



PR 2002/69 - Income tax: Brothers At War Film Project

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Product Ruling

Income tax: Brothers At War Film Project

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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

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 Brothers at War Film Project', 'the Film' 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');
 - Division 27 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 124ZAG ITAA 1936;
 - Section 124ZAO ITAA 1936;
 - Division 5 of Part III ITAA 1936;
 - Section 995-1 ITAA 1997;
 - Section 26AG ITAA 1936;
 - Part IVA 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 *New Tax System (Goods and Services Tax) Act 1999* ('GST Act'). An entity, which includes a person, is able 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; the entity is registered, or required to be registered for GST; and the entity holds a tax invoice.

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).

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 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

11. This Ruling applies prospectively from 22 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 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 The Brothers at War Film Project dated 28 November 2001;
- Prospectus in relation to The Brothers at War Film Project dated 8 June 2001;
- Draft Supplementary Prospectus in relation to The Brothers at War Film Project received by the ATO on 18 April 2002;
- Draft Head Production and Marketing Agreement in relation to The Brothers at War Film Project between ARG Management Limited ('the Responsible Entity') and the investors received by the ATO on 14 May 2002;
- Draft Production and Marketing Agreement in relation to The Brothers at War Film Project between the Responsible Entity, Landy Capitalisation Company Pty Limited ('the Executive Production Company'), Richard Bradley Productions Pty Limited ('the Marketing Company') and Richard Bradley Presentations Pty Limited ('the Production Company') received by the ATO on 14 May 2002;
- Draft Constitution for The Brothers at War Film Project received by the ATO on 19 April 2002;
- Draft Compliance Plan for The Brothers at War Film Project received by the ATO with the application for a product ruling;
- Custodian Agreement for The Brothers at War Film Project dated 4 July 2001;
- Licence Agreement between United International Pictures Pty ('UIP') and Richard Bradley Productions Pty Limited ('the Licensor') dated 24 June 1996;
- Television Program Licence Agreement between the Licensor and Amalgamated Television Services Pty Limited ('the Licencee'; also 'ATS') dated 15 May 1996;
- Correspondence received by the ATO from the applicant's representative dated 25 January 2002, 2 February 2002, 22 February 2002, 4 April 2002, 17 April 2002, 18 April 2002, 19 April 2002, 7 May 2002 and 14 May 2002.

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 details of the arrangement are summarised as follows:

The Participants

16. ARG Management Limited (ACN: 089 240 513) will act as the Responsible Entity.

17. Landy Capitalisation Company Pty Limited (ACN: 095 383 485) will act as the Executive Production Company.

18. Richard Bradley Productions Pty Limited (ACN: 001 886 988) will act as the Marketing Company.

19. Richard Bradley Presentations Pty Limited (ACN: 080 413 869) will act as the Production Company.

The Project

20. The Project involves the production of an Australian feature film to be titled 'Brothers at War'.

21. Provisional Certificate number P04480, dated 23 June 1994, has been issued by the Department of Communications, Information Technology and the Arts in respect of the Film to Richard Bradley Productions Pty Ltd. This certificate is currently in force in relation to the Film and states that the proposed Film will, when completed, be a 'qualifying Australian film' for the purposes of Division 10BA of the ITAA 1936.

22. The total budgeted cost to produce the Film is \$9,944,991. The budget will be raised from investors who are Australian residents for tax purposes. Each interest in the Project will have a value of \$5,000 and investors may subscribe for multiple interests. The maximum number of units is 1989 and the minimum number of units is 1592. The investors will make capital contributions towards the production of the Film under the Head Production and Marketing Agreement.

23. The moneys raised from investors will be held by the Responsible Entity and deposited into the Production Account and made available to start production of the Film once minimum subscription of \$7,955,000 is attained. The Production Account will be held and operated by the Custodian who will make certain disbursements from the Production Account to meet the ongoing costs of producing and marketing the Film. If minimum subscription is not attained by 8 July 2002, no drawdowns will be made from the Production Account for the production of the Film and all rights,

powers, representations and obligations of the parties to the Agreement will be immediately at an end.

24. An investor will not have expended capital moneys by way of contribution to the cost of producing the Film until after the investor has entered into the Head Production and Marketing Agreement, the Responsible Entity has entered into the Production and Marketing Agreement and the minimum subscription for the Film has been achieved.

25. In accordance with the budget, an amount of \$8,813,540 will be spent on the production of the Film. The budget has been prepared in accordance with the standard industry format.

26. In the event that the direct costs of the production of the Film are lower than the estimated costs stated in the budget, any underages will be firstly expended on other areas of production of the Film. Any remaining underages will be paid to the investors in proportion to their investment in the Film.

27. If there is any overage in relation to the production of the Film, it will be met by the Production Company either from its own resources or money provided by the Completion Guarantor or third party lenders.

28. The 'non-deductible' expenditure included in the budget which is not deductible in respect of Division 10BA totals \$1,131,451. However, the exact amount of non-deductible moneys will be determined only after the audit upon completion of the Film.

29. The Film is expected to take between seven and twelve months to produce. However, the completion date will be no later than 30 June 2004 in order to satisfy the two-year requirement of Division 10BA.

30. The Project will terminate five years after the Film has been completed ('Expiry Date'). Investors are expected to earn assessable income from the exploitation of the rights of the Film until 30 June 2009.

31. The Marketing Company has entered into a Licence Agreement with UIP in which it grants to UIP an exclusive licence under copyright to exhibit, distribute, reproduce and exploit the Film. This involves the grant of theatrical, non-theatrical and home video rights in both Australia and New Zealand, and pay television and free television rights in New Zealand.

32. The Marketing Company has also entered into a Television Program Licence Agreement with ATS in which it grants to ATS a licence to broadcast the Film by television during the period detailed in the Agreement.

Head Production and Marketing Agreement

33. The investors in the Film will enter the Head Production and Marketing Agreement with the Responsible Entity.
34. Under this Agreement the investors engage the Responsible Entity as an independent contractor to produce and market the Film.
35. The Responsible Entity is authorised by the investors to appoint a Production Company to produce the Film. The relationship between the Responsible Entity and the Production Company will be governed by the Production and Marketing Agreement, which will contain the duties, termination, and assignment provisions.
36. The Responsible Entity is authorised by the investor to appoint a Marketing Company to market the Film. The relationship between the Responsible Entity and the Marketing Company will be governed by the Production and Marketing Agreement, which will contain the duties, termination and assignment provisions.
37. The Responsible Entity must pay all Gross Receipts attributable to investors in accordance with Items 2, 5 and 6 of Schedule 4 of the Production and Marketing Agreement.

Production and Marketing Agreement

38. The Responsible Entity will enter the Production and Marketing Agreement with the Executive Production Company, the Production Company and the Marketing Company. The Responsible Entity will enter the Agreement as agent for investors participating in the Project and in no other capacity.
39. The Responsible Entity licences the Production Company to produce the Film, subject to the terms of the Agreement and grants to the Marketing Company an exclusive licence to market the Film commencing on the date of the Agreement and continuing to the Expiry Date.
40. The investors are acknowledged as the first owners of the copyright in the Film.
41. Upon minimum subscription being reached, the Responsible Entity will transfer the investors' subscription moneys to the Production Account. The Production Account will be held and operated by the Custodian, as agent for the Responsible Entity. At that stage the subscription moneys will be referred to as the Budget.
42. Subject to the Drawdown schedule, detailed in the Production and Marketing Agreement, the Responsible Entity will then instruct the Custodian to make certain disbursements from the Production Account to meet the ongoing costs of producing and marketing the Film.

43. Under Schedule 4 of the Head Production and Marketing Agreement the proceeds from Gross Receipts from the Project are to be distributed as follows:

PART A: AUSTRALIAN GROSS RECEIPTS DISBURSEMENT

- Item 1: **FIRST**, to meet Australian Marketing Expenses.
- Item 2: **SECOND**, in respect of Australian Gross Receipts actually received, generated or contracted in Australia by the Expiry Date to the Responsible Entity or its nominated agent until the Responsible Entity or its nominated agent has thereby received a total amount equal to 100% of the Budgeted Cost under this clause and Schedule 4 Part B Item 2*.
- Item 3: **THIRD**, in payment to the Production Company until the sum paid under this clause and Schedule 4 Part B Item 3 is equal to any Overages met by the Production Company or borrowed by the Production company including any interest thereon.
- Item 4: **FOURTH**, to pay the Completion Guarantor for reimbursement of any Overages paid by it until the amount paid under this clause and Schedule 4 Part B Item 4 equals those Overages.
- Item 5: **FIFTH**, in respect of Australian Gross Receipts actually received, generated or contracted in Australia a day three (3) years after the Completion Date:
- (a) to the Production Company: 40%;
 - (b) to the Responsible Entity: 60%*. 10% of this amount will be payable to the Production Company as a marketing commission.
- Item 6: **SIXTH**, thereafter in respect of Australian Gross Receipts actually received by the in Australia by the Expiry Date:
- (a) to the Production Company: 50%;
 - (b) to the Responsible Entity: 50%*.
- Item 7: **SEVENTH**, at all times after that 100% to the Production Company.

PART B: OVERSEAS GROSS RECEIPTS DISBURSEMENT

- Item 1 **FIRST**, to meet Overseas Marketing Expenses.
- Item 2 **SECOND**, in respect of Overseas Gross Receipts actually received, generated or contracted in Australia by the Expiry Date to the Responsible Entity or its nominated agent until the Responsible Entity or its nominated agent has thereby received a total amount equal to 100% of the Budgeted Cost under this clause and Schedule 4 Part A Item 2*.
- Item 3 **THIRD**, in payment to the Production Company until the sum paid under this clause and Schedule 4 Part A Item 3 is equal to any Overages met by the Production Company or borrowed by the Production Company including any interest thereon.
- Item 4 **FOURTH**, to pay the Completion Guarantor for reimbursement of any Overages paid by it until the amount paid under this clause and Schedule 4 Part a Item 4 equals those Overages.
- Item 5 **FIFTH**, in respect of Overseas Gross Receipts actually received, generated or contracted in Australia by a day three (3) years after the Completion Date:
- (a) to the Production Company: 40%;
 - (b) to the Responsible Entity or its nominated agent: 60%*. 10% of this amount will be payable to the Production Company as a marketing commission.
- Item 6 **SIXTH**, thereafter in respect of Overseas Gross Receipts actually received by the in Australia by the Expiry Date:
- (a) to the Production Company: 50%;
 - (b) to the Responsible Entity or its nominated agent: 50%*.
- Item 7 **SEVENTH**, at all times after that 100% to the Production Company.

*The Responsible Entity or its nominated agent will be paying these amounts to the investors in accordance with the Head Production and Marketing Agreement.

Constitution

44. The parties to the Constitution are the Responsible Entity and the Executive Producer.

45. The consideration payable by Members shall be \$5,000 for each unit and the Responsible Entity may issue units to an applicant who pays the subscription price and agrees to enter into a Production and Marketing Agreement.

46. The Responsible Entity must on receipt of application moneys and the completed and signed Application Form, if the Application Form is not rejected by the Responsible Entity, pay those moneys as soon as practicable after their receipt but not later than the close of business on the next working day after the day of receipt into the Applications Bank Account.

47. The Responsible Entity shall be entitled to pay all moneys required to be paid by or for and on behalf of the Members pursuant to this Constitution or the Management Agreement in accordance with the relevant provisions out of the Scheme Bank Account including without limitation fees payable pursuant to the Production and Marketing Agreement.

48. The Constitution lists at clause 22.1 the duties of the Responsible Entity.

Finance

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

- 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;
- 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

Division 10BA

50. For each \$5,000 unit invested in the Project, a deduction of \$4,431 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, the tax deduction otherwise allowable will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). For example, for each \$5,000 contribution, an amount of \$4,431, less any GST input tax credit, will be allowable as a deduction.

51. A deduction is not available until the minimum subscription of \$7,955,000 for the Film has been achieved and an investor has entered into the Production and Marketing Agreement.

52. Upon completion of the Film, 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).

53. Interest incurred in respect of funds borrowed by the investors to make their contributions may be deductible to the investors 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 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 (subsection 124ZAO(3)).

54. The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling.

Assessable income

55. The investors who acquire Copyright will comprise a tax law partnership for the purposes of Division 5 of Part III (see definition of

‘partnership’ in section 995-1 of the ITAA 1997) as they will be in receipt of income jointly from the commercial exploitation of their Copyright interest. 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. The licence fees derived by each investor as a partner in the Partnership are assessable income of the investor. 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. If the Partnership is liable for GST the Partnership would be required to lodge a Business Activity Statement.

Part IVA

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

Assumptions

57. 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) \$8,813,540 of the investment moneys contributed by the investors will be used by the Production Company by way of contribution to the cost of producing the 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 Production Company and/or Distribution Company for any other purpose including funding distribution guarantees (paragraph 124ZAF(1)(a) read in conjunction with subsection 124ZA(6)).
- (c) At the relevant time, provisional certificates (section 124ZAB) or final certificates (section 124ZAC) are 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 force (subparagraph 124ZAF(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 Film as mentioned in subparagraph 124ZAFA(1)(c)(ii);
- (f) There will be in force a declaration lodged in respect of the Film 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 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 the investors' interest in the copyright in the Film 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 copyright in the Film before 1 July 2003;
- (k) In producing the Film:
- where an amount is expended by a person ('the Production Company') for the supply of goods or the provision of services; and
 - the Commissioner is satisfied that the production company 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 production company if the Production Company 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 Production Company 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 a ‘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.

Explanations

Division 10BA

The ‘directly expended’ requirement

58. 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.

59. 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

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risks, drawing up performers' contracts and the building of sets and scenery'.

60. Our view is that the 'directly expended' requirement is not met at the point in time when the investors make payments to the Production Company in respect of the budgets for the Film. Rather, the extent of the application of the money by the Production Company 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 Film. This ruling is based on an estimate of what this amount will be.

61. The investors will pay the application money to the Production Company which will use 88.62% of total application moneys, being \$8,813,540, for application towards the production costs. In doing this, the Production Company is to ensure that this proportion of funds contributed by investors is only expended on items within the Film's production budget.

62. In determining the amount that is 'directly expended' on the production of the Film, we will also consider the ultimate application of any funds obtained by the Production Company as 'underage'. In this regard, the Production Company has agreed any underage will be first expended on the production of the Film. Any remaining underage will be paid to the investors in relation to their investment in the Film.

63. 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 the Production Company (known as an audit of the 'film fund') is considered inadequate in this regard.

64. Accordingly, while this Ruling identifies a deduction for 88.62% 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 Film.

65. 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 Film, are actually spent on an unrelated non-deductible activity. Similarly, in a situation where the direct costs of the production of the Film 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

66. 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).

67. 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.'

68. 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.

69. The arrangement ruled on does not contain any features which attract the operation of section 124ZAM.

Non-arm's length transactions

70. 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.

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

72. 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 Film 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 Film dealt with a supplier of goods or a provider of services, in the course of producing the Film, 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

73. 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 film income (subsection 124ZAO(3)).

Assessable Income

74. The investors in The Brothers at War Film Project will be considered to be a partnership for income tax purposes as they are in receipt of ordinary income or statutory income jointly (see the definition of 'partnership' in section 995-1 of the ITAA 1997). The licence fees received by a Partnership of investors in the Film, less any GST payable on those licence fees, will be assessable income of

the investors under section 26AG in the income year in which they are received. 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.

Part IVA

75. 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.

76. 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 Film. 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.

Payment of interest by an investor where an assessment is amended

77. 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.

78. 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.

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