IT 2111 - Taxation incentives for the Australian film industry

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TAXATION RULING NO. IT 2111

TAXATION INCENTIVES FOR THE AUSTRALIAN FILM INDUSTRY

F.O.I. EMBARGO: May be released

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REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1122432	AUSTRALIAN FILM CONCESSIONS	124ZAA - 124ZAN
	DEDUCTIONS FROM CERTAIN FILM ACCOUNT WITHDRAWALS	221ZN - 221ZX
	EXEMPTION OF CERTAIN FILM INCOME	23H
	FILM INCOME ASSESSABLE	26AG

PREAMBLE The purpose of this ruling is to clarify a number of issues which have been raised in relation to the interpretation and operation of Division 10BA of Part III and Division 6 of Part VI of the Income Tax Assessment Act 1936 and sections 23H and 26AG of that Act. Taken together, these provisions implement one of two schemes of taxation incentives for the Australian film industry - the other being contained in Division 10B.

RULING Withdrawal of moneys from film accounts (sub-section 124ZAA(7) and paragraph 124ZADA(l)(h))

2. In giving practical effect to the requirements of Division 10BA, the Taxation Office accepts that moneys withdrawn from a film account in the Australian Film Industry Trust Fund (AFITF) will, upon withdrawal, be expended directly in producing a film, i.e., in the prescribed manner, if the following requirements are met -

(a) moneys withdrawn are immediately deposited or transferred to a non-interest bearing current account opened in relation to the film;

(b) moneys are applied from that account in respect of expenditure directly related to the film production processes within 15 working days of their receipt into that account; and

(c) unapplied moneys are redeposited to the AFITF film account within that 15 working day period.

Funds unspent at the end of that 15 working day period and not redeposited will be treated as not having been expended in the prescribed manner for purposes of the concession and the withholding tax requirements contained in section 221ZN will

apply. These rulings were contained in guidelines released on 24 June 1983 by the Minister for Home Affairs and Environment.

3. Since the release of those guidelines, the following variations have been accepted to the above requirements -

(a) Overseas production expenses - where moneys withdrawn from the relevant film account are for overseas production expenses, the moneys will be accepted as expended, upon withdrawal, in producing the film provided that -

(i) the amount withdrawn is a "bona fide" estimate of overseas production expenses;

(ii) the amount is withdrawn on a date as near as possible to the date of departure; and

(iii) unexpended amounts are redeposited to the AFITF film account as soon as practicable after their prompt return to Australia; and

(b) security deposits or bonds - amounts paid as security deposits or bonds in respect of electricity and telephone services or in respect of rented property or equipment will be accepted as expended, upon withdrawal, in producing the film provided that on the return of that deposit or bond, the amount is redeposited to the AFITF film account.

4. Two related matters concerning film account withdrawals are the use of separate accounts to provide for anticipated PAYE deductions and payroll tax liabilities and the use of a permanent float of moneys in an account for petty cash purposes. Amounts transferred from a film production account to a separate account to meet anticipated liabilities are not regarded as having been expended directly in producing the film and any amounts in the production account held for payment of such liabilities and not paid within the 15 day time limit should, before the expiration of that period, be redeposited to the AFITF film account. The requirement that moneys be applied within 15 days of their receipt in a production account is intended to allow a reasonable period for payment of the moneys for actual film production expenditure and retention of a permanent float of petty cash or similar funds in a separate account is not regarded as consistent with that approach.

Section 124ZADA declaration - "appropriate person"

5. The person who has overall responsibility for a film production or any other person who is so closely associated with the production as to have first hand knowledge of the facts that are required to be included in a declaration pursuant to paragraphs 124ZADA(1)(c) to (f) and to ensure that the requirements of paragraphs 124ZADA(1)(g) and (h) are met would generally be accepted by the Commissioner for purposes of

sub-section 124ZADA(2) as an "appropriate person" to make a declaration in respect of that film under sub-section 124ZADA(1)(or)(5). Accordingly where a declaration has been made by a person who, in relation to a film, is the producer, director, associate producer, financial director, accountant or production manager, it will be accepted by the Commissioner as having been made by an appropriate person, unless there is some reason to doubt that the declaration has been made "in good faith" by that person.

Timing of contributions towards the production of a film

6. Amounts can only be said to have been expended by way of contribution to the cost of producing a film under sub-section 124ZAFA(1) at the time when they are finally committed to the film production. That would ordinarily be the time when an investment is received by the representative of a film fund. However, where an investment is made subject to certain conditions being fulfilled e.g. on condition that the film be fully subscribed within a specified period of time, or that a minimum subscription be achieved, the time of contribution would be when those conditions are satisfied. The investment of those moneys at interest prior to that time would not, therefore, affect the entitlement of investors to the taxation concessions for investment in qualifying Australian films.

Moneys expended "in producing or by way of contribution to the cost of producing a film."

7. Sub-section 124ZAFA(1) (when read with sub-section 124ZAA(6)), specifies as one of the requirements for deductibility of capital moneys contributed to a film production, that those moneys must be expended directly in producing the film.

8. Direct expenses of a film production which qualify for deduction under section 124ZAFA can generally be described as those relating to the production process as distinct from those associated with the financing or marketing of the film. Such expenses would typically include amounts paid for the acquisition of story rights and the surveying of locations, payments to producers, directors and cast, and the costs of insurance of production associated risks, drawing up performers' contracts and the building of sets and scenery.

9. The costs of acquiring script rights and negative footage of an existing film, for use in making a new film, will generally constitute production expenses if the new film is an original film and provided that the old script and footage was produced for purposes unrelated to the new film. The expenditure will qualify on the basis that these items can be regarded as having the character of goods to be used in the production.

Film-related expenditure that is not deductible under section 124ZAFA

10. Capital outlays not directly incurred in film production such as legal costs for drawing up a prospectus or offer document and brokerage or commission charges paid to a promoter or underwriter who raises or provides investment moneys for a film project are neither deductible under section 124ZAFA nor deductible under sub-section 51(1). On the other hand, expenditure related to the marketing of a film (e.g. the making of trailers and publicity costs), would, subject to section 124ZAO, be deductible under sub-section 51(1) where it is incurred in gaining or producing film income that is assessable under section 26AG.

Depositing of investors' funds "upon contribution"

11. Where a deposit is forwarded to an AFITF film account within 5 working days of the contribution by an investor it will be accepted as having been deposited "upon contribution" for purposes of sub-paragraph 124ZAFA(1)(d)(i). For films being progressively funded (i.e. investors are providing funds as the need arises), the depositing of investors' contributions in the relevant film account on a periodic basis is acceptable provided that each investor's contribution is forwarded to the film account within 5 working days of its receipt.

Application of section 124ZAFA and other provisions in respect of taxpayers with substituted accounting periods.

12. Where a taxpayer who has a substituted accounting period ending on, say, 30 September 1984 makes a contribution to a film production before 30 September 1984 but after 30 June 1984 and meets the requirements of sub-section 124ZAFA(1), he or she will be entitled to a deduction under that sub-section in respect of the year of income ending 30 September 1984, i.e., the year of income (of the taxpayer) in which the contribution was made. However, other provisions of Division 10BA which refer to financial years are not affected by substituted accounting period arrangements. Hence, a declaration under section 124ZADA in respect of the film is required to be made before the expiration of 1 month after the end of the financial year during which capital moneys were first expended by way of contribution to the cost of producing the film. If 1983/84 were the financial year in which such contributions were first made, the declaration should be made before 1 August 1984. Moreover, the "relevant 24 month period" mentioned in sub-section 124ZAA (1) commences after the end of the financial year in which capital moneys were first expended in producing, or by way of contribution to the cost of producing, the film. Again, if 1983/84 were the financial year involved, the relevant 24 month period would extend from 1 July 1984 to 30 June 1986.

The "at risk" rule

13. Section 124ZAM empowers the Commissioner to reduce claims for Division 10BA deductions if he is satisfied that the taxpayer was not at risk in respect of any part of his or her

outlay of capital moneys on the production of a film. However, the "at risk" rule does not operate to affect the deductions available to investors where pre-sale arrangements or the sale of distribution rights are effected prior to completion of the film unless the arrangements put funds into the hands of investors - by loan or otherwise - to enable them to make their contributions to the costs of film production. Similar considerations apply in respect of a distribution guarantee arrangement under which an amount may be paid to investors by a producer or another person in exchange for distribution rights, if a specified return is not achieved within a particular period (e.g. a specified percentage of the film budget within 2 years). Payments under an arrangement of that kind would also not offend the "at risk" rule.

Exemption of film income

14. Income from the sale of ancillary rights in a film, e.g. the sale of the storyline/script to a publishing company to produce a book, is not eligible for exemption from tax under section 23H. To qualify for exemption under that provision, the relevant income must be assessable under section 26AG which, inter alia, applies to amounts derived "as consideration for the use of, or the right to use, the copyright or the film...". Copyright is defined in sub-section 26AG(13) as "the copyright subsisting in the film by virtue of Part IV of the Copyright Act 1968..." and copyright in a film pursuant to section 86 of Part IV of that Act relates only to the visual images and sounds of the film. It follows that moneys from the sale of ancillary rights would not be received as consideration for the use of, or the right to use, the film, and therefore would not be assessable under section 26AG. Consequently, the exemption conferred by section 23H does not apply to this income.

COMMISSIONER OF TAXATION
18 October 1984

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