

THE TAX RELIEF SYSTEM IN THE FILM INDUSTRY

The tax relief system introduced with the Act on Motion Picture has a dual purpose: to make Hungary one of the most attractive and competitive film production locations within Central Europe and to create new resources for the Hungarian film sector. Hungary intends to achieve this dual objective at the same time, providing exceptionally favourable conditions for all those who decide to shoot a film in Hungary.

The first few months of the tax relief system have proved that a sufficient amount of private resources can be mobilized in order to support film production if the right incentives are applied. The system has proved to be feasible and the experiences of the first period are positive: the first productions in relation to which the new rules were applied already received 20% support, and sponsoring enterprises are eligible to corporate tax reliefs.

What does the tax relief system offer to film producers?

The objective of the new system is to increase the number of films produced partly or entirely in Hungary, to support the Hungarian audiovisual industry and the production capacity of the country, increasing the number of experts employed in the sector, and thus exerting a positive impact on the economy.

The tax relief system achieves this goal by

- offering opportunities for *refunds* and thereby encouraging foreign film producers to come and produce a film in Hungary because this way they can reduce the production costs of their films,
- *creating additional resources* for co-productions and national films by encouraging Hungarian enterprises to invest in film production.

With the help of the tax relief system, the *refunds (supports) available in Hungary are 20% of local film production costs (incurred in Hungary). (Preproduction, shooting and postproductions work in Hungary to the first master print.)*

The source for the refunds is the profit before taxation of Hungarian economic enterprises, which intend to reduce their tax payable by supporting Hungarian film production.

Why are enterprises subject to corporate profit tax interested in investing in the film industry?

Such enterprises may

- reduce their *tax base* by the amount of their support, and
- reduce their *tax payable* by the amount of the support, thereby achieving a significant amount of tax savings.

The following table illustrates the advantages of support for tax savings purposes with the example of two imaginary enterprises. Both companies in the example generated 1,000 units of profit before taxation, but the first company provides support for film production, and the other one does not.

	Taxpayer supporting film production	Taxpayer not supporting film production
Taxpayer's profit before taxation	1000	1000
Support for film production	100	0
Tax base	900	1000
Tax payable	$(900 \times 0.16) - 100 = 44$	$1000 \times 0.16 = 160$
Tax paid	144	160
Savings	16	

What does the system offer to film producers?

The following table shows the advantages of the system through the examples of three different film production companies. Company A does not use any private support at all, Company B spends 75% of its production budget in Hungary, and Company C produces its complete film in Hungary. The table indicates that the largest savings are achieved in example C.

Producer	A	B	C
Production cost	1 000 000	1 000 000	1 000 000
Direct film production cost in Hungary	0	750 000	1 000 000
Available support (20% of direct production costs in Hungary)	0	150 000	200 000
Total film production costs payable by the producer	1 000 000	850 000	800 000

What kind of productions can receive support eligible for tax relief?

The Film Act distinguishes two types of productions in terms of tax relief.

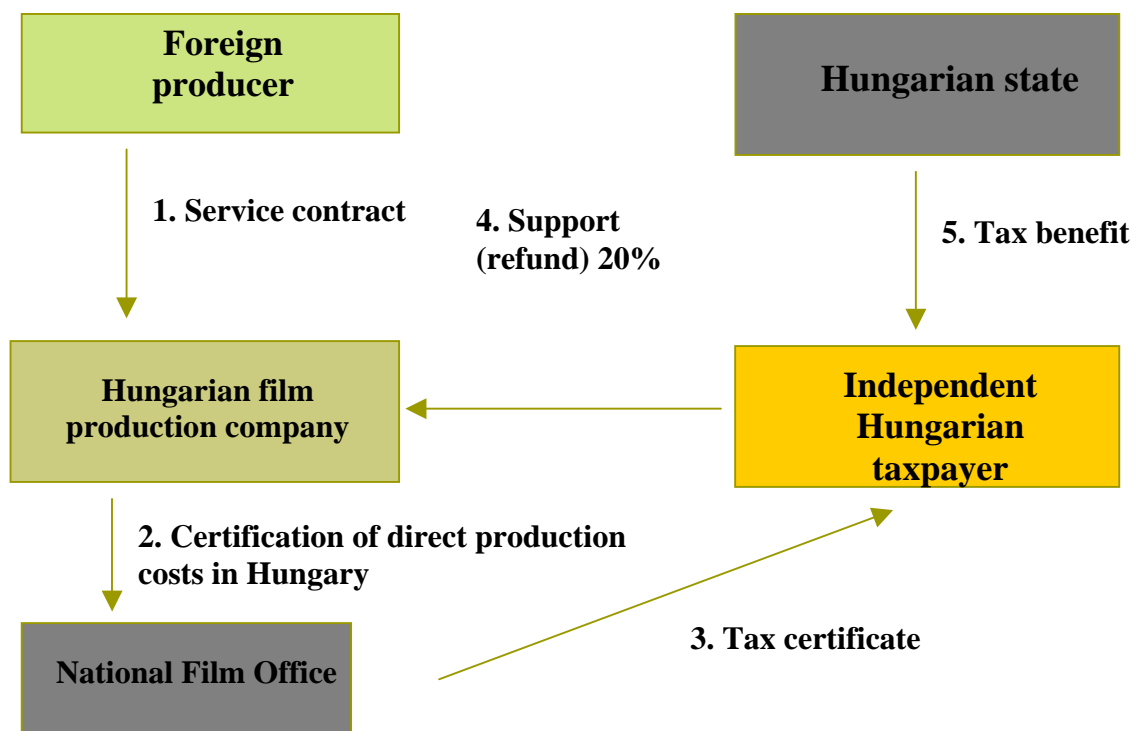
1. Films produced on order (*production services*): productions prepared by foreign film producers in Hungary with the involvement of an assigned Hungarian film production company.
2. Films not produced on order (*co-productions or Hungarian films*): productions produced by a Hungarian producer or co-producer, with the financial involvement of Hungarian investors.

The *first model* supports films where the *film budget is fully guaranteed* (typically by the foreign film producer), but the objective is to reduce production costs in Hungary by the foreign producer through the refund. In this case the *foreign producer directly or the Hungarian production company receives the refund directly*, which originates from a Hungarian taxpaying enterprise.

The *second model* supports films where the *total budget of the film cannot be provided by the producers*, therefore, external private financiers are also involved in the financing process. In this case, the *support is given to the Hungarian producer (co-producer)* from a Hungarian taxpaying enterprise. In both cases, the taxpayer provides the refund (support) to the producer only for tax reduction purposes.

How does the support reach the producer?

1. “Production service” model (films produced on order)



The parties have *contractual obligations* towards each other.

The Hungarian film production company agrees:

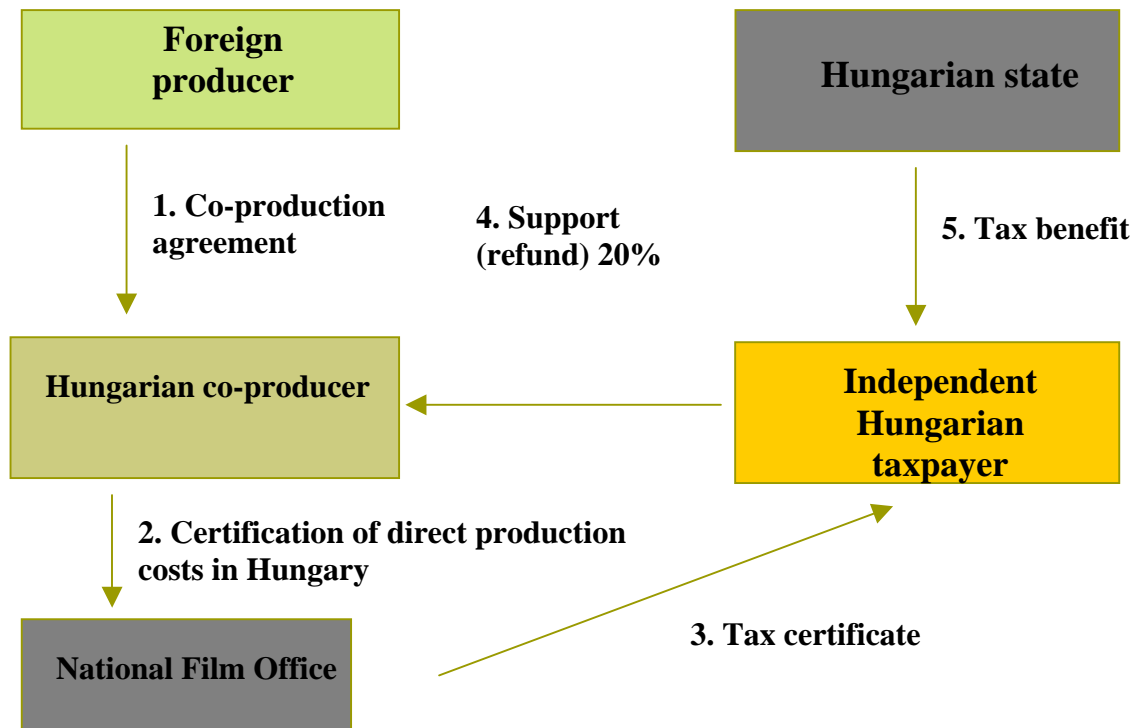
- to register itself and the production with the National Film Office;
- to order and provide the services and other items required for the production of the film under the contract concluded with the foreign producer;
- to use the assumed services in Hungary.

The Hungarian taxpaying enterprise agrees:

- after completion of production in Hungary (or one of its phases) and following the issue of a tax certificate by the Film Office.
- to pay 20% of the Hungarian production cost to the foreign producer

The Hungarian taxpayer providing the support may be involved into the arrangement by both the Hungarian and foreign producer.

2. *Co-production model (films not produced to order)*



Procedure required for issuing the tax certificates (for provision of support)

The National Film Office

- is the government agency responsible for the regulatory tasks defined in the Motion Picture Act and operation of the tax relief system related to films;
- registers film productions requesting support and eligible for tax relief;
- registers Hungarian production companies;
- examines and certifies Hungarian production costs;
- issues support certificates representing eligibility for tax relief.

The procedure

1. *Application phase* – The Hungarian production company requests the registration of the production at the National Film Office 45 days before the start of the shooting of the film in Hungary (submitting the documents specified by the Motion Picture Act and the applicable ministerial decree with the application).
2. *Registration* – The Film Office registers the film production.
3. *Production phase* – Completion of the production work in Hungary.

4. *Controlling phase* – After the completion of production in Hungary (or a specific phase thereof) the Film Office reviews the accounting of the production upon the request of the production company (30 days).
5. *Issue of tax certificate* – To close the controlling phase, the Film Office specifies the total of production costs in Hungary, and issues a certificate with eligibility for tax benefits up to maximum 20% of the production costs.
6. *Payment of support* – Following the receipt of the certificate, the Hungarian taxpaying enterprise fulfils its assumed support obligation based on its contract with the Hungarian film producer.

When does the producer receive the support?

- Sponsors will make the payment if they are certain that they receive a tax relief for their support – which is secured with the tax certificate issued by the Film Office.
- Therefore, tax savings are only guaranteed for sponsors if they perform on the basis of the production costs certified by the Film Office.
- Film producers must seek pre-financing to overcome the deficit between the pre-production and post production stages.
- Nevertheless, the system does not exclude sponsors providing support in advance at their own risk.

The first film financing funds have also been established to provide pre-financing for the 20% missing from the production budget, and for the management of contractual relations between sponsors and film producers.

Financing is made easier by the following:

- Hungarian production can be divided into several phases (quarterly), and
- after the completion of individual phases the issuance of certificates may also be requested for the amount of costs incurred in the given phase.

What is considered direct film production cost incurred in Hungary?

All payments contained in the budget of the film that were made to Hungarian taxpayers, with the exception of royalties and indirect expenses.

Tax benefits for developmental purposes

1. The new system also encourages investments into *the film production infrastructure* with tax benefits. Companies making such investments of at least HUF 100 million are eligible to a *tax relief representing 35-50% of their investment* depending on which region of the country they make their investment in. (Budapest: 35%, Pest County: 40%, Western Transdanubia: 45%, the rest of the country: 50%)

2. The tax regulations applicable to *structures and machinery* (equipment) *used for film production* allow for *favourable depreciation write-offs*. The favourable depreciation rate applicable to machines and equipment used only for film production is 50%, while the depreciation rate for structures is 15%.

