

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: Trading income

Chapter 9: Trade profits: films and sound recordings

Overview

533. This Chapter rewrites the special rules for expenditure on the production and acquisition of films, tapes and discs in sections 40A to 43 of F(No 2)A 1992, section 48 of F(No 2)A 1997 and sections 99 to 101 of FA 2002 as they apply to persons trading in the exploitation of films, tapes and discs. Rules for non-trade businesses involving films or sound recordings are in sections 609 to 613 of this Act.

Section 130: Expenditure to which this Chapter applies

534. This section is based on sections 40A to 43 of F(No 2)A 1992.

535. Section 40A(1) of F(No 2)A 1992 refers to a “master version” of a film. Section 40A(5) defines a “master version” of a film as “a master negative, master tape or master audio disc” of the film. Section 43(1) of F(No 2)A 1992 defines “master negative”, “master disc” and “master tape” in relation to a film.

536. *Subsections (1) to (4)* of this section refer instead to “the original master version of a film or sound recording”. See *Change 38* in Annex 1.

537. *Subsection (5)* excludes interest and the incidental costs of obtaining finance from the definition of expenditure incurred in the production or acquisition of films and sound recordings. See *Change 39* in Annex 1.

538. **Section 135** and sections 137 to 140 of this Act provide for a deduction in calculating the profits of the trade of the amount of preliminary, production or acquisition expenditure on the original master version of a film or sound recording allocated to a relevant period. In each case, the deduction is subject to the application of “any prohibitive rule”. Section 130(7) defines “any prohibitive rule” for the purposes of such deductions.

Section 131: Meaning of “film” and related expressions

539. This section is based on section 43 of F(No 2)A 1992 and paragraph 1 of Schedule 1 to the Films Act 1985.

540. *Subsection (1)* reproduces the definition of “film” in paragraph 1(1) of Schedule 1 to the Films Act 1985. This is based on the requirement in section 43(2) of F(No 2)A 1992 that references to a film in sections 41 and 42 of F(No 2)A 1992 are to be construed in accordance with paragraph 1 of Schedule 1 to the Films Act 1985.

541. *Subsection (3)* provides that a series of films in respect of which the Secretary of State has given a direction under paragraph 1(4) of Schedule 1 to the Films Act 1985 is treated as a single film for the purposes of this Chapter. For the purposes of Schedule 1 to the Films Act 1985 and of this section, “the Secretary of State” is the Secretary of State for the Department for Culture, Media and Sport.
542. Paragraph 1(4) of Schedule 1 to the Films Act 1985 provides as follows:
- “(4) The Secretary of State may direct that a number of films shall be treated as a single film for the purposes of this Schedule if—
- (a) they form a series with not more than twenty-six parts;
 - (b) the combined playing time is not more than twenty-six hours; and
 - (c) in the opinion of the Secretary of State the series constitutes a self-contained work or is a series of documentaries with a common theme.

Section 132: Meaning of “original master version” and “certified master version”

543. This section is based on sections 40A(5) and 43(1) of F(No 2)A 1992.
544. Section 40A(5) of F(No 2)A 1992 defines a “master version” of a film as “a master negative, master tape or master audio disc” of the film. Section 43(1) of F(No 2)A 1992 defines “master negative”, “master disc” and “master tape” in relation to a film.
545. *Subsection (1)* defines “original master version” in relation to both a film and a sound recording. See *Change 38* in Annex 1.
546. *Subsection (3)* introduces the label “certified master version” for a film certified by the Secretary of State for Culture, Media and Sport as a qualifying film, tape or disc under paragraph 3 of Schedule 1 to the Films Act 1985. For the purposes of Schedule 1 to the Films Act 1985 and of this section, “the Secretary of State” is the Secretary of State for the Department for Culture, Media and Sport.
547. The criteria for certification under paragraph 3 of Schedule 1 to the Films Act 1985 are set out in paragraph 4 of that Schedule. Paragraph 4 of Schedule 1 to the Films Act 1985 requires the maker of the film to be ordinarily resident in a member State of the European Union and includes further requirements regarding the percentage of total expenditure on the production of the film to be incurred in the United Kingdom and on the fraction of the labour costs of the film to be paid to citizens of, or persons ordinarily resident in, a member State of the European Union.
548. The special rules for the treatment of certified master versions in sections 40D, 41 and 42 of F(No 2)A 1992, section 48 of F(No 2)A 1997 and sections 99 to 101 of FA 2002 are rewritten in sections 136 to 144 of this Act.

Section 133: Meaning of “relevant period”

549. This section is based on sections 40B, 40D and 43 of F(No 2)A 1992.

Section 134: Expenditure treated as revenue in nature

550. This section is based on section 40A of F(No 2)A 1992.
551. Expenditure on the production or acquisition of a film is in the nature of capital expenditure on the provision of a fixed asset and is eligible for capital allowances under the normal rules in CAA. This section provides for expenditure and receipts in respect of a film or sound recording to be treated instead as revenue for income tax purposes.
552. [Section 143](#) allows the person carrying on the trade to elect for this section and sections 135 to 140 of this Act (which contain rules for allocating expenditure treated as revenue to relevant periods) not to apply.

Section 135: Films and sound recordings: production or acquisition expenditure

553. This section sets out the basic rules for allocation of expenditure to a relevant period. It is based on sections 40B and 40C of F(No 2)A 1992.
554. Section 40B of F(No 2)A 1992 refers to expenditure on the production or acquisition of a master version of a film. *Subsection (1)* refers instead to the original master versions of “films or sound recordings”. See *Change 38* in Annex 1.
555. *Subsection (2)* provides that a deduction for production or acquisition expenditure allocated to the relevant period is subject to the application of “any prohibitive rule”. “Any prohibitive rule” is defined in section 130(7) of this Act as any provision of the Income Tax Acts which prohibits, or restricts the extent of, a deduction in calculating the profits of a trade.
556. *Subsection (4)* provides for production and acquisition expenditure to be allocated to a relevant period in such a way that it will be written off over the period during which the value of the film or sound recording is expected to be realised. This is generally known as the “income matching” method of allocation.
557. *Subsection (5)* allows the amount allocated under subsection (4) to be increased to an amount equal to the value realised in the relevant period. This is generally known as the “cost recovery” method.
558. This section dispenses with the requirement in section 40B(5) of F(No 2)A 1992 for a claim to be made if the “cost recovery” method is to apply. See *Change 40* in Annex 1.
559. *Subsection (7)* provides that if any expenditure in respect of the original master version of a film or sound recording is allocated to the relevant period under the special rules for certified master versions in sections 137 to 140 of this Act (or under the corresponding rules in F(No 2)A 1992) no expenditure in respect of the same master version can be allocated under this section. This gives the person carrying on the trade a choice in any relevant period between allocating expenditure under the basic rules in this section or under the special rules for certified films in sections 137 to 140. See *Change 41* in Annex 1.

Section 136: Application of provisions about certified master versions

560. This section is based on sections 41 and 42 of F(No 2)A 1992.

Section 137: Certified master versions: preliminary expenditure

561. This section allows preliminary expenditure on a qualifying film “genuinely intended for theatrical release” to be written off in the relevant period in which it is incurred. It is based on section 41 of F(No 2)A 1992 and section 99(1) of FA 2002.
562. Preliminary expenditure is not defined. It consists of expenditure incurred in deciding whether to make the film (generally known in the industry as “development” or “pre-production” expenditure). “Genuinely intended for theatrical release” is defined in section 144 of this Act and refers to films intended for commercial release in cinemas.
563. This section dispenses with the requirement in section 41(1) of F(No 2)A 1992 for a claim to be made for preliminary expenditure to be allocated to a relevant period. See *Change 40* in Annex 1.
564. *Subsection (3)* provides that a deduction for preliminary expenditure allocated to the relevant period is subject to the application of “any prohibitive rule”. “Any prohibitive rule” is defined in section 130(7) of this Act as any provision of the Income Tax Acts which prohibits, or restricts the extent of, a deduction in calculating the profits of a trade.

565. *Subsection (7)* prevents preliminary expenditure being relieved both under this section and under the basic rules in section 135 in the same relevant period. See *Change 41* in Annex 1.

Section 138: Certified master versions: production or acquisition expenditure

566. This section allows production or acquisition expenditure on a qualifying film intended for commercial release in cinemas to be written off over three years. It is based on section 42 of F(No 2)A 1992, section 48(4) and (5) of F(No 2)A 1997 and section 99(1) of FA 2002.
567. *Subsection (2)* provides that a deduction for production or acquisition expenditure allocated to the relevant period is subject to the application of “any prohibitive rule”. “Any prohibitive rule” is defined in section 130(7) of this Act as any provision of the Income Tax Acts which prohibits, or restricts the extent of, a deduction in calculating the profits of a trade.
568. *Subsections (3) to (5)* allow up to one-third of production or acquisition expenditure not already allocated under sections 137, 139 or 140 of this Act (or under the corresponding rules in F(No 2)A 1992) to be allocated to a relevant period under this section.
569. This section dispenses with the requirement in section 42(1) of F(No 2)A 1992 for a claim to be made for production or acquisition expenditure to be allocated to a relevant period. See *Change 40* in Annex 1.
570. *Subsection (7)* provides that expenditure may not be allocated to a relevant period under this section if expenditure in respect of the same film has been allocated to that period under the basic rules in section 135 of this Act.

Section 139: Certified master versions: production expenditure on limited-budget films

571. This section allows production expenditure incurred before 2 July 2005 on a qualifying film with total production expenditure of £15 million or less and intended for commercial release in cinemas to be written off in full in the period in which it is incurred. It is based on section 42 of F(No 2)A 1992, section 48 of F(No 2)A 1997 and section 99(1) of FA 2002.
572. *Subsection (2)* provides that a deduction for production expenditure allocated to the relevant period is subject to the application of “any prohibitive rule”. “Any prohibitive rule” is defined in section 130(7) of this Act as any provision of the Income Tax Acts which prohibits, or restricts the extent of, a deduction in calculating the profits of a trade.

Section 140: Certified master versions: acquisition expenditure on limited-budget films

573. This section allows expenditure incurred before 2 July 2005 on the first acquisition of a qualifying film with total production expenditure of £15 million or less and intended for commercial release in cinemas to be written off in full in the period in which it is incurred. It is based on section 42 of F(No 2)A 1992, section 48 of F(No 2)A 1997 and sections 99(1) and 101 of FA 2002.
574. *Subsection (3)* provides that a deduction for acquisition expenditure allocated to the relevant period is subject to the application of “any prohibitive rule”. “Any prohibitive rule” is defined in section 130(7) of this Act as any provision of the Income Tax Acts which prohibits, or restricts the extent of, a deduction in calculating the profits of a trade.

Section 141: Meaning of “total production expenditure”

575. This section defines “total production expenditure” for the rules on limited budget films in sections 139 and 140. It is based on section 48(6),(6A) and (7) of F(No 2)A 1997.

*These notes refer to the Income Tax (Trading and Other Income)
Act 2005 (c.5) which received Royal Assent on 24 March 2005*

576. *Subsection (4)* substitutes an “arm’s length” amount for any expenditure incurred as a result of a transaction between connected persons in arriving at the total production expenditure. “Connected person” is defined in section 839 of ICTA (see section 878(5) of this Act).

Section 142: When expenditure is incurred

577. This section is based on section 48(9) of F(No 2)A 1997 and section 5 of CAA.

Section 143: Election for sections 134 to 140 not to apply

578. This section allows for the person carrying on the trade to elect for sections 134 to 140 not to apply to expenditure on a certified film intended for commercial release in cinemas. It is based on section 40D of F(No 2)A 1992.
579. The effect of such an election is that expenditure on the film will be treated not as revenue expenditure but as capital expenditure. Capital allowances may then be available under the normal rules in CAA.
580. This section dispenses with the requirement in section 40D(3) of F(No 2)A 1992 for an election to be made “in such form as the Board of Inland Revenue may determine”. This is because under section 42(2), (10) and (11) of TMA an election must be made either in a return under sections 8, 8A and 12AA of TMA (the form of which is determined by the Board) or “in such form as the Board may determine” in accordance with paragraph 2(3) of Schedule 1A to TMA .

Section 144: Meaning of “genuinely intended for theatrical release”

581. This section is based on section 99(2) of FA 2002.
582. Section 99(3) and (4) of FA 2002 contain transitional rules for qualifying films which do not meet the “genuinely intended for theatrical release” test but for which application for certification was received before 17 April 2002 or which were commissioned on or before 17 April 2002. See paragraph 35 of Schedule 2 to this Act.