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Lower House Approves Tax Incentive Plan for Film Industry

by Ruth De Baere and Marc Quaghebeur

The Chamber of Deputies, the lower house of the Belgian Parliament, on 1 April approved a bill amending the Income Tax Code to make the so-called tax shelter for audiovisual works even more attractive.

Belgium in 2002 introduced a tax concession to encourage investments in the production of films and documentaries in the country. Companies that invest in the production of certified Belgian audiovisual work will receive a corporate income tax exemption of up to 150 percent of the amounts invested.

Background

Financing difficulties are a chronic problem of the Belgian film and audiovisual industry. The lack of available capital for production houses and the national fragmentation of markets that are dominated by American films make development of the sector precarious.

Belgian producers cannot finance the production costs on their own, and advance sales are not sufficient. Subsidies granted by the Flemish and Walloon authorities also come up short. Film subsidies for Belgian productions are available up to a maximum of €800,000 per film; approximately €16.75 million is provided annually (€9.75 million for Flanders and €7 million for Wallonia).

Nevertheless, Belgium has developed a reputation for the quality of its film technicians and its animated films. It is substantially less expensive to produce films in Belgium than it is in the major film production centers. Belgium also boasts a tax-efficient regime for fees paid to actors.

On 2 August 2002 Belgium introduced a tax shelter for Belgian audiovisual work (article 194ter of the Income Tax Code) that would act as a supplement to the regional subsidies. The legislation, however, could not enter into force until the European Commission approved it in the light of European Community guidelines on state aid.[1]

The European Commission had only one objection: The condition that an investor had to keep the receivables and the ownership rights he or she obtained under the framework agreement in his or her professional activity (which continues to be liable to income tax) was contrary to the principles of the free movement of persons and goods. The Belgian government modified the law accordingly, and the European Commission subsequently approved the amended legislation.[2] In a royal decree dated 3 May 2003 (Belgian State Gazette, 9 May 2003), the government determined that the provisions concerning the tax shelter entered into force with effect beginning in tax year 2004.

To meet the request of the European Commission, the Budget Law of 22 December 2003 (published in the Belgian State Gazette on 31 December 2003) replaced the full text of article 194ter of the Income Tax Code.

[1] Commission Communication: Some legal aspects concerning cinematographic and other audiovisual works, COM(2001)534 final, 26 September 2001, O.J. C 45, 16 February 2002.

[2] Decision N 410/2002 of 13 May 2003.

Investors, however, seem to have been discouraged because they could lose their tax exemption too easily. Although the tax shelter was widely publicized and some 30 projects were pending, no framework agreements were signed in 2003. On 6 January 2004 eight members of Belgium's Parliament, from the four parties in government, proposed a draft bill to make the tax shelter even more attractive.

Amendments

The first of the amendments would make the tax shelter more attractive for companies linked to a television broadcaster, which currently may not benefit from the tax shelter. Feature films now qualify only if they were produced for the cinema; the amendment would allow feature films produced for television to qualify.

Another amendment would clarify that investors would be entitled to the tax exemption in the year that the framework agreement is signed rather than in the year that the funds are made available to the production house.

Finally, the draft bill would give production companies up to five years to provide a certificate from the tax authorities. The current time frame is two years. Moreover, that certificate will make the tax exemption final.

The lower house has adopted the bill; it has been transmitted to the Senate, which is expected to approve the measure without amending it.

The Tax Shelter

The principle of the tax shelter is simple. Corporate taxpayers can invest up to one-third of their taxable profits before tax in the production of Belgian audiovisual work and benefit from a tax exemption of 150 percent of the funds invested. Therefore, the tax shelter is of interest to investors that are liable to Belgian corporate income tax.

Framework Agreement

The Belgian production house should sign up one or more investors with a framework agreement for the production of a certified Belgian film. That agreement must provide the details of the production.

The production house must be a Belgian production house, and its principal purpose must be the development and production of audiovisual works for the cinema or for television. But television broadcasting companies and companies linked to those Belgian or foreign television broadcasting companies are excluded.

Parties to the agreement must guarantee that the production house complies — and continues to comply — with those conditions.

The investors must be Belgian corporations or Belgian permanent establishments of foreign corporations. Belgian production houses and television broadcasting companies are excluded, but companies linked to a Belgian or foreign television broadcasting company can qualify for the tax concession. Moreover, Belgian banks are excluded from investing in films in the form of loans.

The audiovisual work produced must be either a feature film, a documentary film, or an animated film for the cinema, or an animation series or television documentary. Short films, television entertainment and news, advertising films, and soap operas are excluded.

As of 1 January 2006, feature films for television will also qualify. A royal decree may advance that date when conditions have been elaborated for television films.

The Flemish and French community must certify that audiovisual work as European work concerning article 6 of European Directive "Television without Frontiers."[3] Coproductions under the various bilateral cooperation treaties are acceptable. The Flemish or Walloon authorities have joined forces to draft a single form for the certification of audiovisual work.

The production house will have to come up with at least half of the budget, as the investors cannot finance more than half of the budget of the production. They can invest in the form of:

- Loans. A maximum of 40 percent of the investments can be financed in the form of loans. Loan reimbursements are not taxable, while the interest paid is taxable. For obvious reasons banks are excluded from the tax shelter for investments in the form of loans.
- Equity. At least 60 percent of the investments must come in the form of venture capital, that is, in the form of rights linked to the production and exploitation of the audiovisual work. In practice that will be a participation in a joint venture. The return on investment on the equity will be fully liable to income tax.

By splitting an investment into a loan for 40 percent and equity for the rest, the investor can limit his or her risk to 9 percent of his or her investment, even if it provides an interest-free loan.

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[3]Council Directive 89/552/EEC of 3 October 1989 on the coordination of some provisions laid down by law, regulation, or administrative action in member states concerning the pursuit of television broadcasting activities.

For the production to be Belgian an amount equal to at least 150 percent of the equity provided by the investors must be spent in Belgium for the production and exploitation of the audiovisual work within a timeframe of 18 months from the date of signing of the framework agreement. In practice that means that those exploitation costs and financial expenses must constitute taxable earnings for individual beneficiaries or, for Belgian and foreign corporations, profits liable to Belgian income tax, and they must not be disallowed expenses for the production house.

Because the investors cannot provide more than 50 percent of the budget, and the equity part must be at least 60 percent, at least 45 percent of the budget of the film must be spent in Belgium.

The parties to that framework agreement will have to lay out contractually the details of the deal. In particular they will have to specify the budget, the investment of each investor, the remuneration due to each investor, and whether he or she invests by way of equity or by way of loan. Moreover, in that agreement, the Belgian production house will have to undertake that it will spend 150 percent of the equity in Belgium within 18 months, that the funds provided by investors will not exceed half of the total film budget, that the invested amount will be used for the budget, and that the investment by way of loans will not exceed 40 percent.

Tax Exemption

The investors would be entitled to a tax exemption of 150 percent of the funds they have invested in the Belgian audiovisual work, with a maximum of 50 percent of their taxable profits, with an overall maximum of €750,000. The text as it stands would also allow the tax shelter as of the year that the investor signs the framework agreement; the European Commission is likely to refuse this provision.

Only companies with a taxable profit in excess of €1,500,000 will be able to maximize the tax exemption. If the investor does not have sufficient profits, the tax exemption can be carried forward indefinitely.

Failure to comply with those conditions will result in a clawback of the tax write-off for the future plus interest.[4] Therefore, the investor should monitor that the production house complies with the framework agreement, that the external investments do not exceed 50 percent of the entire budget and that they are effectively used for the budget, that not more than 40 percent of their investments are provided in the form of loans, that the production house pays its social security contributions, and that all obligations continue to be met.

But to be entitled to the exemption the investors will have to record and maintain the tax-exempt profit on a separate account on the liabilities side of their balance sheet. Moreover, the tax-exempt profit cannot be used as a basis for the calculation of any remuneration of allocation; that means that the investors cannot distribute the tax-exempt profit by way of dividend.

The investors will have to file a copy of the framework agreement with their tax returns with proof of certification as a European audiovisual work. Moreover, within four years they have to provide a certificate issued by the tax office of the production house to the effect that all the conditions have been met (spending in Belgium, maximum 50 percent investment and not more than 40 percent in the form of loans), together with a certificate by the Flemish and French community. At that time the tax exemption would become final and the tax-exempt profit would be available for distribution.

Considerations for the Investor

A significant limitation is that the investors must keep the full ownership to the receivables and ownership rights in which they have invested until the audiovisual work is finished. They cannot obtain the reimbursement of the loan nor assign the ownership rights for a period of 18 months from the date of the signing of the framework agreement.

If they make a profit from their investment, that will be liable to corporate income tax. But capital losses on the invested receivables or participation cannot be set off against taxable profits.

Furthermore, even if an investor has provided funds by way of equity or loan, the investor is not precluded from making other payments to the production house by way of sponsorship or advertising. This type of spending remains tax-deductible under the ordinary rules concerning allowed expenses.

Conclusion

The amendments to the film tax shelter law are major changes that the European Commission will have to consider in view of its state-aid rules. Informally, the case officer dealing with state aid has accepted the changes, including the provision that the tax exemption becomes final when a finished work is delivered. The European Commission's position, however, was that the tax shelter cannot be granted until the investor actually provides investment funds, rather than the year the framework agreement is signed. Even with this restriction, the amendments to the law make the tax shelter much more attractive to investors. ✦

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[4]Article 416, paragraph 2, ITC 1992.