



PR 2001/128 - Income tax: Film Investment - Desert Vet documentaries

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Product Ruling

Income tax: Film Investment – Desert Vet documentaries

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Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential investors should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of Use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as 'The Desert Vet', 'the Documentaries' or 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Division 10BA of Part III of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 26AG ITAA 1936;
 - Part IVA ITAA 1936;
 - Section 8-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 17-5 ITAA 1997;
 - Division 27 ITAA 1997;
 - unless otherwise stated, all legislative references that follow are in relation to the ITAA 1936.

Goods and Services Tax

3. In this Ruling, where applicable, all fees and expenditure referred to include Goods and Services Tax (GST) set out in the *New Tax System (Goods and Services Tax) Act 1999* ('the GST Act'). In order for a person or entity to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered for GST under the GST Act and hold a valid tax invoice. GST is payable on a taxable supply by the person or entity making the taxable supply.

Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the

application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

Class of persons

7. The class of persons to which this Ruling applies is those persons who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed, i.e., being a party to the relevant agreements until their terms expire, and deriving assessable income from this involvement as a result (as set out in the description of the arrangement). In this Ruling, each of these persons, will have accepted an offer made under subsections 708(1)-(11) of the Corporations Act 2001.

8. The class of persons to which this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

9. The Commissioner rules on the precise arrangement identified in the Ruling.

10. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

11. Note: without limiting the generality of the term, a 'material difference' this may arise in relation to a variation in the facts of the

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arrangement described in the Ruling. It may also arise in circumstances where additional transactions or arrangements (including financing arrangements) are entered into that, when viewed as a whole with the arrangement described in the Ruling, will produce a different taxation consequence from the arrangement described in this Ruling.

12. This might include, for example, where the investor borrows to enter into the arrangement by way of a limited or non-recourse loan and the overall consequence might be that the arrangement is one that would have attracted the application of a tax avoidance provision. A material difference may also arise where an investor enters into or benefits from any device which limits or eliminates the risk in respect of the amount contributed by the investor.

13. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

Date of effect

14. This Ruling applies prospectively from 5 September 2001, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

15. If a taxpayer has a more favourable private Ruling (which is legally binding), the taxpayer can rely on the private Ruling if the income year to which the private Ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private Ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, the Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

16. This Product Ruling is withdrawn on 30 June 2005 and ceases to have effect on and from that date. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the

specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those people, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or the persons' involvement in the arrangement.

Arrangement

17. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Application for a product ruling and Product Ruling Checklist in relation to Desert Vet, dated 25 May 2001;
- Draft Information Memorandum in relation to Desert Vet received by the ATO on 7 July 2001;
- Draft Film Investment Joint Venture Agreement in relation to Desert Vet between John Sexton Productions Pty Limited ("the Producer"), and Investor #1 and Investor #2 received by the ATO on 15 August 2001;
- Draft Accession Agreement in relation to Desert Vet between Investor 1, Investor 2, Doco Pty Ltd ("the Distributor") and the Producer of received by the ATO on 15 August 2001;
- Draft Distribution Agreement in relation to Desert Vet between the Distributor, the Producer and the Investors received by the ATO on 9 August 2001;
- Correspondence received by the ATO from the applicant's representative dated 5 June 2001, 6 June 2001, 7 June 2001, 8 June 2001, 15 June 2001, 18 June 2001, 22 June 2001 7 July 2001, 26 July 2001, 9 August 2001, 13 August 2001 and 15 August 2001.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

18. In accordance with the above documents, an investor who participates in the arrangement must have accepted an offer that was made under section 708 of the Corporations Act 2001. **This Ruling does not apply unless the investor:**

- has accepted a 'personal offer' under subsections 708(1)-(7) of the Corporations Act 2001 ; or
- is a 'sophisticated investor' for the purposes of subsections 708(8)-(9) of the Corporations Act 2001 ; or
- has accepted an offer made by a licensed dealer where the offer meets the requirements of sub-section 708(10) of the Corporations Act 2001 ; or
- is a 'professional investor' for the purposes of paragraphs (a), (b) or (h) of subsection 708(11) of the Corporations Act 2001.

19. Each of these categories is explained in paragraphs 68 to 75 in the Explanations area of this Product Ruling.

20. The details of the arrangement are summarised as follows:

The Participants

21. John Sexton Productions Pty Limited (ACN: 001 744 672) will act as the Producer;

22. Docoz Pty Limited (ACN: 094 262 816) will act as the Distributor.

The project

23. The project involves the production and distribution of up to six documentaries each of one-half a commercial television hour entitled 'Marco Polo's Camels in Mongolia', 'The End of the Silk Road', 'The Golden Horses of Turkmenistan', 'The Vision Splendid', 'The Oryx of Arabia' and 'The Black Bears of Pakistan'.

24. Provisional Certificates numbered, P06075 (Marco Polo's Camels in Mongolia), P06076 (The End of the Silk Road), P06077 (Golden Horses of Turkmenistan), P06078 (The Vision Splendid), P06079 (The Oryx of Arabia) and P06080 (Black Bears of Pakistan) were issued by the Department of Communications, Information Technology and the Arts on 1 June 2001. The certificates state that each documentary will, when completed, be a 'qualifying Australian film' for the purposes of Division 10BA of the ITAA 1936.

25. The total budgeted cost to produce each documentary is \$220,000. The budget will be raised from investors who are Australian residents for tax purposes. Each interest in the Project will have a value of \$5,500 and investors may subscribe for multiple interests. Each documentary will have 40 interests available for purchase.

26. The monies raised from investors will be made available to start production of a particular documentary only upon each documentary reaching the minimum subscription of \$220,000.

27. An investor will not have expended capital monies by way of contribution to the cost of producing a documentary until after the investor has entered into either the Production Agreement or the Accession Agreement and the minimum subscription for the documentary has been achieved.

28. In accordance with the budgets, an amount of \$219,840 will be spent on the production of each of the Documentaries. Each of the budgets has been prepared in accordance with the standard industry format. The Producer will start the production of a particular documentary upon reaching the minimum subscription for that documentary.

29. In the event that the direct costs of the production of the documentaries are lower than the estimated costs stated in the budget, any underages will be dealt with as follows:

- If the underage is less than 5% of the budget of the documentary, it will be paid to the Producer as an additional producer's fee.
- If the underage is more than 5% of the budget of the documentary, an amount equal to 5% of the budget of the documentary will be paid to the Producer as an additional producer's fee and the balance will be used by the Producer for marketing expenses and if none, then treated as proceeds and disbursed to the investors in proportion to their initial investments.

30. The 'non-deductible' expenditure included in each of the budgets which is not deductible in respect of Division 10BA, relates to administrative items amounting to \$160 for each of the documentaries.

31. Any 'non deductible' expenditure apart from the \$160 mentioned above will be met directly by the investors or the Distributor. It will not be met out of the budgets for the documentaries nor by the producer. The exact amount of non-deductible monies will be determined only after the audit upon completion of the film. The amount deducted for monies spent on non-deductible items in the budget will be adjusted with retrospective effect in the subsequent year.

32. The estimated completion date for the documentaries is the period June 2002 to December 2002. This date largely depends upon the date minimum subscription of \$220,000 is reached, but will be no later than 30 June 2004 in order to satisfy the two-year requirement of Division 10BA.

33. Investors are expected to earn assessable income from the exploitation of the rights of the particular documentary until 30 June 2009.

Film Investment Joint Venture Agreement

34. The initial investors in each documentary will enter the Film Investment Joint Venture Agreement with the Producer.

35. For each documentary, the investors will be entitled to become one of the first owners in 50 % of the copyright. Each individual investor's share in the copyright of the documentary will be determined by the amount of money subscribed by the investor. The remaining 50% of the copyright in each documentary will be owned by the Producer.

36. Each investor will have a copyright interest which is limited so that it expires on 30 June 2009. Upon expiry of the investors share of the copyright in the documentaries, 100% of the copyrights in the documentaries will be held by the Producer.

37. Upon the execution of the Film Investment Joint Venture Agreement the Producer will establish or cause to be established a Production Account into which the production monies are to be paid. The Producer will use the funds in the Production Account to produce the documentary.

Accession Agreement

38. The Producer, Distributor and those investors who are not initial investors and therefore not a party to the Film Investment Joint Venture Agreement will enter into an Accession Agreement.

39. By entering into this Agreement, investors will be entitled to a share in the copyright in the documentaries as calculated in accordance with the Film Investment Joint Venture Agreement.

40. This Agreement entails the investor granting an irrevocable licence of the investor's right to use and exploit the copyright in the documentaries to the Distributor as if the investor were a party to the Distribution Agreement and will entitle the investor to receive a share of the proceeds in accordance with the Distribution Agreement.

Distribution Agreement

41. Each investor, as an owner of the copyright in a particular documentary, and the Producer, will enter into a Distribution Agreement with the Distributor under which each of the investors and the Producer licences their rights to use and exploit the copyright in

the documentary to the Distributor and the Distributor will distribute the documentary throughout the world.

42. Schedule 2 of the Distribution Agreement provides for the payment of the net proceeds as follows:

- (a) To meet the Distributor's Commission payable under clause 7.1.
- (b) To meet the Distributor's fixed Marketing Expenses payable under clause 7.2.
- (c) To recover the Actual Distribution Guarantee Amount and interest thereon in accordance with clause 5.2.
- (d) To meet the Producer's marketing expenses and repay any marketing loans taken out by the Producer.
- (e) To pay deferrals and residuals.
- (f) To the investors pro rata and pari passu until each of those investors has received in total an amount equal to the investment of that investor.

Thereafter:

- (i) as to 50% to the Producer; and
- (ii) as to 50% to the investors pro rata and pari passu relative to their share of copyright in the documentary.

43. Clause 5 of the Distribution Agreement provides for the payment of a distribution guarantee by the distributor as follows:

a distribution guarantee equal to the difference (if any) between an amount equal to 65% of an investors investment in the documentary and the total amount of net proceeds received by that investor by 30 June 2005, and

a second distribution guarantee equal to the difference (if any) between an amount equal to 100% of an investors investment in the documentary and the total amount of net proceeds received by that investor by 30 June 2009.

44. The funding of these distribution guarantees is not attributable in any way or form whether directly or indirectly to any money raised or expended in relation to this film. This includes the fees payable to the producer, director and any other person who receives payment out of any moneys contributed to the cost of producing the film.

Finance

45. This Ruling does not apply if an investor enters into a finance arrangement with any of the following features:

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- there are split loan features of the type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved, or become involved, in the provision of finance to investors for the Project;
- there are indemnity arrangements, or other collateral agreements, in relation to the loan, designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to a borrower, for the purposes of section 82KL, or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of principal and payments of interest are linked to derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project, but will be transferred (by any means, and whether directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- the terms or conditions are not arm's length.

Ruling

Assessable income

46. Subject to the assumptions listed below at paragraph 48 of this Ruling:

- For each \$5,500 unit invested in the Project, a deduction of \$5,496 is available to an investor under Division 10BA of the ITAA 1936 in the year that the investment is made. Where an investor who is registered or required to be registered for GST is entitled to an input tax credit for the investment, then the tax deduction otherwise allowable will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). For example, for each \$5,500 contribution, a deduction of \$5,496, less any GST input tax credit, will be allowable as a deduction.

- A deduction is not available until the minimum subscription of \$220,000 for the documentary that the investor contributes to, has been achieved and an investor has entered into the Production Agreement or the Accession Agreement.
- Any amounts payable to the investors for the exploitation of their interest in the copyright and rights attached thereto, less any GST payable on these amounts, will be assessable to the investors as film income under section 26AG of the ITAA 1936. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.
- Interest incurred in respect of funds borrowed by the investors to make their contributions will be deductible to the investors under section 8-1 of the ITAA 1997, but only to the extent of assessable documentary income for the year (subsection 124ZAO(2)). Other deductions available to investors are also limited to the extent of film income derived. Any excess interest and any other deductions may be carried forward indefinitely and offset against future film income (124ZAO(3));
- Upon completion of the documentaries, after the audit has been carried out by an independent auditor, deductions will be withdrawn by the ATO in respect of the monies spent on non-tax deductible items of the budget (subsection 124ZAG). Deductions may also be withdrawn by the ATO where monies, which are specified to be spent on documentary production items in the budget, are in fact spent on non production activities.
- The anti-avoidance provisions in Part IVA will not be applied to deny deductibility or to accelerate accessibility of the above amounts.

47. This Ruling is made subject to the following assumptions:

- (a) The investor was a resident of Australia for tax purposes at the time the money was expended (subparagraph 124ZAF(1)(b)(i));
- (b) \$219,840 of the investment moneys contributed by the investors will be used by the Producer by way of contribution to the cost of producing the documentary that the investor has contributed to. Moneys contributed by the investors towards the cost of production of the documentaries will be directly

expended in the production of the documentaries and will not be used by the Producer and/or Distributor for any other purpose including funding distribution guarantees (paragraph 124ZAFA(1)(a) read in conjunction with subsection 124ZAA(6)).

- (c) At the relevant time, provisional certificates (section 124ZAB) or final certificates (section 124ZAC) are in force in relation to the documentaries;
- (d) Each investor, at the relevant time, expects to become one of the first owners of the copyrights in the documentaries when the copyright comes into force (subparagraph 124ZAFA(1)(c)(i));
- (e) Each investor, at the relevant time, intends to use the interest in the copyright for the purpose of producing assessable income from the exhibition of the documentaries as mentioned in subparagraph 124ZAFA(1)(c)(ii);
- (f) There will be in force a declaration lodged in respect of the documentaries in accordance with subsection 124ZADA(1) by a person accepted by the Commissioner under subsection 124ZADA(2) as an appropriate person to make such a declaration (subparagraph 124ZAFA(1)(d)(iii));
- (g) Before the expiration of six months after the time when the documentaries are completed, an application will be made for a final certificate in accordance with section 124ZAC, otherwise the provisional certificate shall be deemed never to have been in force (subsection 124ZAB(10));
- (h) All requirements of the Department of Communications, Information Technology and the Arts will be met and final certificates will be issued;
- (i) The documentaries will be completed and the investors' interest in the copyrights in the documentaries will be used for income producing purposes within two years after the close of the financial year in which the contributions are made (subsection 124ZAFA(2));
- (j) By reason of the said capital moneys being expended, the investor will become one of the first owners of the copyrights in the documentaries before 1 July 2003;
- (k) In producing the documentaries:

- where an amount is expended by a person ('the documentary producer') for the supply of goods or the provision of services; and
- the Commissioner is satisfied that the documentary producer and the person supplying the goods or providing the services are not dealing with each other at arm's length in relation to the transaction;

that the amount of moneys expended on the supply of those goods or the provision of those services will not exceed the amount of moneys that would have been expended by the documentary producer if the documentary producer and the person supplying the goods or providing the services had dealt with each other at arm's length (section 124ZAJ);

- (l) At the time the investor expends the capital moneys by way of contribution to the cost of producing the documentaries, the investor is at risk, according to the definition of 'risk' in subsection 124ZAM(2), with respect to an amount equal to or greater than the amount of those capital moneys expended (subsection 124ZAM(1));
- (m) No pre-sale arrangements, distribution rights agreements, distribution guarantee agreements, or other like agreements, have been, or will be, entered into in circumstances where such agreements would put funds into the hands of the investors, by loan or otherwise, to enable them to expend capital moneys by way of contribution to the cost of producing the documentaries;
- (n) In the event of any underage, the Producer will expend the underage amount on the production and marketing of the documentaries in a manner that will preserve the status of the documentaries as 'qualifying Australian Films';
- (o) The dominant purpose of the investors is to make a commercial return from their investment in the documentaries and the arrangements will be executed in the manner described in this Ruling;
- (p) Non-deductible expenditure in relation to administrative items associated with the Project in respect of Division 10BA will be paid by the investors. Any other non-deductible expenditure will be met

directly by the investors or the Distributor and will not form part of the budgeted cost.

Explanations

The 'directly expended' requirement

48. Subsection 124ZAA(6) requires that capital money contributed to the production of a film must be 'expended directly in producing [the] film' in order for a deduction under Division 10BA to be available.

49. Paragraph 8 of Taxation Ruling IT 2111 discusses this requirement. It states: 'Direct expenses on a film production which qualify for a deduction under section 124ZAA can generally be described as those relating to the production process as distinct from those associated with 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 the producers, directors and cast, and the costs of insurance of production associated risks, drawing up performers' contracts and the building of sets and scenery' (emphasis added).

50. Our view is that the 'directly expended' requirement is not met at the point in time when the investors make payments to the Producer in respect of the budgets for the documentaries. Rather, the extent of the application of the money by the Producer to elements of production will ultimately determine the portion of the investors' contribution that meets this requirement. Generally, this will not be known until after the completion of the documentaries. This ruling is based on an estimate of what this amount will be.

51. The investors will pay the application money to the Producer who will use 99.9% of total application monies, being \$219,840, for application towards the production costs. In doing this, the Producer is to ensure that this proportion of funds contributed by investors is only expended on items within the documentaries production budget.

52. In determining the amount that is 'directly expended' on the production of the documentaries, we will also consider the ultimate application of any funds obtained by the Producer as 'underage'. In this regard, the Producer has agreed any underage will be first expended on the production of the documentaries. In this instance, the Producer will be entitled as additional producer's fees to a further amount not exceeding 5% of the budgeted cost.

53. Quantification of the amount of money directly expended on the production of a film, and consequently the deduction available under Division 10BA, can only be determined after a film has been

produced. To do this, a full audit of the application of the film production funds would normally be required. The practice of conducting an audit of the contribution account that is held by Producer (known as an audit of the 'film fund') is considered inadequate in this regard.

54. Accordingly, while this Ruling identifies a deduction for 99.9% of the contributions made by Australian investors, the deduction can be withdrawn under the taxation law with retrospective effect if the amounts contributed and previously allowed as deductions are not directly expended on the production of the documentaries.

55. This situation will apply where, for example, monies which were identified in the production budget to be expended on a specified activity relating to the production of the documentaries, are actually spent on an unrelated non-deductible activity. Similarly, in a situation where the direct costs of the production of the Documentaries are in excess of the estimated costs stated in the budget, deductions may be withdrawn if these excess costs are in fact expended on any non-deductible activities. The deduction identified in this ruling is subject to this rule.

The 'at risk' rule

56. Section 124ZAM reduces claims for Division 10BA deductions where the Commissioner is satisfied that a taxpayer was not at risk in respect of any part of the expenditure of capital moneys the taxpayer made by way of contribution to the cost of producing a film. Subsection 124ZAM(2) specifies the amount of risk is the amount of loss that, in the Commissioner's opinion, would be suffered by reason of the taxpayer's said capital expenditure where no income is derived from the taxpayer's interest in the copyright of the Film, other than excepted income as defined in subsection 124ZAM(3).

57. Paragraph 13 of Taxation Ruling IT 2111 discusses the 'at risk' rule and states the 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.'

58. The 'at risk' rule applies to an investor's risk of loss before and after completion and distribution of the Film. Any arrangement which limits an investor's risk of loss can breach the 'at risk' rule. Certain types of common industry arrangements affecting risk during production of the Film are accepted as not offending the 'at risk' rule. This acceptance does not extend to arrangements which put funds into the hands of investors to enable them to make their contributions to the costs of film production. This does not mean that post-completion arrangements are also acceptable provided they do not put funds into the hands of investors to enable them to make their contributions. The position in paragraph 13 of Taxation Ruling IT 2111 is limited to the situations expressly mentioned.

59. The arrangement ruled on involves distribution guarantees which result in moneys equalling 100% of investors investment in the documentaries having been paid to them at the Expiry Date of the project. These guarantees do not attract the operation of section 124ZAM to the arrangement because firstly, they do not result in funds being placed into the hands of investors to enable them to make their contributions to the costs of production of the documentaries, and secondly, investors are at risk in relation to their total investment up until the time of completion of production of the documentaries. In addition, if the Distributor is unable to pay the distribution guarantees, investors will become unsecured creditors of the Distributor.

Non-arm's length transactions

60. Where, in producing a film, an amount is expended by a person ('the film producer') for the supply of goods or the provision of services, subsection 124ZAJ(1) allows the Commissioner to reduce deductions under Division 10BA for such amounts where he is satisfied that:

- the film producer and the person supplying the goods or providing the services were not dealing with each other at arm's length in relation to the transaction; and
- the amount of moneys expended on the supply of those goods or the provision of those services exceeds the amount of moneys that would have been expended by the film producer if the film producer and the person supplying those goods or providing those services had dealt with each other at arm's length.

61. The Commissioner will not be in a position to determine whether his discretion in subsection 124ZAJ(1) ought to be exercised until such time as the documentaries have been produced.

Furthermore, to make such a determination, a full audit of the documentaries application and production funds would normally be required.

62. Accordingly, while a deduction should be available in respect of capital moneys expended by investors by way of contribution to the cost of producing the documentaries of the Project before the end of the financial year ending 30 June 2002, the deduction will be reduced with retrospective effect if the Commissioner determines that a producer of the documentaries of the Project dealt with a supplier of goods or a provider of services, in the course of producing the documentaries, in circumstances where the parties were not dealing at arm's length and the producer paid more for the goods or the services than the producer would have paid had the transaction been at arm's length.

Interest on borrowed funds

63. Interest incurred in respect of funds borrowed by the investors, if any, to make their contributions will only be deductible in any year to the extent of film income derived in that year (subsection 124ZAO(2) of the ITAA 1936). Any excess interest may be carried forward to succeeding years of income for offset against future documentary income (subsection 124ZAO(3)).

Payment of interest by an investor where an assessment is amended

64. Section 204 provides that where an amendment of an assessment increasing the liability of a taxpayer to tax is made, the taxpayer is liable to pay a general interest charge to the Commissioner on the amount by which the tax payable by the taxpayer under the amended assessment exceeds the tax payable by the taxpayer under the assessment that was amended.

65. Investors who expend capital moneys by way of contribution to the cost of producing a film should be aware of this provision because, should the circumstances surrounding the production of a 'qualifying Australian film' require the Commissioner to go back and reduce the deductions claimed by Investors in that film, section 204 will have application. There is a discretion in section 8AAG of the *Taxation Administration Act 1953* (TAA 1953) under which the Commissioner can remit, in appropriate circumstances, the whole or part of the charge.

Part IVA

66. For Part IVA to apply, there must be a 'scheme' (section 177A); a 'tax benefit' (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The arrangement subject to this Ruling will be a 'scheme'. The investor will obtain, for example, a 'tax benefit' from entering into the scheme, in the form of a deduction allowable under the provisions in Division 10BA, that would not have been obtained but for the scheme. However, it is not possible to conclude, from the arrangement outlined in this ruling, that the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

67. An investor to whom this Ruling applies intends to stay in the scheme for its full term and derive assessable income from the exploitation of the copyrights of the documentaries. Further, there are no features of the Project, as described in the said arrangement, that suggest that the Project is so 'tax driven' and 'so designed to produce a tax deduction of a certain magnitude', that the operation of Part IVA is attracted.

Section 708 of the Corporations Act 2001

68. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by the investor under one of four categories in subsections 708(1)-(11) of the Corporations Act 2001. These provisions set out situations where a prospectus or similar disclosure document is not required.

69. Under subsections 708(1)-(7) an investor may participate in the project by accepting a 'personal offer' for an interest in the project. Offers under these provisions cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars.

70. An offer will be a personal offer where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 708(2)).

71. Offers made under other exclusions in section 708 (see below) are not counted for the purposes of the 20 investors limit.

72. Alternatively, an investor who is a 'sophisticated investor' may accept an offer for interests in the project under subsections 708(8)-(10). Under subsection 708(8), an investor in a managed

investment scheme, referred to below as ‘the person’ or ‘the person to whom the offer is made’, will be a ‘sophisticated investor’ where :

- the minimum amount payable for the interests in the project on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the project on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least \$500,000; or
- it appears from a certificate given by a qualified accountant no more than 6 months before the offer is made that the person to whom the offer is made:
 - (i) has net assets of at least \$2.5 million; or
 - (ii) has a gross income for each of the last 2 financial years of at least \$250,000 a year.

73. An investor may also participate in the project where the offer is made by a licensed dealer under subsection 708(10). Under this provision the dealer must be satisfied that the person to whom the offer is made has previous experience in investing which allows them to assess the merits of the offer, the value of the interests in the project, the risks involved in accepting the offer, their own information needs and the adequacy of the information provided.

74. The licensed dealer must provide a written statement of reasons for being so satisfied. Where an investor is accepted into the project under this provision he or she must sign an acknowledgment that they did not receive a prospectus in relation to the offer.

75. Under subsection 708(11) an offer may be made to and accepted by a person who is considered to be a professional investor. Investors who participate in the project under this provision will be, at the time the offer is made :

- a person who is a licensed or exempt dealer and who is acting as a principal ;
- a person who is a licensed or exempt investment adviser and who is acting as a principal ; or
- a person who controls at least \$10 million for the purposes of investment in securities.

Detailed contents list

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Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

PR 1999/95; TR 92/1; TR 92/20;
TR 97/16; TR 98/22; TD 93/34;
IT 2111

Subject references:

- Australian films
- film income
- film industry
- interest expenses
- product Rulings
- public Rulings
- tax avoidance
- tax administration

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- Corporations Act 2001 708
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- Corporations Act 2001 708(5)
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- Corporations Act 2001 708(7)
- Corporations Act 2001 708(8)
- Corporations Act 2001 708(9)
- Corporations Act 2001 708(10)
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- Corporations Act 2001 708(11)(a)
- Corporations Act 2001 708(11)(b)
- Corporations Act 2001 708(11)(h)

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