

BRITISH
SCREEN
FORUM

FRAME THE DEBATE

CONSULTATION SUBMISSION

To Treasury Committee

The Venture Capital Market

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CONTENTS

A. About British Screen Forum	3
B. About this response	3
C. About the screen sectors	4
D. The operation and effectiveness of the current EIS and SEIS schemes ...	6

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 website¹.

ABOUT THIS RESPONSE

This response has been prepared in consultation with our Members, many of whom have a direct or indirect interest in the operation of the venture capital markets, and especially in the operation of the EIS and SEIS schemes. Our comments are limited to the operation and effectiveness of those particular schemes following a number of changes made to them in recent years which have had a detrimental effect on early-stage screen sector companies and on independent film production companies in particular.

British Screen Forum has taken a long standing interest in EIS/SEIS as it plays a significant role in supporting investment into independent film and TV production and video game development companies which make up a key part of the screen sectors and the broader creative economy. This briefing follows substantive engagement with Treasury, HMRC and DCMS both in the period leading up to the publication of new guidance by HMRC in April 2018 and subsequently².

¹ <https://britishscreenforum.co.uk/>

² Prior to 2020, such engagement took place under our former name, British Screen Advisory Council

ABOUT 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 overall Creative Industries contributed £112 billion to the UK economy in 2021, equivalent to 5.8% of UK Gross Value Added (GVA). In 2020, they generated over £41 billion in exports and accounted for 2.2 million jobs. All three of these measures have grown at markedly faster rates than the overall UK economy. By way of comparison, the Creative Industries are bigger than the automotive and aerospace, defence, security and space (ADSS) sectors combined in terms of both GVA and employment.

The screen sectors are a subset of the Creative Industries and comprise film, TV, video games and online audiovisual services. DCMS statistics do not enable a precise calculation of the scale of their contribution to the overall Creative Industries figures, but the following export related examples give an illustration of their significance: UK television exports were worth £1.4 billion in 2020/21 and the UK is the world's second most successful exporter of TV content after the USA³; in the last full year before Covid-19 shut down cinemas, UK films earned a record worldwide gross of \$10.3 billion in 2019, a 29% share of the global box office⁴.

Being based in human creativity, screen sector jobs are considered more resistant than most to technological replacement and are high productivity in nature: productivity in the video game sector was 83% higher than the UK average in 2019, productivity was 36% higher than the UK average for visual effects, 27% higher for animation, and 23% higher for film, high-end TV and children's TV⁵.

Importantly, especially in light of current geo-political events, the screen sectors are largely self-sufficient and can thrive without needing sensitive inputs such as raw materials from Russia. This lack of dependence on long and complex supply chains has enabled the sector to recover at pace from the temporary, pandemic-related interruption to production in 2020. Already on a steep upward curve prior to the pandemic, spending on film and high-end TV production in the UK recovered to a record £5.6bn in 2021, double its 2016 level⁶.

In addition, the projection of our cultural and democratic values through UK audiovisual content viewed across the globe provide soft-power benefits of a kind that no other sector can offer.

In film and TV, record production levels are driven by both domestic and global media companies choosing the UK as the best place to make high quality content, with resultant high levels of inward investment from US Studios and streaming (video on demand) companies. This success is in turn built on a range of factors, including the UK's historic

³ Source: EURODATA TV / MEDIAMETRIE. Figures relate to the period: 1 March 2015 to 28 February 2016

⁴ Source: "UK films at the worldwide box office, 2021", BFI, March 2022

⁵ Source: [Screen Business 2021](#), Olsberg•SPI with Nordicity, December 2021

⁶ Data source: "Film, high-end television and animation programmes production in the UK: full-year 2021", BFI, February 2022

ability to develop talent through the opportunities and experience provided in the independent UK film sub-sector, thus providing the proven and experienced talent and crew that big budget productions demand. British Screen Forum research has demonstrated that of those working in key roles on UK inward investment films, 41% of career credits were gained in independent British films⁷. Such films are unlikely to be sequels or to be part of a successful existing franchise, and often break new ground and explore under-represented aspects of past and present (and sometimes potential future) UK life. This gives them a particular cultural importance, but it also increases their risk profile and makes their financing more challenging.

However talented the filmmakers, the unavoidable reality is that no-one knows in advance which films will be hits. Historically, the risk was shared between hundreds of independent distributors throughout the world, each pre-buying twenty or thirty films a year in advance of production, and judging that, across the piece, the hits would pay for the failures. Once the films were completed, a more informed judgement could be made and marketing spend concentrated on those with the best chance of success, with the others quietly consigned to the shelf. The ability to bear this risk was founded on exploiting the long tail - ancillary revenues in DVD, Pay and Free TV.

It is therefore a matter of great concern for the screen sectors as a whole that the UK independent film sector has been in very choppy waters for a number of years as it navigates the transition to digital distribution and sales models. This transition has seen a marked reduction in revenues from international pre-sales, for example from DVD distributors and Free TV broadcasters, which have traditionally played such a crucial role in the complex finance packages that fund the production of UK independent films. This decline in pre-sales has not yet been offset by new and growing revenues from video-on-demand or by the emergence of new buyers in the form of streaming platforms such as Netflix, and the recent increase in production costs – driven by both the sharp rise in demand for experienced talent and crew, and by the cost of adhering to Covid- related protocols – has exacerbated an already very serious problem.

In such circumstances, risk equity funding – of the type encouraged by EIS and SEIS – has become even more vital. This is a hit-driven business, in which the winning productions need to pay for the losing productions. The rewards of success are high, but the sector's risk profile has always made access to risk capital a challenge and that challenge is particularly hard during the current transition period.

⁷ Local Heroes and Inbetweens: The Contribution of the Independent British Feature Film Sector to the UK Audiovisual Production Industry <https://britishscreenforum.co.uk/wp-content/uploads/2019/10/British-Screen-Forum-Workforce-Study-Local-Heroes-and-Inbetweens-October-2019.pdf>

THE OPERATION AND EFFECTIVENESS OF THE CURRENT EIS AND SEIS SCHEMES

As noted above, many of our Members have a direct or indirect interest in the operation of the venture capital markets, and especially in the operation of the EIS and SEIS schemes. It is therefore of very great concern that – despite repeated assurances that the policy intention was not to exclude film, TV and games companies – the practical effect of the changes brought about in 2017-18 has been to very severely restrict the ability of film and TV production companies in particular to raise risk equity funding through those schemes.

We fully support the policy objective of ensuring that the tax-advantaged venture capital schemes are focused on investment in early-stage companies that have the intention to grow and develop in the longer term. Such tax relief should not be available for investments that are not within the spirit of the schemes; that is, ‘capital preservation schemes’ where the investor’s capital is not significantly at risk and/or the investee company does not have objectives to grow and develop. We therefore welcomed the new statutory ‘risk-to-capital’ condition for eligibility. It was right for Government to reject calls for film and TV production to be added to the list of excluded activities: the policy objective is fully consistent with EIS or SEIS being used to support film and TV production companies, and games development companies.

Our concern in early 2018 was that the guidance drafted by HMRC was capable of being interpreted in a manner which would, in practice, make it extremely difficult for early-stage film and TV production and games development companies which have the intention to grow and develop in the longer term to benefit from investment through EIS or SEIS. Given the importance to the sector of securing such financing, we feared that the effect on UK independent film production in particular could be chilling, with negative knock-on effects for the broader audiovisual sector over the longer term.

As we noted at the time, much would depend on how individual HMRC Officers interpreted the new guidance in the context of actual advance assurance applications and post investment EIS1 and SEIS1 applications from early-stage screen sector companies.

As 2018 drew to a close, we sought views from our members and other stakeholders on how these had played out in practice during the year. This briefing was provided to DCMS in early 2019 and reflected the clear and uniform view of those we had consulted who had had direct experience of making EIS/SEIS advance assurance applications in relation to tv/film production or video game development companies (hereafter referred to as ‘creative screen sector companies’).

In short, correspondence from HMRC suggested what amounted to a de facto exclusion of some creative screen sectors may have been in operation. This exclusion appeared to be caused by a lack of understanding of the creative screen sectors as the growth and development pattern of creative screen companies is necessarily different from that which is

typical in other industrial sectors. The position of HMRC was evident in the blanket approach being applied to the sector since the risk to capital condition was introduced.

Our report to DCMS highlighted the fact that stakeholders reported that many rejections or follow up questions or requests for information emanating from HMRC indicate a profound lack of understanding of the normal business practices of creative screen sector companies with ambitions to grow and develop over the longer term. These include:

- Requesting details of purchase of source intellectual property rights for a business plan based on developing original TV formats in-house
- Requesting details of parties to contracts and/or copies of contracts in relation to projects which have experienced producers on board, where it is clear that the project is still in a relatively early stage of development and which require a capital injection to proceed to the stage of generating contracts.
- Querying the planned use of subcontracting for many elements of production projects within the company's portfolio, even though subcontracting for film and TV production projects is recognized in the guidance as normal business practice for film/TV production companies and in that context is not necessarily an indication of capital preservation
- Requesting a detailed revenue waterfall for a project in development, when a waterfall will only be generated when a finance package is completed for a project.

In addition, the approach taken by HMRC led to very lengthy delays. This contrasted starkly with the Treasury assertion that by making it easier to 'weed out' a large number of inappropriate applications at an early stage, the new test would help HMRC to provide advance assurance decisions within the target of 15 working days. Regardless of the eventual outcome of the application, the fact that delays of several (and sometimes many) months were commonplace proved problematic as potential investors were deterred by the extended period of uncertainty over the tax position and the investee companies missed out on commercial opportunities due to lack of funding.

Central to the delays were routine requests for further information. The experience of relevant stakeholders was that creative screen sector applications for advance assurance were typically met with what appeared to be a blanket set of requests for significant amounts of further information. In some cases the information had already been provided and in others the requested information was not relevant or applicable given the nature of the company. This suggested an inappropriate 'tick box' approach was being followed rather than a rounded assessment of relevant factors taking into account the particular nature of normal business practices in the content creation sector.

Stakeholders advised that the impact of delays was compounded by the impact of inconsistencies in interpretation, especially with regard to the treatment of:

- Use of sub-contracting in planned production projects
- The role of fund managers in operational decision making, even when the company is entrepreneur founded and controlled
- Whether or not assets have been 'wrapped' in a company with an intention to sell them off at the end of the qualifying, even when there is no established market for the assets and the company has a range of other business activities, an entrepreneurial management team and a significant workforce
- Evidence of a long term growth plan – it makes no sense for an independent film/TV production company or games development company to plan specific creative projects beyond a 3-5 year window, as the appetite of the market for particular projects is simply unknowable so far in advance. In too many cases, this was being interpreted as lack of a long term growth plan, even though the company had ambitions to develop new projects throughout the interim period.

Although the HMRC Guidance issued in 2018 acknowledged that film production companies would inevitably work through a slate of projects over a period of time, stakeholders reported that the lack of understanding of the sector by HMRC led to a blanket approach, with the phrase "working on a project basis" appearing time and again in rejections of applications from creative screen companies planning a slate of projects. This indicated a common and inappropriate approach to creative businesses which necessarily operate through a series of projects and which seek to grow and develop through the scale, range and success of the projects undertaken. This is the intrinsic nature of independent film/TV production and video game development companies in a hit-based creative sector. The blanket approach experienced by stakeholders was difficult to reconcile with the assurances given to us by Treasury about the policy intention behind the introduction of the risk to capital condition.

Indeed, we had reason to understand that following an HMRC policy review involving consideration of a number of creative screen sector cases, a decision had been taken that companies intending to operate through an ongoing series of creative projects should be considered as failing the 'growth and development' part of the risk to capital condition because each such project has a limited lifespan. This policy approach was being applied not only to advance assurance applications (where an overly cautious approach might have more justification) but also in relation to post-investment claims for tax relief. If such a blanket approach was being applied by HMRC, it would amount to the de facto inclusion of the film/TV production and games development sectors in the 'excluded activities' list even though such a move was explicitly rejected as a policy option and despite assurances given

to us at the time that the intention was not to make it impossible for such companies to benefit from EIS/SEIS supported investment.

Even if we leave aside the apparent policy position described above, taken together, rejections based on inadequate understanding of the sector and/or a suspicion of growth plans based on a series of creative projects, combined with delays and inconsistencies in decision making, created an inhospitable climate for EIS/SEIS supported investment in the sector. Such investment inevitably found a home elsewhere and was lost to the screen sectors – our stakeholders advised that it was increasingly difficult to sell EIS/SEIS supported investment propositions in content creation businesses to investors because of the scale of these delays and uncertainties, and the perception that HMRC would ultimately decide that they fail the new risk to capital test. It is, of course, difficult to quantify the amount of new venture capital funding that would otherwise have supported new content creation companies, or the contribution such companies might have made in terms of culture and diversity, quite apart from their economic contribution.

Our conclusion at the start of 2019 was that the concerns we expressed at the time the guidance was being developed were being realised and that the impact was likely to be significantly detrimental to the independent film/TV production and games development sectors. Given the role of those sectors within the broader audiovisual ecology, especially with regard to talent development, the long term effects on a key economic sector for the UK were likely to be significant.

Following our report to DCMS in early 2019, we held a number of meetings directly with HMRC in order to try and resolve a number of issues of interpretation which we judged to arise from a lack of understanding of normal business practices within the screen sectors. As part of that process we detailed how the guidance could be changed in order to encourage HMRC Officers to assess applications in a manner which reflected the letter of the risk to capital condition, the policy intention which lay behind the condition, and the normal working practices of legitimate screen sector content creation companies with a genuine aim to grow and develop.

Although significant changes to the relevant HMRC guidance were made in 2021, there is little evidence to date that those changes have had a material impact in practice on the decisions being made by HMRC. In the intervening years, many private investors have simply looked to other sectors and abandoned our own, and some fund managers have ceased offering investment opportunities in the sector. The result has been that the EIS and SEIS schemes, once an important source of finance for early stage independent film production companies in particular, are now providing very little support to this sector.

We have commissioned a study of independent film finance in order, among other things, to evidence the scale of the fall in EIS/SEIS supported investment in UK independent film production in particular and hope to publish later this year, but it is already evident that the decline is highly significant. The fact that it has come at a time of great challenge for this particular sub-sector, which is so important in developing the talent on which the broader screen sectors depend, is of particular concern and we very much hope that an outcome of

this inquiry will be a recommendation for significant change such that EIS and SEIS schemes can once again play a significant role in supporting risk equity investment in creative content companies in general and in film production companies in particular.

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