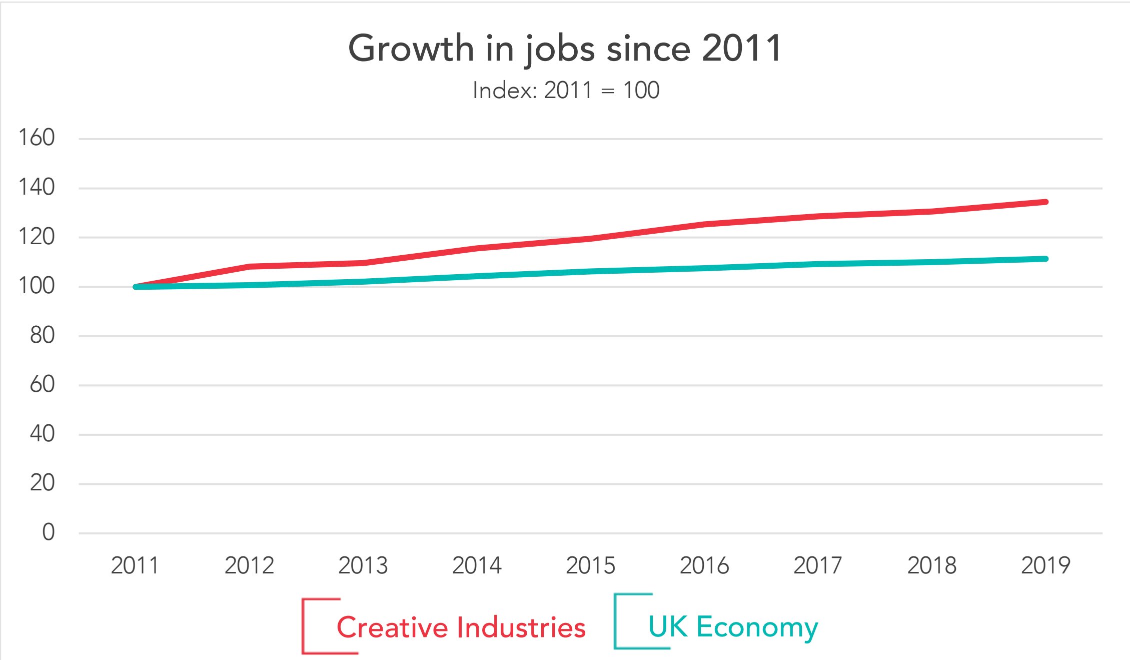
- For UK YouTube creators, 85% of viewership comes from outside of their home country[9].



Data source: DCMS

[6] Source: EURODATA TV / MEDIAMETRIE. Figures relate to the period: 1 March 2015 to 28 February 2016
[7] Source: BFI – UK Films and British Talent Worldwide, page 4
[8] Source: Data provided by Ukie
[9] Source: Data provided by Google

The Creative Industries have also delivered strong jobs growth over recent years, including for UK nationals. They employed 2.1m people in the UK in 2019, up 34.51% since 2011[10] – a growth rate more than three times the rate seen in the economy as a whole. This success has included employing 156,000 more UK nationals in 2019 than in 2015, an increase of 9.5% in the number of UK nationals employed compared with a national growth rate of 3.1% over the same period[11]. It is worth noting that employment in the sector was badly affected by the pandemic and the maintenance of existing support for the sector is the minimum necessary for a return to a strong jobs growth path.



Data source: DCMS

Within the Creative Industries, jobs in the screen sectors have significantly higher than average rates of productivity, as demonstrated in *Screen Business* - an analysis of various constituent parts of the screen sectors by Olsberg•SPI with Nordicity on behalf of the British Film Institute[12], the results of which are illustrated in the table below. Productivity in the video game sector is 35% higher that the UK average, for visual effects productivity is 31% higher than the UK average, and for film, High-End TV and children's TV productivity is 25% high than the UK average.

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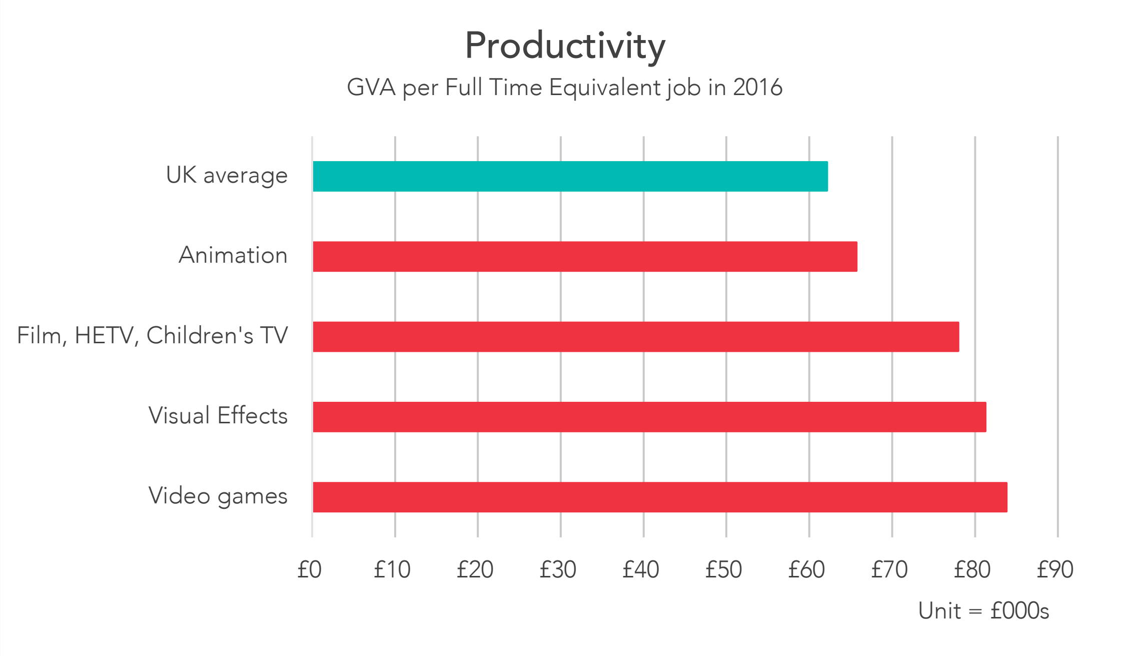
[10] Creative Industries jobs grew by 34.51% between 2011-19, jobs in the wider economy by 11.36%. Source: DCMS Sectors Economic Estimates Employment 2018 and DCMS Sectors Economic Estimates Employment 2019

[11] Source: DCMS Sectors Economic Estimates Employment 2015 and DCMS Sectors Economic Estimates Employment 2019

[12] Source: 'Screen Business – how screen sector tax reliefs power economic growth across the UK', Olsberg•SPI with Nordicity, October 2018



Data source: Olsberg•SPI / Nordicity

Given the creative nature of the work, these high productivity jobs in the screen sectors are considered to be less vulnerable to technological change than in many other industries.

The jobs and prosperity created by the screen sectors are increasingly spread across the nations and regions: between 2015 and 2018 Creative Industries jobs grew faster than the UK average of 3.5% in Scotland, Wales and Northern Ireland, and in 6 of the 9 regions of England. The strongest jobs growth was in the North East with an increase of 21.1%. The North West and Northern Ireland also saw double digit increases in Creative Industries jobs[13]. Some CI sectors have a strong regional footprint, for example games. According to a report from UKIE in 2020, **Think Global Create Local**, 55% of games development jobs are based outside London and the SE[14].

Despite this improving picture, the audiovisual sector is still heavily concentrated in London and the South East of England. National and local authorities, including national screen agencies, have a mandate to support their local screen sectors and such public policy measures to address the geographical imbalance are of continuing importance.

The number of jobs provided for BAME people has also increased dramatically in recent years, rising 34.6% from 2015-18 to a total of 288,000. This represents 14.1% of the Creative Industries workforce[15].

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[13] Source: DCMS Sectors Economic Estimates Employment 2015 and DCMS Sectors Economic Estimates Employment 2019

[14] https://ukie.org.uk/resources/think-global-create-local-the-regional-economic-impact-of-the-uk-games-industry

[15] Source: DCMS Sectors Economic Estimates Employment 2015 and DCMS Sectors Economic Estimates Employment 2019

There is, however, significant work to be done to ensure that BAME people, women and other demographics protected under equality legislation (e.g., those with a disability or LGBTQ+ people), and people from less advantaged backgrounds are more fairly represented, especially at more senior levels, and the screen sectors are committed to achieving this.

The UK has an exceptional record of success in creating filmed content for audiences at home and around the world. Consequently, it is a major centre of film and TV production activity for both domestic and international content creation companies, attracting 12% ($21bn) of all global screen production expenditure in 2019[16]. The majority of this expenditure, $15.8bn, represents inward investment from outside the UK, as major US studios and streaming companies in particular choose the UK as the place to film major feature films and TV series. This activity has demonstrated an extraordinary ability to bounce back strongly from the effects of the pandemic: the final quarter of 2020 saw the second highest UK production spend of all time.[17]

Other parts of the screen sectors, including digital platforms and video games have proved exceptionally resilient during the pandemic, not only in terms of consumer spend (the UK market for video games reached a record £7bn in 2020, an increase of 29.9% from 2019, beating 2018's previous record by more than a billion pounds[18]) but also in terms of business continuity: the majority of video game businesses reporting no risk of closure and only 24% reporting any need for pandemic related government support.[19]

The screen sectors also deliver public value in terms of cultural and social benefits in addition to their economic contribution. By creating stories serving and reflecting the diversity of the UK and the uniqueness of the UK experience, made specifically for UK audiences, they provide socially cohesive and inclusive experiences which are widely shared and help to foster and strengthen common bonds. The values of impartiality, accuracy and trust represented by the main UK news broadcasters are more important than ever and are likely to remain so in the years ahead. UK screen sector exports are also a key driver of soft power abroad – as a House of Lords report on soft power notes:

"The UK's creative industries boost the UK's profile everywhere, especially among the global middle class with its discretionary spending power, appetite for media and cultural content, and increasing social influence." [20]

[16] Source: Global Screen Production – The Impact of Film and Television Production on Economic Recovery from COVID-19, Olsberg•SPI, June 2020, page 13
[17] Source: BFI, see https://www.bfi.org.uk/news/bfi-official-2020-statistics
[18] Source: Ukie, see https://ukie.org.uk/news/uk-games-industry-valuation-2020
[19] Source: Ukie, see https://ukie.org.uk/resources/playing-on-how-the-uk-games-sector-reacted-to-the-challenges-presented-by-covid-19
[20] Source: "Persuasion and Power in the Modern World", House of Lords Select Committee on Soft Power and the UK's Influence", March 2014

C. STRATEGIC POLICY INTERVENTIONS

The UK screen sectors are one of the most successful, and fastest growing parts of the economy. However, they are also, one of the most vulnerable, in that the underlying economics of the sector are unusual in a number of ways (described below), and the success of the sector is dependent on a range of supportive policy interventions which have been developed to address a range of market failures. It is worth noting here that interventions on competition and growth policy grounds in relation to the screen sectors will often have complex inter-relationships with cultural policy objectives.

British Screen Forum submits that the success and growth of the UK's creative industries in recent years, and the screen sector in particular, has been underpinned by a series of smart and targeted government interventions, in particular the maintenance of support for public services broadcasting as the key investor in the domestic TV market, the introduction of the Terms of Trade in the Communications Act 2003 (which supercharged the independent production sector) and, more recently, the introduction of the Film Tax Relief and subsequent Creative Sector Tax Reliefs. Each of these interventions demonstrates a sophisticated understanding across government of the economic, social, cultural, and soft power benefits that are derived from the creative industries.

They are also recognition of the fact that the underlying economics of the screen sectors are unusual in a number of ways. They are hit-based businesses, with particularly high levels of risk and uncertainty from project to project. High-end content has a distinctive and asymmetrical cost profile, with very high fixed costs and low marginal costs, meaning that the bulk of the investment relating to any given project must be borne before any consumer revenues may be earned. This incentivises the development of large companies able to access capital and develop broad portfolios to manage commercial risk and sustain viable business models. With a short life cycle in the primary window, ancillary markets play an essential role in providing secondary revenue streams. Some content has universal appeal, which cuts across cultural and national boundaries, providing further revenue streams from global territories.

Audiovisual companies with large homogenous domestic territories – such as the US and, increasingly, China and India – therefore have significant advantages, as they can exploit economies of scale in their home markets. A key rationale for public intervention is to counterbalance this asymmetry in size between the UK market and those of these global competitors, enabling the UK to exploit the advantages it has in terms of creativity and expertise in the screen sectors. Interventions in audiovisual markets stimulate a virtuous circle between investment, content production/service provision, audience demand, and the revenues that underpin further investment. By ratcheting up the scale at which the industry operates, the UK audiovisual sector is significantly bigger, more vibrant and more competitive than would be expected of an economy of our size and is able to punch above its weight on the world stage, including in terms of inward investment and exports.

Compared to other countries, the UK's audiovisual sector has a number of distinctive features that contribute to its success: an unusually rich mixture of public and private companies, competition between which helps to grow the overall sector and drive innovation; one of the most vibrant and successful independent TV production sectors in the world; and a central role for inward investment by global media companies, especially the US studios and streamers.

These features did not develop without public intervention. The ability of the UK's screen sectors to deliver economic and cultural value has been significantly enhanced by enlightened government policies which have created and enabled a vibrant sector with the complex ecology described above, helping to create the scale that enables the sector to sustain the skills and capital base to support content creation across a wide range of budgets.

The ecosystem has developed very significantly over recent decades, for example in the television sector through the expanded range of commercial broadcasters facilitated by a range of technological developments and regulatory adjustments. More recently the rise of new video on demand services has contributed to a UK production boom in high-end TV content. Prospects for export led growth are strong, for example, pre-pandemic, the annual growth rate of the UK-based film, TV and TV-related industries was predicted to rise to between 5% and 8% per annum by 2025, largely driven by international revenues[21].

Key interventions have included enlightened policies such as public service broadcasting, PSB quotas for independent and regional productions, and fiscal incentives. They also include the establishment of institutions that support the sector using public funding, such as the British Film Institute and national/regional screen agencies. As a result, competitive tensions see the diverse range of companies operating in the sector pushing each other to new creative heights and collectively creating an industry of sufficient scale to compete successfully in the global market for screen sector content and to be the location of choice for the creation of such content.

To take one example of a highly successful intervention, the Creative Sector Tax Reliefs have delivered returns on investment for each £1 of tax relief of £7.69 (film), £6.10 (High-End TV), £4.44 (animation), £4.00 (video games) and £2.73 (children's content)[22]. Screen sector production activity is often highly mobile and there is intense international competition to attract it.

Alongside these economic factors, market failure justifications for intervention in audiovisual markets also arise due to the positive externalities that result from these services. Alongside their economic contribution, TV (and other kinds of audiovisual content such as games) provide benefits to society in terms of access and inclusion, quality of life, sense of community, educated citizens, cultural understanding, and informed democracy (as Ofcom and others have described). Notwithstanding the proliferation of choice in media markets,

[21] Source: "The contribution of the UK-based film, TV and TV-related industries to the UK economy, and growth prospects to 2025", Oliver & Ohlbaum , October 2018
[22] Source: Screen Business: how screen sector tax reliefs power economic growth across the UK – Olsberg.SPI & Nordicity for the BFI, 2018

these externalities remain relevant. Indeed, there are compelling arguments that they are more important than ever.

D. THE R&D TAX RELIEFS CONSULTATION

Q9: Is there evidence to suggest areas of activity other than those currently covered by the R&D definition drive positive externalities which should be recognised by the tax system?
As the Government makes clear in its consultation document *"innovation is at the heart of the UK's strategy to boost productivity and growth."* Measures that are specifically designed to incentivise innovation such as the R&D Tax Reliefs are, therefore, of vital importance. It is against this backdrop that the Government is exploring whether the qualifying definitions for R&D might be extended.

This submission supports the argument for a broadening of the current definition of qualifying expenditures to bring into scope more of the R&D activity undertaken by the UK's creative industries and, in particular, the screen sectors[23]. It also supports greater activity and cooperation between relevant government departments and trade bodies in the CIs to (i) promote the existing R&D schemes and their eligibility criteria and (ii) clarify and provide improved guidance as to how they may be successfully accessed.

As evidenced in **SECTION B**, the creative industries have been growing rapidly in recent years. In 2019 they contributed £115.9 billion to the UK economy, or 5.9% of total UK Gross Value Added. 80% of the UK economy is in 'services', and the growing economic importance of the Creative Industries means it makes sense to consider whether there are additional ways to incentivise even greater growth in the sector, in particular in UK developed IP, as we emerge from the current Covid-19 pandemic.

SECTION C references the numerous positive externalities that derive from the sector, i.e., innovation in products and services in the screen sector demonstrably deliver much wider social, economic, and cultural benefits.

As stated in the consultation document at paragraph 4.4, *"The UK definition [of qualifying R&D] is more tightly drawn than some international competitors. Some stakeholders have suggested that areas such as pure mathematics, <u>the creative industries</u> or social sciences should be brought within the definition and allowed to qualify for tax reliefs."*

The definition of R&D in the OECD's Frascati manual, from which the current UK definition (which is more narrowly focused on science and technology) is derived, makes specific reference to *"**creative** and systematic work undertaken in order to increase the stock of knowledge – **including knowledge of humankind, culture and society** – and to devise new applications of available knowledge"*. As such, there is scope for the UK Government to broaden its current definition to incorporate more of the activity undertaken in the creative

[23] Film, TV, video games, VR, AR, XR

industries. France, Italy, Denmark, Czech Republic, Brazil and Korea, have all adopted a definition that incorporates AHSS.

Many creative companies and individuals consider that they are engaged in R&D on an ongoing basis, but not necessarily within the somewhat narrowly focused parameters of the current definition of R&D used by the UK Government. The report **R&D in the Creative Industries Survey - 2020**, undertaken for DCMS by OMB Research[24], highlights that whilst just 14% of the Creative Industries consider themselves to be conducting R&D that matches the HMRC definition, 55% can identify R&D activities they undertake within the Frascati definition. The report emphasises that *"creative businesses perceive R&D differently from those in other sectors, seeing R&D as something related more to investments in projects and content rather than directly to technologies and innovation in processes and products."* The report goes on to observe: *"This means that the definition of R&D is crucial: what is typically seen elsewhere as R&D may not be regarded as such within the creative industries, with the result that it may be under-reported and potentially under-supported in policy terms."* In a global market context where the development and exploitation of IP is of increasing economic importance, this final point is crucial and underpins calls for a reframing of the current regime, which has largely been designed with tangible products in mind.

British Screen Forum believes that evolving the current definition to capture more of the R&D activity in the CIs would dramatically boost the amount of R&D and innovation being undertaken in the UK creative industries and, in turn, spur further growth. CI interviewees, who took part in research undertaken by the Creative Industries Council (CIC) in support of its response to this consultation, all *"confirmed that, were they able to claim more or more efficiently through the Tax Relief schemes, they would use funds released to invest back into R&D activity."*[25]

95% of companies in the CIs are microbusinesses, with less than 10 employees, which often struggle to access early-stage finance for development. Broadening the scope of the definition, and providing improved guidance and assistance to such companies, could help to boost economic activity right across the UK.

In high-risk areas such as animation and children's content, for example, the upfront costs of developing new IP, is a major challenge. The high demand for and uptake of funding made available by the recently established BFI Youth Audience Content Fund (YACF)[26] is evidence of the support needed. It is also clear evidence that there are plenty of companies with great ideas they would like to bring to market, with the appropriate economic support.

It is worth noting that direct public funding for R&D in the CIs currently lags behind the support given to other sectors. In a recent blog[27] on this topic Professor Andrew Chitty, of the Institute for Media and Creative Industries at Loughborough London, stated, *"Our own analysis of Government data suggests that whilst 28% of the R&D spend of the Life Sciences*

[24] R&D in Creative Industries Survey – 2020 (publishing.service.gov.uk)
[25] See CIC response to R&D Tax Reliefs consultation 2021
[26] Source: Latest projects supported through Young Audiences Content Fund announced | BFI
[27] Source: R&D Tax Credits – wider, bigger, better – CRAIC (lboro.ac.uk)

sector is provided by Government Funding (£3bn public R&D spend vs £7.5bn industry R&D spend on sector GVA £16.7bn) only 6% of Creative Industries R&D spend is supported by government (<£100m public R&D spend vs c£1.5bn industry R&D spend, on sector GVA of £111bn)."

Any extension to the current qualifying definition for R&D Tax Reliefs would, of course, need to be carefully developed to ensure that it is properly targeted to deliver the intended policy objectives. It is also crucial that any evolution of the R&D Tax Relief regime fits well with the existing range of world-leading Creative Sector Tax Reliefs that have underpinned so much of the success and rapid growth of the UK's film, TV and games industries in recent years. Evidence gathered as part of the CIC's response to this consultation suggests that there are good examples of the two forms of relief working well together in the games sector.
If that can be achieved, British Screen Forum believes that a measured broadening of the current definition could bring into scope a range of potential innovations, including in an overwhelmingly services-based economy like the UK's, for example the delivery of experiences as well as products and the development of novel formats and production techniques, that otherwise would struggle to emerge.

The opportunity for the R&D Tax Reliefs to drive further growth in the CI's has been recognised by The Creative Industries Council (CIC)[28] and the Policy and Evidence Centre for the Creative Industries (PEC). In February 2021, the PEC published a paper arguing for an expansion of the current definition entitled **Business R&D in the arts, humanities, and social sciences: what R&D in the AHSS looks like in a business setting and why it matters**[29].

In support of their responses to this consultation the CIC and PEC commissioned research from companies in the sector to evidence current usage of the R&D tax reliefs, how the operation of the current system might be improved, and whether the scope of the definition of what qualifies should be extended. British Screen Forum supports this work and echoes its key recommendations that (i) there is a need for better promotion of the applicability of the existing reliefs to the CIs (ii) a greater level of clarification and guidance on qualifying CI activity should be provided and (iii) there should be a targeted expansion of the current eligibility criteria.

As things stand, it is likely that the current STEM focus of the R&D tax reliefs means that even companies in the CI's with more of a STEM focus (e.g., VFX, AR, VR etc), and especially those which are SMEs, may not be making the most of the already available support. Given the potential of such businesses to drive positive externalities in terms of social, environmental, and cultural change, as well as economic benefit, at the very least HMRC should prioritise ways in which the current system can be optimised, so that the existing reliefs are as accessible and user-friendly as possible.

[28] Creative Industries Council - GOV.UK (www.gov.uk)
[29] Creative Industries Policy & Evidence Centre (pec.ac.uk)

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