In confidence

OFFICE OF MINISTER FOR ECONOMIC DEVELOPMENT
OFFICE OF MINISTER FOR ARTS, CULTURE AND HERITAGE

MEMORANDUM FOR CABINET

SCREEN PRODUCTION INCENTIVES

Proposal

1 This paper recommends changes in both the structure and level of government support for overseas and New Zealand productions under the Large Budget Screen Production Grant (LBSPG) and Screen Production Incentive Fund (SPIF) in order to promote the development of a screen sector that in the longer term is less dependent on taxpayer incentives for its commercial success.

Executive summary

2 New Zealand's screen sector is experiencing a period of difficulty, potentially putting at risk the sector's development over the last decade. A combination of factors, principally increases to the incentives offered by competing jurisdictions and our already high exchange rate, has led to this situation.

3 Attracting international screen production to New Zealand produces a range of direct and indirect economic benefits, including on the ground spending and spill-over benefits for other areas of economic activity, for example through international recognition of the New Zealand brand, as an attractor for tourists and technology transfer to other industries. International productions located here help to build industry reputation and scale so that domestic producers can compete for overseas production and generate self-sustaining income streams.

4 Support for New Zealand productions also helps to build scale and local edge and allows New Zealanders to see their own stories on screen. There is a missing middle of New Zealand productions, however. Incentivising New Zealand productions in the $15m-$50m production bracket would also contribute significantly to building a base for a more financially sustainable and internationally competitive screen sector that, over time, generates more domestically-owned intellectual property (IP) and becomes less dependent on incentives to attract mobile international productions.

5 The Government recognises that the global screen industry is dynamic and rapidly changing. It is important that discussions on the future direction of the sector focus on long-term strategies, and take account of the diversity and strengths of our local screen industry.

6 Countries that are engaged in using increasingly generous incentives to entice international business are effectively promoting a "race to the bottom" mentality. New Zealand should not simply seek to compete on this basis as in the longer term this is likely to lead to an economic loss to New Zealand and it will not assist in building sustainable screen businesses.

7 New Zealand also has other advantages, including the ease of doing business here and our skilled and capable workforce. We should not underestimate what we have to offer.

8 Having said that, we consider there is a case for revisiting the current screen incentives in the shorter term in order to provide a breathing space within which to develop a more sustainable industry that generates more domestically-owned IP which is more strongly linked to New Zealand. Other countries are at this time offering increasingly generous grant rebates and tax relief to attract screen production. These factors, coupled with the sustained high value of the dollar, have prompted us to take another look at screen production incentive settings.

9 The LBSPG is directed at international productions and the SPIF at New Zealand productions. They need to be sufficiently attractive to ensure that New Zealand is able to attract or produce some high value productions that would not otherwise be produced here. Amendments to these schemes also need to be designed to build the base for a more sustainable industry.

10 This paper discusses two options for improving these schemes with these objectives in mind. Option A involves combining the two schemes and having one new, uncapped scheme, with significant enhancements. Option B involves enhancing the two existing schemes.

11 Chief among the enhancements are:

- introducing a new baseline rebate of 20% for the LBSPG, with provision to qualify for an additional 5% under a points test where there are significant economic benefits; or retaining the current baseline rebate of 15% with the provision to qualify for an additional 5% plus a further 5% under certain circumstances; and
- incentivising more middle size New Zealand-owned and developed productions above $15m and up to a maximum of $50m through an equity share as opposed to a grant payment. These productions would also need to meet a points test reflecting both New Zealand cultural and business factors.

12 Further work will be necessary on detailed design issues under either option, especially in relation to the proposed points tests.

13 Although the revised policy settings discussed in this paper stand independently from any one production, a decision will allow discussions on bringing the *Avatar* sequels to New Zealand to be advanced and possibly concluded before Christmas.

Background

14 The Government made a number of adjustments to the LBSPG and SPIF in July 2013 following a review of screen sector initiatives by officials. It was agreed that both grants would be evaluated again by December 2016. [EGI Min (13) 14/2 refers].

15 Since these decisions were announced, there has been significant concern about a downturn in international production activity, especially for television in Auckland. An

industry summit which took place on 14 November called for the Government to increase the LBSPG to a level which would restore New Zealand's international competitiveness.

16 A similar concern has been reported by Sir Peter Jackson in respect of international film. Sir Peter has voiced concern that, unless action is taken, New Zealand will lose much of the world class capability and reputation that has been successfully built up over the last decade.

17 The NZFC, working with industry partners including FNZ, the Wellington City Council, Park Road Post and leading New Zealand producer and director Andrew Adamson, has commissioned reports from PricewaterhouseCoopers and the New Zealand Institute of Economic Research (NZIER) on international competitiveness and economic impact issues respectively, the conclusions of which inform the recommendations of this paper.

18 Against this background, a jurisdiction is currently being sought for the production of three intended sequels for *Avatar* by the films' sponsors. Qualifying New Zealand expenditure on the first *Avatar* was $362.7m, [withhold, s 9 (2) (b) (ii)], resulting in grants of $52.9m.

[withhold, section 9 2 (b) (ii)]

Comment

Rationale for government intervention

19 The rationale for government intervention in the screen sector is both economic and cultural. The screen sector produces a range of direct and indirect economic benefits and allows New Zealanders to see their own stories.

20 The case for ongoing grants to support local film and television is reasonably clear-cut. The cultural benefits of New Zealanders being able to see their own stories would not be able to be sustained without financial support.

21 International productions located here can generate valuable direct and indirect economic benefits, including spill-over benefits for other areas of economic activity, for example through international recognition of the New Zealand brand, as an attractor for tourists and technology transfer to other industries. Support for international film and television productions is intended to build industry reputation and scale so that domestic producers can compete for overseas production and generate self-sustaining income streams.

22 IP has a number of different meanings in the screen sector. IP rights are hard to capture in relation to international productions. While New Zealanders can and do hold IP rights in relation to domestic production, and some, particularly television series such as *Outrageous Fortune*, *Reservoir Hill* and *The Almighty Johnsons* have been successful overseas. In a number of cultural industries, New Zealand artists have shown that they are capable of competing successfully on the international stage, the most recent examples being young Kiwi music star Lorde, and Man Booker prize winner Eleanor Catton. Developing a significant stable of New Zealand-sourced, internationally-

successful screen productions would increase the sustainability of the New Zealand screen sector and make it less dependent on incentives. Achieving this will take some time, however.

23 Another aspect of IP in the screen sector is the development of "local edge" that is not easily replicable, for example the IP developed by Weta Digital through the production of such films as the *Lord of the Rings, Avatar* and *The Hobbit*. The challenge is to grow business and creative skills at a commercial scale, i.e. to develop the skill sets that enable New Zealanders to develop commercially viable production.

24 The point at which the Government will no longer be required to support the development of the screen sector in this way is unclear. It is apparent, however, that in the short to medium term New Zealand will need to provide significant incentives to attract international work if it wishes to have a financially sustainable and internationally competitive screen sector.

Problem definition

25 New Zealand's screen sector is experiencing a period of difficulty, potentially putting at risk the sector's development over the last decade. A combination of factors, principally increases to the incentives offered by competing jurisdictions and our already high exchange rate, has led to this situation.

26 The screen sector has gone through peaks and troughs over the last 10 years. The current trough would seem to be potentially long-lasting given the challenging trading conditions. The current situation has revealed that parts of the industry have been over-reliant on particular ways of operating, and less able to adjust and adapt. In addition, recent developments have highlighted a significant reliance on a very small number of players.

27 Other jurisdictions with which New Zealand competes have made significant adjustments and increases to their incentives and industry representatives have called for an increase in incentives. Ministers are concerned to ensure that any adjustment to incentives avoids the race to the bottom whereby the costs of assistance outweigh the direct and indirect benefits of retaining production in New Zealand, and where New Zealand contributes to ever increasing competition between countries to increase incentives.

28 It should be noted, however, that a number of factors affect a country's attractiveness and comparisons of rebate levels alone can be misleading. It is not useful, for example, to simply compare New Zealand incentives with those of key competitor countries as each jurisdiction has different criteria. Some jurisdictions have grant rebates while others offer tax rebates, some incentives are based on where goods and services are provided and some on where they are paid for. A summary of screen production grant rebates and tax relief offered in other jurisdictions is provided at Appendix 1.

29 The evaluation of the LBSPG suggests that the current grant provides modest net economic benefits. Any changes therefore need to be very carefully designed to ensure that the economy as a whole does not incur costs from the scheme. This means that we have to work hard to maintain a balance between developing the industry and responsible fiscal management. This also means that any changes to the incentive schemes must be aimed at ensuring there is a much sharper focus on building industry sustainability, and that no expectation is created on ongoing increases to incentives.

30 We also need to keep in mind that other industries are affected by the exchange rate and global trading conditions, and those industries do not receive turnover incentives or subsidies in the way that the screen industry does. The reality, however, is that financial incentives in this industry have become commonplace around the world over the last decade. They have become a pre-requisite for any government seeking to establish or maintain a screen industry in its jurisdiction.

31 Much of the recent debate focuses on the level of incentives. While this is clearly important, especially to studios making production-location decisions, we should not underestimate other advantages New Zealand has to offer. The ease of doing business here, our skilled and capable workforce, competitive labour costs, flexible employment laws and natural scenery are examples of factors that make New Zealand an attractive location for screen production. New Zealand's competitive position in the global screen industry needs to emphasise that we have advantages that others do not have and that we do not compete on incentives alone.

32 The current situation has also revealed that while our schemes encourage international production and small scale New Zealand content, there is a missing middle of New Zealand productions in the $15m-$50m bracket which are likely to have the greatest chance for internationalisation from a New Zealand base. Having more productions of this order would greatly assist in providing commercial scale, skills and local edge in the sector. It would also enable New Zealand productions to be made on a scale, and to a level of production quality, that would restore and develop the opportunity for international recognition and sales and distribution in international markets.

33 The current rebate available under SPIF for film productions which tell New Zealand stories and have a high level of New Zealand content is 40%. Cabinet recently agreed a number of changes to SPIF, including requiring applicants to find a greater proportion of their budget from private sector sources. The cultural content test, which awards points for productions meeting certain criteria, such as New Zealand subject matter, was adjusted slightly to include additional points for business-related outcomes.

34 SPIF is relatively restricted, however. Its overall budget is capped and individual productions are capped at a low level (refer Appendix 2 for details). The cultural content points test remains a barrier for medium to large projects that have strong New Zealand creative input and export-focussed IP but do not have New Zealand subject matter.

Case for revisiting incentive schemes

35 The fiscal break-even point for rebates will vary depending on the circumstances, as will the level of incentives required to attract international productions.

36 Research by PricewaterhouseCoopers (PwC) indicates that to be competitive New Zealand's LBSPG rebate for film, television and post digital and visual effects (PDV) needs to be in the range 20%-25%. The current rebate of 15% has become uncompetitive and likely to remain so for the foreseeable future. The report found that New Zealand remained competitive internationally in terms of labour costs, a skilled workforce and ease of doing business.

37 The recent evaluation of the LBSPG found modest, net positive impacts, and concluded that without the grant New Zealand would not have attracted the same level of international production. The evaluation did not take specific spill-over benefits into account because these are difficult to quantify with any confidence.

38 There is some data available, however. Tourism New Zealand reports that, from January to June 2013, 8.5% of all non-business international visitors surveyed said that *The Hobbit* was a factor stimulating their interest in New Zealand as a destination. Some 13.2% of international visitors in this period took in a Hobbit experience while in New Zealand, including group tours visiting film sites. The equivalent spend of this group was estimated to be $168m or $460m on an annualised basis.

39 The broader role of incentives, including creating spill-overs and enhancing New Zealand's profile and brand globally, supports an economic case for considering an increase in the rebate level.

40 If the Government sees a role for a domestically-based screen sector then an increase in the incentives will be necessary to maintain a New Zealand-based workforce while more sustainable business models are developed.

Policy objectives

41 In assessing options in respect of New Zealand's existing incentive schemes, policy objectives can therefore be summarised as to:

- create spill-overs and additional economic activity;
- build scale and critical mass in the industry;
- encourage screen businesses to develop resilient business models, for example, by generating and controlling IP or through developing capabilities that are hard to replicate;
- encourage international screen production to New Zealand that supports the New Zealand brand, including the *New Zealand story;*

- encourage screen production in New Zealand (and the resulting expenditure in New Zealand) that would not have otherwise been made here as a way of supporting an underlying level of activity in the industry while developing more unique IP owned by New Zealanders;
- support the development of capable internationally successful directors, producers, and writers who can attract production to New Zealand and generate their own productions within New Zealand;
- support the creation of New Zealand content and New Zealand stories;
- build New Zealand's competitive edge and value proposition across a range of fronts, for example, innovation and technology.

Options

Present incentive schemes

42 Details of the present arrangements under the LBSPG and SPIF, including expenditure incurred to date, are summarised at Appendix 2.

43 The LBSPG is an uncapped grant that is accessible solely on the basis on qualifying expenditure in New Zealand. Currently, productions over $200m qualify for an additional rebate of 15% capped at $9.75m. Depending on the production budget, the effect of this is to give such productions an effective rebate of approximately 20%. Because the additional grant is calculated on guaranteed deferments or participation payments which are only known at towards the end of production, however, this provision is not something that can generally be taken into account in initial finance plans on which location decisions are based.

44 Unlike the LBSPG, the SPIF is a capped grant regulated by a New Zealand content points test. To gain the 40% rebate under SPIF, film productions must score at least 20 points on a New Zealand content test; television productions must score at least 15 points but only qualify for a 20% rebate. Individual film and television productions with qualifying expenditure of up to $15m are currently capped at grants of $6m and $3m respectively. These caps are primarily in place to manage demand for the capped SPIF funds.

Status quo

45 The risk of doing nothing is that New Zealand will lose skills and infrastructure that would be hard to replace and adversely affect our ability to generate New Zealand-owned IP.

46 Of the options for changing the status quo and enhancing New Zealand's incentives schemes, two main options present themselves which are discussed below as Options A and B.

Option A – new screen grant combining the LBSPG and SPIF

47 Option A would involve combining the two schemes and having one new, uncapped scheme (the New Zealand Screen Production Grant (NZSPG)). The new scheme would incentivise more international production in New Zealand, and also support the creation of high quality New Zealand content and stories.

48 Under this option, the current rebates of 15% and 40% for the LBSPG and SPIF respectively would be replaced by three rebates: 20%, 20%+5% and 40%.

49 The rebate of 20% would replace the current rebate of 15% and become the new baseline provision, accessible on the basis of qualifying expenditure in New Zealand, as before. As noted above, this is already the effective rate for a limited number of productions.

50 Then, to gain an additional 5% rebate, it would be necessary to meet a points test relating to significant economic benefits such as:

- size of the proposed expenditure;
- employment of New Zealanders in key roles;
- support for the development of New Zealand screen sector businesses;
- provision of an R&D initiative;
- support for skill development;
- undertaking additional business activities in New Zealand, e.g. post production; musical scoring etc;
- entering into marketing, promotion or other beneficial arrangements with relevant government agencies.

51 Given that the objective is to attract such productions, it would be desirable for any points test not to be overly prescriptive. The aim would be to maintain as much flexibility as possible while still operating on the basis of objective criteria which can be applied transparently and consistently. It would be expected, however, that the additional 5% would be broadly matched by the value that would be supplied to New Zealand from the listed economic benefits.

52 New Zealand is much more likely to secure valuable business working within a framework of such criteria than by setting arbitrary limits which define who is in and who is out. This does not imply that the test should be easy. On the contrary, it should be demanding.

53

[withhold, section 9 (2) (i)]

54 For New Zealand productions, a two tier system would be established.

55 For New Zealand productions up to $15m of qualifying New Zealand expenditure, the existing approach would apply, i.e. to gain the 40% rebate, payable as a grant, it would be necessary to gain a certain number of points on the New Zealand content test. This would necessarily involve a New Zealand story and a high level of New Zealand creative control.

56 For New Zealand productions with qualifying New Zealand expenditure in excess of $15m and up to a maximum of $50m, as well as gaining the same number of points on the New Zealand points test, it would also be necessary to gain points relating to business factors such as:

- producer's track record in producing commercially as well as creatively successful productions;
- production's likely export potential;
- extent to which IP is New Zealand-owned.

57 The purpose of having such a test would be to provide assurance that only high quality material will be produced and bring benefits in terms of building a more sustainable production base in New Zealand.

58 In addition, support for these productions would be provided by way of an equity stake as opposed to a grant payment. This would allow the Crown to recoup some of its investment in the event of a production being commercially successful. Based on experience under the former New Zealand Production Fund (NZPF), this might be in the region of 10-30% of the amount invested.[1]

59 It is proposed that film and television production be treated equally for rebate purposes, both below and above the threshold of $15m, since production of either kind is consistent with the underlying policy objectives outlined above.

60 At present, co-productions are deemed to meet the test of significant New Zealand content. Further consideration is needed as to whether this situation should continue under what is proposed.

61 Under this option a new appropriation would need to be established. This is likely to involve transferring existing funding appropriated for the LBSPG and SPIF to the new fund. Officials will report back to Cabinet by 1 March 2013 with details for establishing a new appropriation for the NZSPG.

62 Option A is summarised at Appendix 3.

[1] The NZPF was established in 2000 and and was responsible for backing such films as *Whale Rider, Boy* and *The World's Fastest Indian.*

Option B – enhancements to the existing incentive schemes

63 Option B would involve essentially the same changes as those discussed under Option A except that these would be made within the existing schemes which would be retained. The same changes discussed above in relation to the SPIF would apply under this option, including establishing an uncapped, demand-driven appropriation. Two sub-options are also presented in respect of the LBSPG:

a) *Grant rebate at 20% with an additional 5% available under certain circumstances*

64 Under this option, all eligible productions meeting the qualifying New Zealand production expenditure threshold would receive a 20% rebate on that expenditure.

65 An additional 5% rebate would be available for productions able to satisfy a points test in relation to significant economic benefits, as outlined above.

b) *Grant rebate at 15%, with flexibility for an additional 5% plus 5%*

66 Under this option, the 15% rebate would be retained and available to applicants who reach the threshold for qualifying New Zealand expenditure, i.e. $15m for feature film, $4m for television and $1m for PDV.

67 As noted above, we recognise that from time-to-time the ability to offer a higher rate will be important to secure key productions. To this end, we could offer two tiers of an additional 5%. The first tier of the additional 5% would be tied to the production expenditure threshold. In this, we are aiming to attract high-value productions. Indicatively, since July 2004, at a $200m expenditure threshold, four previous productions would have qualified for the additional 5%. This figure increases to five productions at the $100m expenditure threshold and 14 productions at a $50m expenditure threshold.

68 To gain the further additional 5% and take the total rebate to 25% on qualifying New Zealand expenditure, applicants would be subject to meeting a points test as outlined above.

69 There are some disadvantages with this option, however. It would exclude a number of high value and quality PDV productions where New Zealand has strengths. Very little television production, except major productions, would qualify. It would also result in a fairly complex scheme.

70 Option B is summarised at Appendix 4.

Assessment

Level of rebate

71 Using the methodology of the evaluation of the LBSPG, at both the high point and mid-point ranges, a 25% rebate would result in a net economic cost to government. Using the same methodology, a 20% rebate at the high point retains a net economic benefit. A 20% rebate at the mid-point leads to a small net economic cost. As noted above, the evaluation does not attempt to account for spill-overs, as these are difficult to quantify with any accuracy. Accordingly, a shift to 20% is preferred as a baseline adjustment to the rebate but with provision to go to 25% if significant economic value can be established, as determined under a points test. The use of a points test as opposed to a monetary threshold would help manage the risk that the 25% rebate could become the standard rebate.

Choice of options

72 As well as incentivising more overseas productions to come to New Zealand, both options would facilitate the making of more high quality New Zealand productions in the middle bracket ($15m-$50m) that tell important New Zealand stories with sufficiently high production values to attract international as well as local audiences. New Zealand has a number of internationally-proven directors who are likely to relish this opportunity but who currently find it very difficult to raise finance for New Zealand stories.

73 The case for a new incentive across both overseas and New Zealand productions with rebate levels tied to the nature of work performed in New Zealand would emulate the approach taken in the UK and some other jurisdictions by using a points test to determine the level of rebate on offer.

74 The main choice between Options A and B is one of presentation and perception as to complexity and difficulty of implementation. Option A involves creating a new scheme from two schemes which have been operating since 2004 and 2008 respectively whereas Option B involves making changes within the current schemes.

75 As part of this process, it would also be desirable to reduce the compliance burden of complex legal and financial documentation that are a feature of SPIF productions due to the need to find a third party lender until the grant is paid out. Reforming this aspect would avoid valuable support for production activity being used to cover financial and legal costs. There may also be scope for tidying up other minor aspects.

Funding implications

LBSPG

76 The LBSPG is an uncapped, demand-driven grant. The current appropriation is $50.5m p.a. Any new productions resulting from a different rebate would take some time to apply for a grant. Current forecasts indicate that the appropriation is likely to be underspent in 2013/14. We would expect little change in the flow of applications for the grant in the remainder of 2013/14, and a gradual ramping up from 2014/15. Accordingly, Ministers may wish to consider an appropriation change at a later date.

77 Based on previous patterns of productions accessing the grant, a 20% rebate rate could result in an additional grant of up to $21m p.a. If an additional 5% were available, this would result in additional grant expenditure. The final costs will depend on the design and the uptake of the provision.

78 Officials will assess the impact on the market of the changes and within one year of their introduction will report back on options for the appropriation.

SPIF

79 The cost of SPIF has been $47.7m since 2008 based on qualifying expenditure in New Zealand of $142.5m or $9.54m p.a. on average. By removing current caps on the total budget allocation and amounts for individual productions, it will be possible for more productions to be supported, including at a higher budget level. The current appropriation for SPIF is $63.75 million over five years. Under this option, SPIF will be a demand-driven appropriation and by nature can exceed the annual appropriation. This is the same arrangement as is currently in place for the LBSPG.

80 The current SPIF appropriation is likely to meet future demand for funding. A sudden increase in applications seems unlikely given the small size of the New Zealand industry and the number of new productions that could be supported. Moreover, given the lead times involved, it is unlikely that any middle sized New Zealand production would be requiring support until 2015/16 at the earliest. We assume that the number of films with budgets up to $15m will be constrained by available NZFC funding and thus will remain at the current level of approximately $10m p.a. We anticipate that only one to two middle sized New Zealand productions would be supported in the coming five years equating to a maximum investment of $40m (being two productions at the maximum $50m qualifying New Zealand expenditure each). There is potential for $4m to $12m of this amount being returned to Government (assuming 10% to 30% recoupment of the investment as the amount is an equity stake).

81 Removing the overall cap on SPIF funding would not require any changes to the existing appropriation. Ministers may wish to consider an appropriation change at a later date if there is greater than anticipated demand on the fund.

82 Officials will report on any issues within a year of the changes to the SPIF being introduced, as part of the report back noted above in respect of the LBSPG.

<u>Implementation</u>

83 Under both options further work will be necessary on detailed design issues. Particular issues to consider include the position of PDV under the proposed points test for an additional 5% rebate and the treatment of television productions and co-productions under changes to SPIF and alignment with other funding agencies e.g. NZ on Air. These are issues that can be resolved by responsible Ministers on advice from the NZFC, FNZ and officials. This will also provide an opportunity to involve the industry in the implementation of high level decisions made by Cabinet which should be possible by 1 April 2014.

Other issues

Administrative implications

84 The LBSPG and SPIF have been administered by the NZFC since their inception and there is no reason why this situation should not continue under either Option A or B. Currently, SPIF decisions are made by a committee comprising the NZFC and industry representatives. LBSPG decisions are made by a panel comprising the NZFC, MBIE and industry representatives. It may be desirable, however, to consider reconstituting these decision-making bodies to include MCH officials or possibly others given that a further level of discretion is now being contemplated. This will have financial implications, as will the additional complexity of administering what is proposed.

85 Accordingly, if the recommendations of this paper are accepted, the Minister for Arts, Culture and Heritage will be developing funding proposals in the context of the 2014 Budget to increase resources for the NZFC.

Implications for overseas marketing

86 Regardless of which option is preferred, there is a case to step-up New Zealand's overseas marketing efforts by creating more pulling power for New Zealand, enhancing business to business marketing and enhancing New Zealand brand marketing. Some initiatives are already being contemplated but more funding and a streamlined approach to marketing and promotion of the New Zealand screen sector would be needed for them to progress.

87 Accordingly, if the recommendations of this paper are accepted, the Minister for Economic Development and Minister for Arts, Culture and Heritage will be developing funding proposals in the context of the 2014 Budget to increase resources for the NZFC and FNZ for overseas marketing efforts.

Review process

88 New Zealand's small size and generally efficient decision-making processes relating to its incentives schemes give it a potential advantage over competitors in adjusting policy settings to suit the environmental and economic conditions that apply. In the screen sector, a particular advantage is that New Zealand's screen production incentives, while transparent and rules-based, are delivered by way of grants that are administratively set rather than through the tax system as is the case in some other jurisdictions.

89 A mechanism is needed, however, to ensure that New Zealand stays within the golden mean, i.e. sufficient to attract screen production of benefit to New Zealand but not overly attractive if, for example, the economy was operating at full capacity.

90 One way to manage this might be to de-couple the rebates from the underlying mechanism. Thus, the Minister for Economic Development might periodically determine the particular rebates that will apply, in consultation with the Minister of Finance and the Minister for Arts, Culture and Heritage. The factors that the Minister would take into account would likely include the exchange rate, the screen production pipeline, capacity constraints and general economic conditions.

91 It is proposed that officials be directed to consider this issue further and report back to Ministers with recommendations early in the New Year.

[withhold, sections 9 (2) (b) (ii), and 9 (2) (j)]

Consultation

95 The NZFC, in conjunction with FNZ, has taken soundings on the options discussed in this paper with selected senior industry figures and Ministers will report on the outcome in presenting this paper to Cabinet.

Treasury comment

96 Treasury does not support any further subsidies for the film industry. The two evaluations of the current subsidy regime show at best small economic benefits, with limited evidence of spill-over benefits within the film industry, tourism and New Zealand in general. Further subsidies will only increase costs and offer weak benefits. The 2011 evaluation indicated that the LBSPG delivered net economic benefits of $13.6m over the 7 years from 2004-2011, at an annual rate of return of less than 1%. In addition, the 2011 evaluation is based on generous assumptions about premiums paid by large productions on goods and services. The current regime is also estimated to have had an overall negative fiscal impact of $168m once tax revenue that would have been earned anyway is taken into account.

97 Other jurisdictions are offering large subsidies to attract films and further New Zealand subsidies will simply add to this cycle and future demands for larger subsidies. Permanently matching overseas subsidies to generate activity in New Zealand is not a sound basis for economic development policy and favours the film industry over other sectors.

98 SPIF parameters were only recently adjusted to broaden the overall mix of cultural, capability development and business development objectives. It would be desirable to allow sufficient time for these changes to become embedded, and their efficacy to be tested, before any further adjustments are contemplated, particularly in light of little evidence of any presenting problems around availability of production funding for screen content with significant New Zealand content.

99 There is no clear urgency for large scale changes to the LBSPG and SPIF. Given the proposals are likely to involve a fiscal impact, they should be considered as part of Budget 2014, where they can be assessed against other, potentially higher-priority and higher-value initiatives. The paper does not outline the fiscal implications of both increasing the subsidy and removing current caps on how much of a subsidy can be claimed. This information should be provided before decisions are made. If Ministers consider decisions are needed quickly to retain the *Avatar* production in New Zealand, Cabinet could consider a one-off increase in support for that production only.

Recommendations

100 It is recommended that Cabinet:

International screen sector in New Zealand

1 **Agree** that New Zealand should work to achieve a screen sector that is financially sustainable and internationally competitive;

2 **Note** that, for the time being, some amendment to screen production incentives is required to attract international film and television to New Zealand;

Options for enhancement

EITHER:

3 **Agree** to combine the current Large Budget Screen Production Grant (LBSPG) and Screen Production Incentive Fund (SPIF) into one scheme to be known as the New Zealand Screen Production Grant (NZSPG), effective from 1 April 2014, with the following enhancements:

a) a new baseline rebate of 20% for qualifying New Zealand expenditure, replacing the current baseline provision of 15%;
b) the ability for productions to qualify for an additional 5% if a certain number of points are met on a point test relating to significant economic benefits;
c) the removal of the current appropriation cap for SPIF and an increase in the cap on individual productions to $50m of qualifying New Zealand expenditure;

d) the requirement that for New Zealand productions with qualifying New Zealand expenditure in excess of $15m and up to a maximum of $50m, support be provided as an equity share as opposed to a grant payment and be subject to scoring a certain number of points on a points test relating to business as well as cultural factors;
e) the removal of distinctions between New Zealand film and television productions for rebate purposes;

4 **Direct** officials from the Ministry of Business, Innovation and Employment (MBIE) and the Ministry for Culture and Heritage (MCH), in consultation with the Treasury, to report back to Cabinet by 1 March 2013 on combining the LBSPG and SPIF under a new appropriation structure for the NZSPG;

(Option A discussed in this paper)

OR:

5 **Agree** to retain the LBSPG and SPIF as two separate schemes and incorporate the same essential changes as those outlined above, subject to:

Either:

a) a new baseline rebate of 20% for qualifying New Zealand expenditure for the LBSPG, replacing the current baseline provision of 15%, with the ability for productions to qualify for an additional 5% if a certain number of points are met on a points test relating to significant economic benefits;

Or:

b) retention of the baseline rebate at 15% for qualifying New Zealand expenditure for the LBSPG, with the ability for productions to qualify for an additional 5% plus 5% if the production is high value and then if a certain number of points are met on a points test relating to significant economic benefits;

(Option B discussed in this paper)

OR (Treasury recommendation):

6 **Agree** to retain the LBSPG and SPIF at the current levels of subsidies, with no further increase or changes in thresholds;

7 **Note** that the existing baselines for the LBSPG and SPIF could be exceeded in out-years as a result of the changes proposed in this paper;

<u>Implementation issues</u>

8 **Direct** officials from MBIE and MCH, in consultation with the Treasury, to report back to Vote Ministers by October 2014 with an assessment of the impact of the LBSPG and SPIF changes, including the extent to which these are putting pressure on available baseline funding for the respective schemes and options for how any such pressure might be managed;

9 **Note** that, in order to implement either of the above options, it will be necessary for the New Zealand Film Commission (NZFC), Film New Zealand (FNZ) and officials from the Ministry of Business, Innovation and Employment (MBIE) and the Ministry for Arts, Culture and Heritage (MCH) to finalise work on detailed design issues, especially relating, but not limited, to the proposed points tests, and that it would be desirable to involve the industry in this process;

10 **Note** that, as part of this process, consideration will be given to reducing the compliance burden of complex legal and financial documentation that are a feature of SPIF productions due to the need to find a third party lender until the grant is paid out;

11 **Invite** the Minister for Economic Development and Minister for Arts, Culture and Heritage to announce and finalise detailed arrangements to give effect to the above proposals;

Other issues

12 **Note** that the Minister for Arts, Culture and Heritage will be developing funding proposals in the context of the 2014 Budget to increase resources for the NZFC to administer changes in respect of the LBSPG and SPIF;

13 **Note** that the Minister for Economic Development and Minister for Arts, Culture and Heritage will be developing funding proposals in the context of the 2014 Budget to increase resources for the NZFC and FNZ for overseas marketing efforts;

14 **Invite** the Minister for Economic Development to oversee discussions on the possibility of the three planned sequels to *Avatar* being produced in New Zealand, with a view to a decision being reached by Christmas;

15 **Authorise** the Minister for Economic Development to approve a negotiating brief for the discussions referred to above, if required;

16 **Direct** the Ministry of Business, Innovation and Employment and the Ministry for Culture and Heritage to report to the Minister for Economic Development and Minister for Arts, Culture and Heritage by 31 March 2014 on proposals for an ongoing review process to ensure that New Zealand's incentives for overseas production remain appropriate.

Hon Steven Joyce
Minister for Economic Development

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Hon Chris Finlayson
Minister for Arts, Culture and Heritage

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Appendix 1

Summary of screen production grant rebates and tax relief offered in other jurisdictions

Jurisdiction	Type of incentive scheme
Australia	• 16.5% tax rebate on Australian expenditure • 30% tax rebate on Australian expenditure on post, digital and visual effects production (PDV) work on large budget productions, including those not necessarily shot in Australia • A$20 million fund which films above $30m can apply for. This fund effectively gives successful applicants 30% • Producers Offset – 40% tax rebate on qualifying expenditure on Australian feature films and 20% tax rebate for other Australian formats • Other production is being brought in through a liberal interpretation of the Producers Offset offering 40%
South Africa	• A rebate of 20% of qualifying local expenditure, which can increase to up to 25% for expenditure of at least US$0.3m on post-production in South Africa • In addition, South African interests are doing deals on top of this
Canada (labour-based)	• 16% refundable tax credit on qualifying Canadian labour costs plus the ability to combine the incentive with regional incentives • 25% refundable tax credit for qualifying Canadian labour on Canadian productions • The incentives are stackable, regional and federal incentives can be used together • Quebec, for example, offers 25% cash-back on all expenses plus a 20% bonus on green screen shots applicable on extended eligible labour – no minimum spend, no caps
United Kingdom	• 25% tax credit for UK qualifying production expenditure for British productions with budgets under £20 million. • 20% tax credit for UK qualifying production expenditure for British productions with budgets over £20 million. • For television – a 25% tax credit; production costs must be at least £1m per hour • The uncapped United Kingdom feature film tax credit has points that are very liberal – most/all on the ground expenditure qualifies including above the line and has resulted in production hubs – soundstages, crew base and equipment, other infrastructure. The UK also allows participation payments
Louisiana and Georgia	Uncapped and: • Have tax credit percentages sitting at face value up to 30% (with additional credits for different items on top in some cases) • Are very liberal – most/all on the ground expenditure qualifies including above the line • Has resulted in production hubs – soundstages, crew base and equipment, other infrastructure

Appendix 2

Present arrangements

Scheme	Eligibility	Threshold	Rebate	Funding	Cost
LBSPG	Feature film	$15m	15%	Uncapped, with figure of $50.556m p.a. used for purpose of estimating likely budget required	$472.48m from 2004 to September 2013 on qualifying expenditure in New Zealand (QNZPE) of $3,308.44m, or $52.49m p.a. on average
	Television	$4m	15%		
	PDV	$1m	15%		
	Any production	$200m	Additional 15%	Capped at $9.75m and calculated on production ex post	
SPIF	Feature film	$2.5m	40% if at least 20 points are scored on a New Zealand content test, with at least 10% of budget from non-government sources	Capped at $15m QNZPE per production (so maximum for film is $6m and television $3m)	$47.7m since 2008 on QNZPE of $142.5m, or $9.54m p.a. on average
	Television	Amounts per hour and in total vary, depending on format	20% if at least 15 points are scored on a New Zealand content test, with at least 25% of budget from non-government sources	Total fund capped at $63.75m over 5 years	

Appendix 3

Option A – a new screen grant combining the LBSPG and SPIF

Scheme	Eligibility	Threshold	Rebate	Funding	Additional cost
New Zealand Screen Production Grant (NZSPG)	Any production activities	Could simplify, e.g. $1m or $0.5m per hour for television, or use existing thresholds as appropriate	20% flat rate for any qualifying production Additional 5% subject to meeting a points test relating to significant economic benefits For New Zealand productions of up to $15m of qualifying New Zealand expenditure ($6m of grant): 40% if a certain number of points are scored on a New Zealand content test For New Zealand productions in excess of $15m and up to a maximum of $50m of qualifying New Zealand expenditure ($20m of grant): support provided by equity stake as opposed to grant payment and subject to a points test relating to business-related factors	Uncapped	Estimated additional cost of 20% rebate is $189.3m or $21m p.a. on average, i.e. 5% of qualifying New Zealand expenditure of $3308.44m

Appendix 4

Option B – enhancements to the existing incentive schemes

Scheme	Eligibility	Threshold	Rebate	Funding	Additional cost
LBSPG	Feature film	$15m	20%	Uncapped	
	Television	$4m	20%		
	PDV	$1m	20%		
	Any production	Any production which meets a points test relating to significant economic benefits	Additional 5%	Uncapped	Estimated additional cost of 20% rebate is $189.3m or $21m p.a. on average, i.e. 5% of qualifying New Zealand expenditure of $3308.44m
		Any qualifying production Productions meeting a specific threshold Productions meeting points test	15% plus 5% plus 5%		Nil Estimated $21m pa Subject to design and uptake
SPIF	Feature film	Could simplify, e.g. $1m or $0.5m per hour for television, or use existing thresholds as appropriate	For New Zealand productions of up to $15m of qualifying New Zealand expenditure ($6m of grant): 40% if a certain number of points are scored on a New Zealand content test For New Zealand productions in excess of $15m and up to a maximum of $50m of qualifying New Zealand expenditure: support provided by equity stake as opposed to grant payment and subject to a points test relating to business-related factors	Uncapped	Estimated one to two middle sized New Zealand productions equating to an additional investment of up to $40m (being two productions at the maximum $50m qualifying New Zealand expenditure each)