

**THE CHANGING FACE OF  
INTERNATIONAL FILM PRODUCTION:  
THE STATE OF PLAY OF FILM  
INCENTIVES IN THE U.K., U.S.A.,  
CANADA AND BEYOND**

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## **TAX CREDITS – CANADA**

### **A. INTRODUCTION**

The Canadian Film and Video Production Tax Credits have attracted additional film and television productions from around the world to Canada. Several other countries, as well as several American states, including New York, have introduced or are preparing to introduce similar tax credits to encourage their film production industries.

To understand what led to the development of the labour based tax credits it is necessary to have a bit of historical perspective.

### **B. HISTORY**

Canada, like most of the world outside of the U.S.A., has developed incentives to protect and encourage its film production industry. This is not done for economic reasons, but instead to help develop film as part of the Canadian culture. In Canada, these incentives include everything from requirements for specified levels of Canadian content on the broadcast networks to direct grants to assist with the production of Canadian film and television products.

In the mid-1990's, the Canadian government blocked the use of Capital Cost Allowance tax shelter transactions that had been used to assist in the financing of Canadian indigenous films. To avoid creating a funding crisis for the indigenous film production industry, the Canadian government created, through an amendment to the Canadian *Income Tax Act*, the Canadian Film or Video Production Tax Credit. While this credit proved to be administratively cumbersome for the Canadian producers, particularly in the initial period, it did deliver the desired financial incentive in a predictable and cost effective way.

In 1993, Revenue Canada gave several advanced tax rulings on a tax shelter structure called Production Service Limited Partnerships. These were designed to allow for the deduction of production expenses incurred in connection with foreign, usually American, owned productions. While these transactions were blocked three times by amendments to the Canadian *Income Tax Act*, the structure, in various forms, was used throughout the period from 1993 to the end of 2001. At their apex, between two and three billion dollars of film production costs per year were flowing through the large public tax shelter structures.

The reasons for blocking the Production Services Limited Partnership transactions were basically two-fold. Firstly, the tax shelters were seen as creating an unfair advantage for the relatively well-to-do, who were avoiding tax, over other taxpayers. Secondly, the Minister of Finance believed they were an inefficient way to encourage film production, as a large portion of the money raised ended up in the hands of the promoters, accountants and lawyers.

The second time the *Income Tax Act* was amended to block the Production Services Limited Partnership transactions occurred in 1997. At that time Paul Martin, Canada's current Prime Minister, was the Minister of Finance. The film and video production service industry had grown rapidly during the first four years of the Production Services Limited Partnership transactions. Not wanting to find out what would happen to this growing industry if there was no replacement for the Production Services Limited Partnership transactions, the Department of Finance went looking for a replacement incentive.

In order to replace the *de facto* industrial incentive of the Production Services Limited Partnership transactions, the Government of Canada looked to the tax credit that it had developed for indigenous film. It consulted with the film production industry in order to ensure that the incentive it proposed would be effective. The Film or Video Production Services Tax Credits that were created after these consultations provided much lower levels of financial incentives than the tax credits designed for indigenous films. They did, however, provide a simpler and more efficient set of rules for claiming the tax credits.

The federal Film or Video Production Services Tax Credit was initially set at 11% of qualified Canadian labour expenses. By tying the tax credit to Canadian labour expenses, the Department of Finance knew it would recover the amount paid as tax credits from the taxes paid by the Canadian crew.

Because the Production Services Limited Partnership tax shelter transactions created deductions from both federal and provincial taxes, the federal government was of the view that the provinces should provide part of the funding. In 1997, shortly after the federal Film and Video Production Services Tax Credits were introduced, Ontario announced its intention to introduce an 11% provincial tax credit. B.C. followed suit in 1998 and Canada now has some form of tax credit in most of the provinces.

In 2004 the federal government increased its tax credit to 16% of eligible labour expenditures. The intention was to move the aggregate incentive closer to the benefit level of the old Production Services Limited Partnership tax shelter transactions.

An interesting irony is that in 1998, ways were found to work around the tax rules passed in 1997 to block the Production Services Limited Partnership tax shelter transactions. The Production Services Limited Partnership transactions reached their apex from 1999 through 2001. Producers enjoyed the new found benefits of the labour tax credits at the same time as they were able to enter into Production Services Limited Partnership transactions.

### **C. THE PRESENT – TAX CREDITS IN THE CANADIAN PROVINCES**

British Columbia, Ontario and Quebec are the three Canadian provinces with the largest film production industries. Each province has a provincial tax credit program modeled on the Canadian Film or Video Production Services Tax Credit.

While the tax credit rates and technical rules vary slightly from province to province, a review of the British Columbia tax credits is illustrative of how the tax credit programs operate in Ontario and Quebec. The programs in Saskatchewan, Manitoba, Nova Scotia and some other provinces are also tax credit based, but have some additional requirements and generally offer higher tax credit rates. Alberta has a system of provincial grants.

British Columbia has a comprehensive tax credit program in two separate streams of tax credits, Film Incentive B.C. and the Production Services Tax Credit.

Although two streams exist with respect to tax credits in British Columbia, only one stream may be accessed with respect to any given production. The first stream, Film Incentive B.C. (“FIBC”) is an economic initiative designed to develop the British Columbia film and television industry. To qualify, the production company must be an eligible production corporation that is British Columbia controlled. That corporation must own more than 50% of the copyright in the production. In addition, the producer must be a British Columbia based individual, although there are exceptions for treaty co-productions and inter-provincial co-productions. The production must also be a Canadian content production. Typically this means that the production is certified by the Canadian Audio-Visual Certification Office as a “Canadian film or video production”. To be certified a production and its producer must meet a number of stringent tests including achieving a minimum of six points from a ten creative point list and satisfying the more subjective Producer Control Guidelines. Official treaty co-productions have their own set of rules.

There are four basic tax credits that comprise FIBC: (1) Basic Tax Credit; (2) Regional Tax Credit; (3) Training Tax Credit; and (4) Digital Animation or Visual Effects (“DAVE”) Tax Credit.

The FIBC Basic Tax Credit is 20% of Qualified British Columbia Labour Expenditures (“QBCLE”). “Qualified BC Labour Expenditures” is defined in the British Columbia *Income Tax Act* (R.S.B.C. 1996, c. 215, s. 79(1)) as the lesser of British Columbia labour expenditures and 40% of the total cost of production. British Columbia labour expenditures include all amounts paid to British Columbia-based individuals or companies for services rendered with respect to a production. As of January 1, 2005, an additional basic tax credit equal to 10% of the corporation’s QBCLE may be claimed. To qualify for the additional 10%, principal photography must have begun between December 31, 2004 and April 1, 2006. This credit applies to British Columbia labour expenditures incurred after December 31, 2004. Transition rules may apply when claiming the new FIBC basic tax rate.

The Regional Tax Credit is available for productions on which shooting occurs in areas of British Columbia other than Vancouver. It is equal to 12.5% of QBCLE, prorated according to the number of days of principal photography in British Columbia outside of the designated Vancouver area as a portion of the total days of principal photography in British Columbia.

The Training Tax Credit is provided for productions on which training of British Columbia film industry workers takes place. It is equal to the lesser of 3% of the QBCLE or 30% of trainees’ salaries.

Finally, the Digital Animation or Visual Effects (“DAVE”) Tax Credit is available for British Columbia labour expenditures directly attributable to digital animation or visual effects activities. DAVE will be discussed in further detail below.

The second stream of tax credits, the Production Services Tax Credit (“PSTC”), is an economic initiative created to encourage film, television, digital animation and visual effects production in British Columbia. To qualify, the production company must be an accredited production corporation that is British Columbia controlled. However, contrary to the requirements for the FIBC, the producer does not have to be a British Columbia based individual, and the production does not need to be a Canadian content production. To claim the PSTC, the production must meet minimum budget requirements which have been set for both episodic television and other productions. The corporation claiming the tax credit must own the copyright in the production or, if the copyright owner does not have a permanent establishment in British Columbia, a British Columbia-based production corporation which has directly contracted with the copyright owner may qualify. The PSTC consists of the Basic PSTC, the Regional PSTC, and the DAVE credit.

The Basic PSTC is equal to 11% of Accredited Qualified British Columbia Labour Expenditures (“AQBCLE”). An additional basic tax credit has also been established as of January 1, 2005,

whereby an additional 7% of the corporation's AQBCLE may be claimed, for a total of 18%. To qualify for the additional credit, principal photography must have begun between December 31, 2004 and April 1, 2006.

The Regional PSTC is 6% of AQBCLE, prorated according to the number of days of principal photography in British Columbia outside of the Vancouver area to the total days of principal photography in British Columbia.

The DAVE PSTC is 15% of the AQBCLE that is directly attributable to digital animation or visual effects activities.

DAVE is an enhancement to both streams of tax credits. As previously mentioned, it is a tax credit for digital animation or visual effects activities performed in British Columbia. It is equal to 15% of QBCLE directly attributable to digital animation or visual effects activities. It can be combined with the Basic, Training, and Regional Tax Credits. To be eligible, the production corporation and the production itself must qualify for either the basic FIBC or the PSTC. In addition, the effect must be created primarily (more than 50%) with digital technology using prescribed DAVE activities. Also, the labour claimed must be directly attributable to the DAVE effect. Examples of activities that are included are: designing, modeling, rendering, lighting, painting, animating, compositing, and visual effects photography. Activities that do not qualify for DAVE credits include audio effects, in-camera effects, credit rolls, subtitles, animation or visual effects all, or substantially all, of which are created by editing activities, and animation or visual effects created for use in promotional material for the production.

The tax credits in Canada have proven to be a successful tool for developing the Canadian film production industry. Production rates have escalated, as is evidenced by the number of feature films and other productions that are shot in Canada.

October 21, 2005

## **TAX CREDITS – NEW YORK CITY AND NEW YORK STATE**

### **A. INTRODUCTION**

The Canadian Film and Video Production Services Tax Credit has been adapted and adopted in other countries. Examples of similar tax credit programs are those of New York City and New York State. The credits are generally based on production costs incurred in the respective jurisdictions, as opposed to Canada's system, which bases tax credits on labour expenditures. While basing the tax credits on production costs is more attractive to the production companies, it may not ensure that tax revenues generated exceed tax credit payments.

In New York, eligible productions include feature films, episodic television series, television pilots, and television movies and miniseries. Information on this credit is available through the City of New York Mayor's Office of Film, Theatre and Broadcasting at [http://www.nyc.gov/html/film/incentives/tax\\_credit\\_overview.shtml](http://www.nyc.gov/html/film/incentives/tax_credit_overview.shtml). Documentaries, news or current affairs programs, interviews or talk show programs, instructional programs, sporting events, game shows, award shows, daytime dramas, commercials, reality television and similar programs do not qualify for the New York Credit.

### **B. HOW THE NEW YORK TAX CREDITS WORK**

New York State recently announced the establishment of the Empire State Film Production Credit (the "NY Credit"). The NY Credit allows corporate franchise and personal income taxpayers to claim a tax credit for film production activity in New York State. It applies to state business and personal income taxes and New York City personal income and general corporation taxes. The NY Credit has been in effect since January 1, 2004 and is to continue for four years from that date. It is available for the taxation year in which production is completed.

The NY Credit allows taxpayers who satisfy a minimum threshold level of film activity in New York State to claim a 10% credit for qualified film and television production costs. Another 5% credit has been available in New York City since January 3, 2005. The option to introduce this additional 5% credit is open to any city in New York State having a population of one million or more.

The NY Credit includes a number of technical rules relating to the size and the proportion of the production costs spent in New York. There are also some unusual rules relating to the size of the film production facility (i.e., the physical studio). For example, to be eligible for the tax credit, the production must be shot on a set, on a stage, at a qualified production facility in New York City. It must also spend at least 75% of the total facility-related expenses at a qualified facility. Total tax

credits can be up to 15% for the work done at the facility. To be considered a qualified production facility, the facility must be a stage facility in which television shows and films are or are intended to be regularly produced. Such facilities must have at least one sound stage of at least 7,000 square feet.

The NY Credit is available on a first-come, first-served basis. Applications must be submitted not more than 180 days before the start of principal and ongoing photography. The total available credit each year for the New York State Credit is \$25 million, with an additional \$12.5 million available under the New York City program. Any applications received after the aggregate credit has been allocated will be treated as having been applied for on the first day of the following year. Excess credit is 50% refundable in the first year and any excess credit carried forward is fully refundable in the second year.

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