


# ***IT 2377 - Income tax : pre-20 September 1985 film underwriting contracts***

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TAXATION RULING NO. IT 2377

INCOME TAX : PRE-20 SEPTEMBER 1985 FILM UNDERWRITING  
CONTRACTS

F.O.I. EMBARGO: May be released

REF H.O. REF: L85/84-7 Pt2 DATE OF EFFECT: Immediate

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1206803	FILM UNDERWRITING CONTRACTS	124ZAFA(1AA) 124ZAFA(5) 124ZAFA(6)

PREAMBLE The Taxation Laws Amendment Act (No. 5) 1985 (Act No. 168 of 1985), which received the Royal Assent on 16 December 1985, amended the Income Tax Assessment Act 1936 (the Act) to modify the income tax concessions available in respect of investments in Australian films. The amendments generally reduced the income tax deduction for an eligible investment from 133% to 120% and the income tax exemption available in respect of the film's net revenue from 33% to 20% of the eligible investment - where the investment was made under a contract entered into after 19 September 1985.

2. However, in terms of sub-section 124ZAFA(1AA) of the Act as amended, the higher 133/33 rates of deduction and exemption remain available to an investor who contributes to the cost of producing a qualifying film in place of an underwriter who would have been entitled to the higher rates - that is, an underwriter who, under the film production contract or a separate underwriting contract (either of which was entered into after 23 August 1983 and before 20 September 1985), had agreed to underwrite the production cost of the film. The higher rates are available only to the extent that the investor's post-19 September 1985 contributions relieve the underwriter's obligations. Any excess contributions may qualify for the 120/20 rates of deduction and exemption but there is no scope for averaging the rates between investors. In respect of an eligible film investment made after 19 September 1985, an investor is entitled to either the 133/33 or the 120/20 rates.

3. This Ruling discusses the requirements of sub-section 124ZAFA(1AA) in relation to an underwriter as a party to a film production contract or a separate underwriting contract and the factors to be taken into account in determining whether such a contract was entered into on or before 19 September 1985.

RULING 4. A film "production contract" is defined in sub-section 124ZAFA(5) of the Act - as a contract under which a person has, or persons have, agreed to expend capital moneys in or as a contribution towards the production of a film, but excluding an

"underwriting contract". A party to a production contract who had conditionally agreed to contribute to the film's production cost (in terms of paragraph 124ZAFA(1AA)(d)) would be an underwriter. A film "underwriting contract" is also defined in sub-section 124ZAFA(5) - to mean a contract under which a person has, or persons have, conditionally agreed (and no person has agreed otherwise than conditionally) to contribute to the cost of producing the film. For these purposes, sub-section 124ZAFA(6) of the Act provides that a person is to be taken to have conditionally agreed under a contract to contribute to a film's production cost if the person has agreed to contribute only in the event that the aggregate of capital moneys expended or agreed to be expended, either in producing the film or by way of contribution to the cost of producing the film, is less than the amount proposed to be contributed under the contract. In other words, an underwriter contracts to contribute the shortfall only in the event that other investors are not found.

5. In determining whether an obligation under a purported underwriting agreement was intended to arise only in the event that other investors could not be found, it may be necessary to have regard to any associated arrangements or actions. While it must be the clear intention of the parties that the agreement between them amounts to an underwriting agreement, this intention may be recognisable from factors other than the terms of the agreement itself. Where, having taken all relevant factors into account, it can reasonably be concluded that the parties to the agreement intended that the obligation under the agreement would be limited to any shortfall between the agreed amount and the amount otherwise committed to the production of the film, the agreement (whether forming part of the production contract or the subject of a separate underwriting contract) should be accepted as an underwriting agreement within the scope of sub-section 124ZAFA(1AA) of the Act. For example, although an underwriting contract may provide only that the underwriter "will contribute or will cause to be contributed" a specified amount, the fact that the parties had actively sought other investors to take up all or part of the underwriter's liability would, in the absence of evidence to the contrary, indicate that the parties intended the underwriter's obligation to be limited to any shortfall.

6. To attract the 133/33 rates of deduction and exemption, the production contract to which the underwriter is a party, or the separate underwriting contract, must have been entered into on or before 19 September 1985. Sub-section 124ZAFA(1AA) of the Act envisages a contract under which the underwriter was bound, as an underwriter, at 19 September 1985. The relevant date is that on which a legally enforceable contract came into existence and an option existing at 19 September 1985 to enter into an underwriting contract at some later date would not be sufficient to meet the requirement.

7. Whether a binding contract exists is a question of fact which, in each case, ultimately turns on the intention of the contracting parties. In order to determine the state of legal relations between the parties at 19 September 1985, regard

should be had to matters which would indicate the intention of the parties, including of course the terms of any agreement or agreements signed by the parties. Evidence of the conduct of the parties in relation to each other should be taken into account, particularly having regard to any relevant business or industry practices in the film industry.

8. In considering whether a binding contract was in force at 19 September 1985, the following guidelines should also be applied:

- . If a contract is subject to a condition completely outside the control of the contracting parties (for example, that a Bill before the Parliament, which would allow filming in a key but hitherto restricted location, receives the Royal Assent before a certain date), it should not be accepted that the contract was in force before 20 September 1985 unless the condition was satisfied before that date.
- . Where a contract is subject to a condition within the control of either party (for example, that a distribution agreement be in place by a particular date), its non-fulfilment prior to 20 September 1985 should not be taken as a bar to the existence of a binding contract, unless it is clear from the evidence as to the intention of the parties that neither was to be bound until the condition was satisfied.
- . If failure to fulfil any term or condition of a contract gives rise only to a right of either party to terminate all, or any, of the obligations under the contract, the contract should be accepted as remaining binding until the relevant party exercises that right - the contract being only voidable.
- . In the absence of evidence to the contrary, a condition to the effect that an agreement is subject to the approval or satisfaction of a board of directors, or that formal documentation is to be to the satisfaction of advisers, should be viewed as a condition precedent to the formation of a contract. If a negotiator does not have authority to commit a relevant party and this is known to all other parties (evidenced by the presence of the condition itself), that relevant party is not to be taken to have been committed to the contract until the required approval is given.
- . Where an underwriter can provide evidence that, at 19 September 1985, the amount of the underwriter's commitment under the contract had been earmarked in the underwriter's books of account, or

arrangements had been made to secure that amount, or negotiations had commenced with investors with a view to their taking up some part of the underwriter's commitment, it should be accepted, in the absence of evidence to the contrary, that the underwriter intended to be bound by the contract.

9. Particular care should be taken where an agreement entered into prior to 20 September 1985 states that the underwriter has the sole and absolute discretion as to whether certain essential conditions (for example, in relation to the distribution agreement or a completion guarantee, or that the film be made by a specified cast or crew members) are satisfied. The agreement should, subject to evidence to the contrary, be treated as constituting only an option to underwrite and not a binding contract. In these circumstances, a contract should not be taken to have come into force until such time as the underwriter took action to indicate acceptance that the conditions had been satisfied or in some other way demonstrated to the other parties that the option to underwrite had been taken up.

COMMISSIONER OF TAXATION  
5 December 1986