

Written evidence submitted by TaxWatch

Summary

- 1 Creative sector reliefs, specifically Video Games Tax Relief and Film Tax Relief, are costing far more than anticipated. The vast majority of this relief is going to large multinational corporations, who are developing entertainment products that would have been produced regardless of whether or not the relief was available.
- 2 Companies claiming hundreds of millions of pounds in reliefs are engaging in profit shifting. These multinationals are producing games and films in the UK while claiming relief, then selling the intellectual product at effectively cost price to overseas parent companies. It is these overseas companies, usually US based, which then distribute the product, generating significant profits, and with that, significant Corporation Tax bills.
- 3 HMRC's estimate of fraud and error with R&D relief is likely a significant underestimate. While the true scale of abuse with R&D reliefs is not known, it likely costs billions of pounds every year.
- 4 Tax advisers are boasting of 100% success rates in applying for R&D relief. There are companies that offer software which auto-generates relief claims, and accountants stating that it is the government intent to provide R&D relief for things such as cocktails and menu updates.

About TaxWatch

- 5 TaxWatch is a UK charity dedicated to compliance and sound administration of the law in the field of taxation. We conduct forensic research and analysis on tax avoidance, tax policy, and tax law, publishing our research to improve public understanding of tax issues. Through our work we seek to encourage high standards of tax conduct and civic responsibility.

Preliminary remarks

- 6 This submission will focus on non-structural reliefs. At TaxWatch we have researched and published extensively on creative industry tax reliefs, as well as to a lesser degree on R&D reliefs.
- 7 Creative industry tax reliefs are a group of eight Corporation Tax reliefs that allow qualifying companies to reduce the amount of Corporation Tax they need to pay. If the company is loss making, the loss can be surrendered and the relief can be converted into a payable tax credit.
- 8 The National Audit Office report “The Management of Tax Expenditures” identified a number of issues with the current administration of tax reliefs, including large increases in expenditure over and above the forecast spend and deficiencies in evaluating value for money.

Video Games Tax Relief

- 9 Video Games Tax Relief (VGTR) provides a good case study of a tax relief that is significantly above forecast expenditure. VGTR was introduced to provide targeted support for games that were “culturally British”, with a particular focus on support for small and medium sized businesses. The idea at the time being that only smaller publishers would be interested in producing games aimed solely at the British market.
- 10 Video Games Tax Relief was estimated to cost just £35m a year when it was introduced,¹ yet we are now seeing one company, Rockstar Games, claiming almost double that in a single year. £197m of VGTR was paid in the year ending March 2022, taking the total cost to the UK taxpayer up to £830 million since the scheme was introduced in 2014.
- 11 In order to meet EU State Aid rules, relief had to be limited to culturally British productions. This cultural certification is provided by the BFI. When approving the scheme the European Commission stated: “*the incentive objectives of the fund would be to make*

1 “It is estimated that this generous new corporation tax relief will provide around £35 million of support per year to the sector.”, Video games companies to begin claiming tax relief, *HM Treasury*, 19 August 2014, <https://www.gov.uk/government/news/video-games-companies-to-begin-claiming-tax-relief>

cultural products that are likely to be uneconomical, commercially viable, thereby promoting the production of new cultural products that would not have been made in the absence of the tax relief”.

- 12 Games which have received the cultural certification include Marvel Ultimate Alliance, Halo Wars 2, Mortal Kombat X, Tom Clancy's The Division, Lego Star Wars, and Sonic Forces. It is highly unlikely that these are what the public would class as culturally British.
- 13 We found is that it is difficult to fail the test, something which has led to some tax advisers advertising a “100% success record” in applying for the relief. Games developed anywhere in the European Economic Area, in the English language, and written by a British citizen, are able to claim that they are “culturally British”. It is that simple, there is no requirement for any reference to the United Kingdom in the game. A quarter of the points are awarded if the game is in an “undetermined” location and we don’t know the main characters nationality – even Sonic the Hedgehog passes this hurdle.
- 14 The relief is dominated by large companies. A study from The Guardian showed that between 2014 and 2018 just four companies claimed 46% of all VGTR.² Follow up research has not been conducted, but we assess it is likely that this amount has since increased.
- 15 Since the introduction of the relief in 2014 through to March 2022, 1,499 games received the “cultural” certification. Of these, only two were published by Rockstar, with Grand Theft Auto V receiving the accreditation in 2015, and Red Dead Redemption 2 in 2019.
- 16 Of the £624m in VGTR paid by March 2021, £205m has gone to Rockstar.³ The result is that in the first seven years of VGTR, Rockstar managed to claim a third of the total amount paid out whilst only being responsible for 0.13% of the games receiving the relief.
- 17 The staggering amounts paid out to Rockstar Games was raised by Lord Prem Sikka in February of this year, speaking during a debate on the Finance (No. 2) Bill, he said:

“According to its accounts, it [Rockstar] has claimed £136.6 million in total in tax relief over the years. It has paid no corporation tax at all but has paid £67.5 million in dividends. Where exactly did those dividends come from? They came from picking the pockets of the British taxpayer. There is no other explanation for this. It does not seem to me that these kinds of tax reliefs are monitored. No evidence is provided by any government department to show what exactly the benefit to the UK economy is of this American company receiving all these tax reliefs.”

2 Revealed: global video games giants avoiding millions in UK tax, *The Guardian*, 02 October 2019, <https://www.theguardian.com/games/2019/oct/02/revealed-global-video-games-giants-avoiding-millions-in-uk-tax-sony-sega>

3 Rockstar annual accounts for 2021-2022 are not yet available, hence the figures from 2020-2021.

Film Tax Relief

- 18 Film Tax Relief was the first of the creative industries tax reliefs, and is by far the largest. It was introduced in 2007 to encourage production in the UK. At the time it was estimated that it would cost around £120m a year. In 2020-21 it was worth £611m, out of a total £1.3bn for all of eight of the creative reliefs. 2021-2022 saw a significant drop to £362m, though this is assessed to likely be a result of the pandemic, and is anticipated to rise again.
- 19 The recent James Bond films are a good case study when looking at the relief. Unlike the dubious claims of Britishness seen with some videogames, James Bond is undoubtedly a British story. Our research has found that since the introduction of Film Tax Relief, the production company behind the Bond films has claimed over £121m in subsidy from the UK government. However, despite the franchise bringing in billions at the cinema and raking in hundreds of millions of dollars in profit, under a tax structure set up more than 50 years ago, the Bond franchise has managed to minimise corporation tax in the UK for decades.
- 20 While the Bond films are made in the UK, with production done by the British company EON, the rights to exploit the film are owned by a non UK company. The profits from the Bond films sit with the owner of the intellectual property, Delaware based Danjaq, and with the studios which distribute the films such as Sony, Universal, and MGM.
- 21 Mark Spencer, the Conservative MP for Sherwood, stated in Parliament during a debate on tax avoidance and multinational companies on 03 February 2016: *“We are blessed with a global taxation system agreement whereby companies pay tax not on the profit they make in the country but where they add the value and create the IP.... I was fortunate enough to go to the cinema to see “Spectre”, the latest James Bond movie, which was created in Pinewood Studios in the UK. Tax on the profits from those movies should be paid in this country, not all over the world.”*⁴
- 22 A similar structure is seen with Rockstar Games. Grand Theft Auto V was made in the UK, but the rights to sell the game, and with that the revenues, profits, and ultimately corporation tax, sit in the US with the owner of Rockstar Games, the US video games giant Take-Two.
- 23 As a result of this profit shifting, coupled with the creative industry reliefs, we see little to no corporate tax liabilities in the UK year after year. EON has a very small liability as it makes a small profit on production services.
- 24 International tax rules state that profits should be allocated based on where value is created, with tech companies often using this argument to explain why they only pay taxes in the

4 Tax Avoidance and Multinational Companies, 03 February 2016, <https://hansard.parliament.uk/Commons/2016-02-03/debates/16020363000001/TaxAvoidanceAndMultinationalCompanies>

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US. If this is the case, why is it that franchises that generate billions in revenue, and hundreds of millions in profits, pay little to no tax in the UK – all while receiving corporate subsidies?

R&D

- 25 The cost of the UK's R&D scheme is over double the initial forecast from when it was launched. It was thought the relief would cost around £1.06bn by 2017-2018, but the actual costs were closer to £2.19bn, this in itself is an issue, and presents the question of why were predictions of actual cost so far off?
- 26 HMRC believes that in 2019-2020, fraud and error with R&D reliefs accounted for £311m. At TaxWatch we believe that the actual amount is far greater.
- 27 The total number of claims for R&D tax credits for 2019-20 was 85,900, with £7.4bn in relief claimed on £47.5bn of expenditure. The ONS estimates that businesses only carried out £25.9 billion of privately-financed R&D in the UK in 2019. While some of this may be from overseas expenditure, which can qualify for the relief⁵, that amount is likely to be far less than £21.6bn. HMRC estimated that there was between £4bn and £7bn of overseas expenditure in 2017-2018. If we are to take the high end number of £7bn, and assume that there was that amount of overseas expenditure in 2019-2020, that still leaves £14.6bn in R&D expenditure unaccounted for.
- 28 The true scale of the abuse is simply not known, partially due to HMRC's policy of "process now, check later." This leaves the system open to abuse, and has led to the appearance of R&D claims factories, which submit claims on behalf of clients, often with little supporting evidence. Websites offer to auto-fill forms using software specifically designed to make claims, and boast of 100% success rates.
- 29 At TaxWatch, we have seen tax advisers publicly stating that R&D reliefs are "grants", and that it is the Government's intent for HMRC to give "free cash" to bars and restaurants for developing their menus, as a way of "getting money back into the industry." The idea that the Government is seeking to support the leisure industry through subsidising bars developing cocktails is, of course, in contrast to the actual stated government purpose for R&D reliefs, which is specifically that: "Research and Development (R&D) reliefs support companies that work on innovative projects in science and technology."
- 30 There is a significant risk that mass marketed tax credit abuse, combined with HMRC's limited capacity to review claims, will lead to a large caseload of overpayments being built up, often by claimants that outsource their claims to third parties and so will have little understanding of what is being done in their name. If HMRC challenges these claims,

5 From the 2023-2024 tax year, R&D activity will have to be physically located in the UK in order for the costs to be included.

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thousands of SMEs risk being hit with large, unexpected requests for repayments. This scenario would not be too dissimilar to that of freelancers and contractors subject to the loan charge.

Further comments

- 31 Weak rules around who qualifies for creative industry tax reliefs, combined with the fact that the benefit to individual companies is uncapped, goes a long way to explaining why expenditure on creative industry tax reliefs is vastly outstripping projected spend.
- 32 This raises real questions about the value for money of these reliefs, when judged against their intended purpose. Creative sector reliefs appear to have been captured by large multinationals, and used to subsidise products that they would have produced without the benefit of the relief in any event.
- 33 The true scale of abuse within the R&D relief system is not known, though is highly likely several orders of magnitude larger than what is stated in HMRC's annual report. There is a real risk that poor advice from tax advisers has led to many SME's submitting claims, without fully understanding what they are doing. This is likely to lead to significant issues in future should HMRC have the capacity to audit R&D relief applications.

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