



PR 2002/51 - Income tax: Film Investment - 'Macquarie Nine Film & Television Investment Fund'

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 This document has changed over time. This is a consolidated version of the ruling which was published on *1 May 2002*



Product Ruling

Income tax: Film Investment – ‘Macquarie Nine Film & Television Investment Fund’

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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

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.

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 laws' 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 Fund', 'the Projects' or 'the arrangement'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Division 5 of Part III of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 26AG of the ITAA 1936;
 - Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 8-1 of the ITAA 1997;
 - Section 17-5 of the ITAA 1997;
 - Section 82KL of the ITAA 1936;
 - Division 10BA of Part III ITAA 1936;
 - Division 10B of Part III ITAA 1936; and
 - Part IVA of the ITAA 1936.

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 *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act'). A person or entity is entitled to claim input tax credits for the GST included in its expenditure provided that the acquisition is for a creditable purpose under Division 11 of the GST Act.

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 a Prospectus.

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. 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. The Ruling will be withdrawn or modified.

10. 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 part 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

11. This Ruling applies prospectively from 1 May 2002, 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).

12. 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

13. 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 persons, 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

14. The arrangement is the Macquarie Nine Film & Television Investment Fund and 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 by Macquarie Financial Products Management Limited as the Responsible Entity dated 14 December 2001;

- Macquarie Nine Film & Television Investment Fund Constitution dated 25 January 2002;
- Macquarie Nine Film & Television Investment Fund Compliance Plan dated 20 February 2002;
- **Production & Investment Agreement** between the Production Company, the Responsible Entity, and each Investor for each Project in the Fund in the form received on 24 December 2001;
- Production & Licence Agreement between the Production Company and the Distributor for each Project in the Fund in the form received on 24 December 2001;
- Executive Producer Agreement between the Production Company and the Distributor for each Project in the Fund in the form received on 24 December 2001;
- **Distribution Agreement** between the Distributor, the Responsible Entity, and each Investor in the form received on 24 December 2001;
- Macquarie Nine Film & Television Investment Fund Prospectus dated 6 March 2002 ('Prospectus'); and
- **Loan & Security Agreement** between each Investor who chooses to borrow and Macquarie Bank Limited in the form set out in Section 17 of the Prospectus.

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

15. The documents highlighted are those which Investors enter into or become a party to. There are no other agreements, whether formal or informal, and whether or not legally enforceable, that an Investor, or any associate of an Investor, will be a party to.

16. In accordance with the above documents, an Investor who participates in the arrangement must have made an application to invest pursuant to a prospectus or disclosure document issued in accordance with the *Corporations Act 2001*.

The Participants

17. The parties involved in the arrangement are:
- Macquarie Financial Products Management Limited ('MPF' or 'Responsible Entity' or 'RE'), the responsible entity under the managed investment scheme relating to the offer of the Copyright Interests;

- Nine Films & Television Pty Ltd ('Distributor'), the distributor;
- each Investor, being a purchaser of a copyright interest who licences it to derive assessable income;
- each Production Company ('PC') which makes one of the Projects, the Production Company; and
- Macquarie Bank Limited ('MBL'), the financier.

The Project

18. The RE will make an invitation to the public to invest in the Fund. Investment will involve an Investor paying to the RE an amount ('Investment'), together with Application Moneys equal to 5.5% of the Investment amount (to cover non-deductibles).

19. The RE will apply 50% of each Investment to investment in television series which are 'Australian films' for the purposes of Division 10B ('Television Sub-Fund') and will apply the other 50% of each Investment to investment in feature films which are 'qualifying Australian films' for the purposes of Division 10BA ('Film Sub-Fund').

20. Depending on the level of funds raised under the offer, a varying number of Projects will be made. The RE has the final choice of which Projects are selected and which Projects are discarded (having regard to the requirement to split the funds 50/50 as described above).

21. The RE will determine the level of acceptance of applications to ensure that the amount raised and to be contributed to the cost of producing Division 10BA Films (i.e., 50% of the total amount actually raised) is equal to the budgeted cost of the Division 10BA Films which the RE selects to be produced. This will ensure that the need for an underwriting agreement is removed whilst still satisfying the requirements of Division 10BA.

22. The Distributor will enter in a Distribution Agreement with the RE contracting on behalf of each of the Investors severally. It will cover each of the Projects and will provide for the Distributor to pay license fees quarterly based on the performance of the Projects. The Distributor will provide a distribution guarantee which will guarantee that Investors will receive (on a cumulative basis) distributions equal to 25% of their Investment by 30 June 2003, 42.5% of their Investment by 30 June 2004, and 50% of their Investment by 30 June 2005.

23. MBL has agreed to lend to approved borrowers on a full-recourse basis with a five year term. Interest will be payable

quarterly in arrears and the principal will be repayable in five equal annual payments.

Television Sub-Fund

24. Depending on the level of funds raised, either two or three television series will be commissioned and produced with agreements being entered into at Closing between the RE on behalf of the Investors severally and the relevant PC.

Film Sub-Fund

25. Depending on the level of funds raised a number of small to medium budget films will be commissioned and produced with agreements being entered into at Closing between the RE on behalf of the Investors severally and the relevant PC.

26. An Investor will not have expended capital moneys by way of contribution to the cost of producing a particular Film until after the Investor (through the RE) has entered into the Production and Investment Agreement relating to that Film and the minimum subscription for the Fund has been achieved.

27. Each Investor will be entitled to become one of the first owners in up to 50% of the copyright. Each individual Investor's share in the copyright of the Film will be determined by the amount of money subscribed by the Investor. The remaining 50% of the copyright in each Film will be owned by the PC and/or other parties.

28. In the event that the direct costs of the production of a Film 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 Film, it will be paid to the Executive Producer as an additional producer's fee; or
- If the underage is more than 5% of the budget of the Film, an amount equal to 5% of the budget of the Film will be paid to the Executive Producer as an additional producer's fee and the balance will be used by the PC for marketing expenses. If there are no marketing expenses, the balance will be treated as proceeds and disbursed to the Investors in proportion to their initial investments.

29. Any 'non deductible' expenditure will be met directly by the Investors or the Distributor. It will not be met out of the budgets for the Films nor by any of the PCs. The exact amount of non-deductible moneys will be determined only after the audit upon completion of the

film. The amount deducted for moneys spent on non-deductible items in the budget will be adjusted with retrospective effect in the subsequent year.

30. The estimated completion date for each of the Films is the period January 2003 to December 2003. For each Film this date largely depends upon a number of factors (principally the starting date and the length of filming required), but will be no later than 30 June 2004 in order to satisfy the two-year requirement of Division 10BA.

31. Investors are expected to derive assessable income from the Projects until 30 June 2009.

Constitution

32. The Constitution sets out the terms and conditions under which the Responsible Entity agrees to act for the Investors and to manage the Project.

33. Investors are bound by the Constitution by virtue of their acceptance into the Project.

34. On acceptance of an application at the Closing, the Responsible Entity determines which Projects it will proceed with and will enter into the relevant agreements relating to those Projects and will transfer the production moneys for the production of those Projects to the respective PCs.

35. The Responsible Entity will act on behalf of each Investor in handling certain aspects of the day to day management of the Investors' respective investments.

Compliance Plan

36. The Compliance Plan sets out the terms and conditions under which the Responsible Entity agrees to deal with each of the Investors.

Production and Investment Agreement

37. The Production and Investment Agreement for each Project makes provision for the production of the Project for a fixed budget and in accordance with the terms of the agreement. It also provides for each of the Investors to be a first owner of copyright (for Division 10BA Projects) or an owner of copyright (for Division 10B Projects).

Production and Licence Agreement

38. Under this agreement the Distributor acquires an interest in the copyright of a Project, takes a licence of the PC's interest in the copyright, and obtains a number of representations and warranties to enable it to distribute the Project.

Distribution Agreement

39. The funding of the distribution guarantees is not attributable in any way or form whether directly or indirectly to any money raised or expended in relation to the Projects. 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 Projects.

Executive Producer Agreement

40. This agreement requires the Distributor to provide certain production related services to the PC in respect of the particular Project and to receive a fee for those services.

Prospectus

41. Interests in the Fund are offered to Investors through a Prospectus.

Loan & Security Agreement

42. Under the Loan & Security Agreement, MBL will lend each Investor up to an amount equal to the Investment plus the Application Fee, subject to normal Investor approvals. The loan is provided by MBL on a full recourse basis to the Investor.

43. Each loan will be for a term of five years, and will be at a fixed rate of interest. Interest is payable quarterly in arrears but, if there are insufficient distributions in respect of the Projects, can be capitalised (subject to the following). On 30 June in each succeeding year, the Investor must repay 20% of the borrowing together with any outstanding or capitalised interest at that time. The Loan & Security Agreement is set out in full in the Prospectus.

44. Under the Loan & Security Agreement, each Investor, amongst other things, creates a fixed charge over all of the Investor's present and future right, title and interest arising under the Fund, including the right to receive all moneys under the Fund, but excluding the Investor's Copyright Share.

45. This security granted by the Investor to MBL under this document secures the Investor's payment obligations.

Finance

46. This Ruling does not apply if a finance arrangement entered into by an Investor to fund the Investor's investment in the arrangement includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- 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 the borrowers for the purpose 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 the principal and payments of interest are linked to the derivation of income from the Project; and
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender or any associate of the lender.

Ruling

Assessable Income

47. In relation to each Television Sub-Fund Project, the Investors who acquire Copyright will comprise a tax law partnership for the purposes of Division 5 of Part III of the ITAA 1936 (see definition of 'partnership' in section 995-1 of the ITAA 1997). Investors will receive income jointly from their commercial exploitation of their Copyright interest. Section 90 of ITAA 1936 provides that the net income of a partnership is calculated as if the partnership were a resident taxpayer, and is the assessable income less all allowable deductions. The Partnership will be required to lodge a partnership return for each year of income, as required by section 91 of the ITAA 1936. The licence fees received by a Partnership in respect of the Australian Films, less any GST payable on those licence fees, will be assessable income of the Partnership under section 6-5 of the

ITAA 1997 in the income year in which they are received from the Distributor.

48. In relation to each Film Sub-Fund Project, the Investors who acquire Copyright will comprise a tax law partnership for the purposes of Division 5 of Part III of the ITAA 1936 (see definition of 'partnership' in section 995-1 of the ITAA 1997) as they will be in the receipt of income jointly from the commercial exploitation of their Copyright interest. The licence fees received by a Partnership in respect of the Australian Films, less any GST on those licence fees, are assessable income of the Partnership under section 26AG of the ITAA 1936 in the income year in which they are received from the Distributor. However, pursuant to subsection 26AG(9), any income received by a Partnership from the use of, or the right to use, the copyright is taken to have been derived by the partners. No such income is taken into account for the purposes of calculating the net income or loss of the Partnership of any year of income and, if this is the only income derived by the Partnership, it will not be necessary to lodge partnership income tax returns.

49. The licence fees received by the Distributor, less any GST payable on those licence fees, will be assessable income of the Distributor in the income year in which they are received.

50. Section 17-5 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

51. Amounts received in foreign currencies will be converted for Australian tax purposes into Australian dollars in accordance with subsection 20(3).

Division 10B

52. An Investor in a Television Sub-Fund Project is entitled to an income tax deduction under Division 10B. Where the episode is completed on or before 30 June 2002, this deduction will be equal to 50% of the Investment in that Project (being the cost of the copyright interest to the Investor) in the year ending 30 June 2002 and 50% of the Investment in that Project in the year ending 30 June 2003. Where the episode is completed after 30 June 2002 but on or before 30 June 2003, this will be equal to 50% of the Investment in that Project (being the cost of the copyright interest to the Investor) in the year ending 30 June 2003 and 50% of the Investment in that Project in the year ending 30 June 2004.

Division 10BA

53. An Investor in a Film Sub-Fund Project is entitled to a deduction under Division 10BA. Upon Closing, Production and

Investment Agreements will be entered into under which moneys are transferred to the respective PC to make the Film. At that point, provided the whole of the expected cost of producing the Film is contracted prior to 30 June 2002, the Investor will be entitled to a deduction in respect of the moneys contributed to the cost of producing the Film.

54. In respect of each of the Films, each Investor will be entitled to become one of the first owners in up to 50% of the copyright.

55. For each \$5,000 interest invested in the Project, a deduction of \$2,500 is available to an Investor under Division 10BA of the ITAA 1936 in the year that the investment is made but only to the extent that the funds are contributed to the cost of producing Division 10BA Films in that year.

56. A deduction is not available until the minimum subscription for the Project has been achieved and an Investor has entered into the Production and Investment Agreement.

57. Upon completion of the Films, after the audit has been carried out by an independent auditor, deductions will be withdrawn by the ATO in respect of the moneys spent on non-tax deductible items of the budget (section 124ZAG). Deductions may also be withdrawn by the ATO where moneys, which are specified to be spent on Film production items in the budget, are in fact spent on non-production activities.

Section 8-1

58. The interest payable by an Investor on the loan from Macquarie Bank Limited to fund the Investor's participation in a Television Sub-Fund Project will be deductible under section 8-1 of the ITAA 1997 when incurred.

59. The interest payable by an Investor on the loan from Macquarie Bank Limited to fund the Investor's participation in a Film Sub-Fund Project will be deductible to the Investor under section 8-1 of the ITAA 1997, but only to the extent of assessable film income for the year (subsection 124ZAO(2)). Other deductions available to Investors (not being expenditure in respect of which a deduction is allowable under section 124ZAF or section 124ZAF A) 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)).

Goods and Services Tax ('GST')

60. For GST purposes, and other than for the payment for the acquisition of the Copyright, an Investor will be considered a partner in a partnership rather than an individual Investor.

Division 35 ITAA 1997

61. Division 35 of the ITAA 1997 will not apply on the basis that any losses which may arise are attributable to a passive investment which does not constitute a business activity.

Section 82KL

62. Section 82KL does not apply to deny the deductions otherwise allowable.

Part IVA

63. Part IVA will not apply to deny deductibility or to accelerate assessability of the above amounts.

Assumptions

64. This Ruling is made subject to the following assumptions in respect of each Television Sub-Fund Project:

- (a) An Investor will incur capital expenditure on the purchase of Copyright (paragraph 124L(1)(b));
- (b) An Investor's interest in the Copyright amounts to ownership of the Copyright for the purposes of Division 10B (subsection 124K(1));
- (c) The series will be completed and the Partnership will use the Copyright for the purpose of producing assessable income (section 124L(1));
- (d) The Investors will not exercise the discretion contained in subsection 124UA(2);
- (e) The effective life of the Copyright in the series is two years (subsection 124UA(1));
- (f) No consideration will be payable to the Partnership as a result of the execution of distribution agreements in relation to the arrangement; and
- (g) The dominant purpose of the Investors is to make a commercial return from their investment in the film and

the arrangements will be executed in the manner described in this Ruling.

65. This Ruling is made subject to the following assumptions in respect of each Film Sub-Fund Project:

- (a) The Investor was a resident of Australia for tax purposes at the time the money was expended (subparagraph 124ZAF(1)(b)(i));
- (b) All of the investment moneys contributed by the Investors will be used by the RE by way of contribution to the cost of producing the Division 10BA Film. Moneys contributed by the Investors towards the cost of production of the Film will be directly expended in the production of the Film and will not be used by the RE, the PC and/or Distributor for any other purpose including funding distribution guarantees (paragraph 124ZAF(1)(a) read in conjunction with subsection 124ZA(6));
- (c) At the relevant time, a provisional certificate (section 124ZAB) or a final certificate (section 124ZAC) is in force in relation to the Film;
- (d) Each Investor, at the relevant time, expects to become one of the first owners of the copyright in the Film when the copyright comes into existence (subparagraph 124ZAF(1)(c)(i));
- (e) Each Investor, at the relevant time, intends to use the interest in the copyright of the Film for the purpose of producing assessable income from the exhibition of the Film as mentioned in subparagraph 124ZAF(1)(c)(ii);
- (f) There will be in force a declaration lodged in respect of the Film in accordance with subsection 124ZAD(1) by a person accepted by the Commissioner under subsection 124ZAD(2) as an appropriate person to make such a declaration (subparagraph 124ZAF(1)(d)(iii));
- (g) Before the expiration of six months after the time when the Film is 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 Film will be completed and will be used for income producing purposes within two years after the close of the financial year in which the contributions are first 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 copyright in the Film before 1 July 2004;
- (k) In producing the Film:
- where an amount is expended by a person ('the Film producer') for the supply of goods or the provision of services; and
 - the Commissioner is satisfied that the Film 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;
- 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 Film producer if the Film 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 Film, 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 Film;
- (n) In the event of any underage, the Producer will expend the underage amount on the production and marketing of the Film in a manner that will preserve the status of the Film as 'qualifying Australian Film';
- (o) The dominant purpose of the Investors is to make a commercial return from their investment in the Film

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 of the Film.

Explanations

Assessable Income

66. The licence fees received by a Partnership of Investors in a Television Sub-Fund Project, less any GST payable on those licence fees, will be assessable income of the Partnership under section 6-5 of the ITAA 1997 in the income year in which they are received from the Distributor. The amounts received are payments for the right to use the rights attaching to the unit of industrial property possessed by the Investors in respect of a particular period.

67. The licence fees received by a Partnership of Investors in a Film Sub-Fund Project, less any GST payable on those licence fees, will be assessable income of the Investors under section 26AG of the ITAA 1936 in the income year in which they are received from the Distributor. Although there exists a tax law partnership, subsection 26AG(9) provides that income of a partnership assessable under section 26AG is taken to be income derived by the partners/Investors. The amounts received as income are payments for the right to use the rights attaching to a 'qualifying Australian film' possessed by the Investors in respect of a particular period.

68. Section 17-5 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

Division 10B

69. Each episode of each of the television series is an 'Australian film' within the meaning of section 124K. Hence, each episode will have an effective life of two years.

70. Each Investor in entering into the Distribution Agreement through the RE on or prior to 30 June 2002 is using a unit of industrial property for the purpose of producing assessable income.

71. Each Investor and each PC will be dealing with each other at arm's length. There are no other arrangements between them.

72. To the extent that copyright in respect of an episode in one of the television series comes into existence prior to 1 July 2002, the Investors will be entitled to claim a deduction in respect of the cost to them of that episode with 50% being allowable in the year ending 30 June 2002 and 50% being allowable in the year ending 30 June 2003.

73. To the extent that copyright in respect of an episode in one of the television series comes into existence after 30 June 2002 but prior to 1 July 2003, the Investors will be entitled to claim a deduction in respect of the cost to them of that episode with 50% being allowable in the year ending 30 June 2003 and 50% being allowable in the year ending 30 June 2004.

74. The foregoing means that the requirements of section 124M which permits an annual deduction over the effective life of the unit of industrial property are satisfied. Reference should be made particularly to IT 2629 paragraphs 17 to 20.

Division 10BA

The 'directly expended' requirement

75. 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.

76. Paragraph 8 of Taxation Ruling IT 2111 discusses this requirement. It states that '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.'

77. 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 Films. 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

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not be known until after the completion of the Films. This ruling is based on an estimate of what this amount will be.

78. Each of the Investors will pay their Investment to the RE and the RE will make the payments to each of the PCs under each of the Production & Investment Agreements. In turn the PC will use the total moneys received for application towards the production costs. In doing this, the PC is to ensure that the funds contributed by Investors is only expended on items within the Project's production budget.

79. In determining the amount that is 'directly expended' on the production of the Films, 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 Films. In this instance, the Executive Producer will be entitled to a further amount not exceeding 5% of the budgeted cost as additional producer's fees.

80. 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.

81. Accordingly, whilst this Ruling identifies a deduction for 100% 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 Films.

82. This situation will apply where, for example, moneys which were identified in the production budget to be expended on a specified activity relating to the production of the Films are actually spent on an unrelated non-deductible activity. Similarly, in a situation where the direct costs of the production of one of the Films 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

83. 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).

84. 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.'

85. 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.

86. The arrangement ruled on involves distribution guarantees which result in moneys equaling 50% of the Investors' Investment in the Films 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 Films, and secondly, Investors are at risk in relation to their

total investment up until the time of completion of production of the Films. 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

87. 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.

88. 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 Films have been produced. Furthermore, to make such a determination, a full audit of the Film's application and production funds would normally be required.

89. 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 Films 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 Films of the Project dealt with a supplier of goods or a provider of services, in the course of producing the Films, 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.

Section 8-1

90. The funds that are borrowed by an Investor will be used to acquire an asset that will be income producing. The interest payable by an Investor on the MBL loan will be an allowable deduction under section 8-1 of the ITAA 1997 (subject to the application of section 124ZAO in relation to Film Sub-Fund Projects).

91. The MBL loan is full recourse and there are no arrangements in place which permit the borrower to avoid the full obligation to repay the loan.

Division 35

92. Subsection 35-5(2) of the ITAA 1997 specifically provides that Division 35 of the ITAA 1997, which regulates the deduction of losses from non-commercial business activities, is not intended to apply to 'activities that do not constitute carrying on a business, for example, the receipt of income from passive investments'.

93. The transactions covered by the arrangement amount to an acquisition of passive investments and the deriving of income from those investments. Hence, Division 35 of the ITAA 1997 does not apply to the Projects.

Section 82KL

94. Section 82KL has no application to Division 10BA arrangements and is therefore not relevant to any Film Sub-Fund Projects.

95. The operation of section 82KL depends, amongst other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided under the Television Sub-Fund Projects to trigger the operation of section 82KL.

Part IVA

96. 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' from entering into the scheme, in the form of a deduction allowable under the provisions of Division 10B or Division 10BA, that would not have been obtained but for the scheme. It is not possible to conclude, from the arrangement outlined in this ruling, that a scheme will be entered into or carried out with the dominant purpose of obtaining a tax benefit.

97. 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 Projects. There are no facts that would suggest that Investors have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or if any parties are not at arm's length, that any adverse tax

consequences result. Further, there are no features of the Projects, as described in the arrangement set out above, that suggest that the Projects are so 'tax driven' and 'so designed to produce a tax deduction of a certain magnitude', that the operation of Part IVA is attracted.

Payment of interest by an Investor in a Film Sub-Fund Project where an assessment is amended

98. 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.

99. 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* under which the Commissioner can remit, in appropriate circumstances, the whole or part of the charge.

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Commissioner of Taxation

1 May 2002

<i>Previous draft:</i>	- ITAA 1936 124ZAB(10)
Not previously released in draft form	- ITAA 1936 124ZAC
	- ITAA 1936 124ZADA(1)
	- ITAA 1936 124ZADA(2)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 124ZAF
PR 1999/95; TR 92/1; TR 97/16;	- ITAA 1936 124ZAF(1)(a)
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- Australian films	- ITAA 1936 124ZAF(2)
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ATO references:

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ISSN: 1441 1172