


PR 2002/91 - Income tax: Film Investment - 'The Complete History of Cricket - From Dawn to Stumps'

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Product Ruling

Income tax: Film Investment – ‘The Complete History of Cricket – From Dawn to Stumps’

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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 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 Complete History of Cricket – From Dawn to Stumps', 'the Film' or 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Division 27 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 995-1 (ITAA 1997);
 - Division 10BA of Part III of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - section 124ZAG (ITAA 1936);
 - section 124ZAO (ITAA 1936);
 - Division 5 of Part III (ITAA 1936);
 - section 26AG (ITAA 1936); and
 - 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 *A 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 valid 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). In this Ruling, each of these persons, will have accepted an offer made under subsections 708(8)-(10) 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. 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.

PR 2002/91

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 19 June 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 dated 26 April 2002, received from the Applicant;
- Budget for the Film ‘The Complete History of Cricket – From Dawn to Stumps’, received with the application dated 26 April 2002;
- Provisional Certificate under section 124ZAB dated 12 March 2002;
- Draft Film Investment Deed between the Representative (Investors’ Representative) and Dawn to Stumps Pty Ltd, received with the application dated 26 April 2002;
- Draft Production Agreement between the Investors’ Representative, Dawn to Stumps Pty Ltd and Jousting Sticks Productions Pty Ltd, received with the application dated 26 April 2002;
- License Agreement between Dawn to Stumps Pty Ltd and Off The Fence BV dated 11 May 2002;
- Draft Product Ruling received with the application dated 26 April 2002;
- The Constitution of Dawn to Stumps Pty Ltd dated 12 April 2002;
- Draft Offer Information Memorandum received by the ATO with the application dated 26 April 2002;
- Correspondence received by the ATO from the Applicant dated 27 May 2002;
- Correspondence from the ATO to the Applicant dated 17 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. In accordance with the above documents, an Investor who participates in the arrangement must have accepted an offer that was made under subsections 708(8)-(10) of the *Corporations Act 2001*. **This Ruling does not apply unless the Investors are ‘sophisticated investors’**. The term ‘sophisticated investor’ is explained in paragraphs 37 to 40 below.

The participants

16. The following entities are participants in the project:
- A suitably qualified and experienced person will act as the Investors' Representative;
 - Dawn to Stumps Pty Ltd will act as the manager of the Project;
 - Jousting Sticks Productions Pty Ltd will act as the Principal Production Company for the Film;
 - The Investors will appoint Dawn to Stumps Pty Ltd as their agent to market the Film;
 - Dawn to Stumps Pty Ltd will licence Off The Fence BV to act as distributor of the Film worldwide, except for Australia and New Zealand.

The project

17. The project involves the production of a documentary film to be titled 'The Complete History of Cricket – From Dawn to Stumps'.
18. Provisional Certificate number P06262 dated 12 March 2002 has been issued by the Department of Communications, Information Technology and the Arts in respect of the Film to be made by Jousting Sticks Productions Pty Ltd. The 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.
19. The estimated completion date for the Film is August 2003 but will be no later than 30 June 2004 where the Production Agreement is entered into by 30 June 2002, or no later than 30 June 2005 where the Production Agreement is entered into by 30 June 2003, in order to satisfy the two year requirement in Division 10BA.
20. The budgeted cost of the Film is \$6,872,360 with an amount of \$6,047,360 (88%) being allocated to 'deductible expenses' and \$825,000 (12%) to 'non-deductible' expenses under Division 10BA.
21. Investors will make capital contributions towards the budgeted cost of the film under a contract entered into once the minimum subscription is achieved, which could be on or before 30 June 2002 or 30 June 2003.. The minimum subscription is the budgeted cost of the Film. No prospectus will be lodged and Investors will be sophisticated investors as set out in subsections 708(8)-(10) of the Corporations

Law. It is anticipated that each Investor will invest at least \$500,000 and generally not less than \$300,000 will be accepted.

Subscription Application Agreement

22. The Subscription Application Agreement is Schedule 3 of the Film Investment Deed. The Agreement is between Dawn to Stumps Pty Ltd, the Investor's Representative and the Investor. Under the terms and conditions of the Agreement an Investor agrees to be bound by the provisions of the Film Investment Deed. An Investor will forward a cheque for their capital contribution to Dawn to Stumps Pty Ltd drawn in favour of the Investors' Representative, who is required to deposit them into the Proceeds Account.

23. An Investors application to invest in the Film cannot be accepted until the minimum subscription of \$6,872,360, which is the Film budget, has been raised. On acceptance of their application an Investor will be entitled to share in the Film Copyright and Film Proceeds as outlined in the Film Investment Deed.

Film Investment Deed

24. The Film Investment Deed is between Dawn to Stumps Pty Ltd as Manager and the Investors' Representative. Clause 2.2 states that where Dawn to Stumps Pty Ltd and/or the Investors' Representative enters into any agreements relating to the Film Copyright they do so as agent on behalf of the Investors.

25. An Investor will contribute their investment as a portion of the budget prior to the 30 June 2002 or 30 June 2003. The year in which an Investor contributes to the budget will depend on whether the minimum subscription is reached on or before 30 June 2002 or 30 June 2003. In accordance with clause 7 each investment will be paid into a Proceeds Account under the control of the Investors' Representative. Upon attaining the minimum subscription the Investors' Representative is to pay \$6,047,360 into the Production Account and \$825,000 into the Non Deductible Account. The Production Account is controlled by Dawn to Stumps Pty Ltd, as Manager, and Jousting Sticks Productions Pty Ltd, as the Principal Production Company, and is for the deductible Division 10BA production costs of the Film. The Non Deductible Account is controlled by the Investors' Representative and is for the costs of the Film which are non deductible under Division 10BA.

26. Under clause 12.1 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 Film will be determined by the amount

of money contributed by the Investor compared to the total Investor contributions. The remaining 50% of the Copyright will be owned by Dawn to Stumps Pty Ltd. The Ancillary Rights, which are defined at clause 1.1, will be owned by Jousting Sticks Productions Pty Ltd (clause 12).

27. Each Investor will have a Copyright interest which is limited in that it expires on 30 June 2007 (clause 12 and definition of relevant period). Upon the expiry of the Investors' share of the Copyright, 100% of the Copyright will be owned by Dawn to Stumps Pty Ltd.

28. Clause 8.1 outlines the manner and order in which the Film Proceeds paid or payable to the Proceeds Account are to be applied. Proceeds from the distribution of the Film will be paid into the Proceeds Account net of distribution fees and expenses. The order of payments from the Proceeds Account is as follows:

- (a) first, in repayment of any moneys (if any) raised by the Completion Guarantor, the Principal Production Company or the Distributor to complete, finalise or enhance the Film, and any interest and associated expenses paid or payable with respect to these matters;
- (b) second, in payment of any remuneration deferrals (if any) of the Manager, Representative, the Principal Production Company or the Distributor or any person or company contracted to assist in the Completion of the Film;
- (c) third, in repayment to the Principal Production Company for any Overage (if any) paid for by the Principal Production Company from its own resources or from loans obtained by the Principal Production Company either in its own name or from any Investor which meets the criteria prescribed by subsection 708(8) of the Corporations Law for sophisticated investors together with interest and costs of the loans, and if repaying moneys advanced by the Principal Production Company to pay for Overage, interest at the Westpac Banking Corporation indicator rate for loans in excess of \$100,000 calculated on a daily basis, the interest being payable before principal;
- (d) fourth, in payment or repayment of any ongoing costs (including but not limited to Administrative Costs and any fees set out in the Offer Document) of the Film Project and in the setting aside moneys to meet the reserve requirements, storage and library maintenance costs, and in payment to the relevant Distribution Account for ongoing sales activities of an amount of

- \$20,000 or any other amount as from time to time determined by the Manager and the Distributor;
- (e) fifth, as a licence fee for granting the licence of its interest in the Copyright under clause 12, each Investor shall be entitled to a share of the Proceeds in the proportion that its Interest or Interests bears to the Total Interests until each Investor has received a sum equal to its Applicants' Contribution and 15% of the Applicants' Contribution for its Interest or Interests;
 - (f) sixth, the balance of the Proceeds in payment to the following persons is it persons or entities in the following percentages:
 - (i) the next \$5,000,000.00 of Proceeds, 50% to the Investors and 50% to the Manager, and
 - (ii) as to any further Proceeds, 25% to the Investors and 75% to the Manager.

Production Agreement

29. The Production Agreement is between Dawn to Stumps Pty Ltd as Manager, Jousting Sticks Productions Pty Ltd as the Principal Production Company and the Investors' Representative.

30. Under the Agreement Jousting Sticks Productions Pty Ltd undertakes to produce the Film as a 'qualifying Australian film' as defined in section 124ZAA(1) of the ITAA 1936.

31. Dawn to Stumps Pty Ltd shall direct Jousting Sticks Productions Pty Ltd, upon the attaining of minimum subscription, to establish an interest bearing Production Account (clause 6). The deductible Division 10BA production costs of \$6,047,360 will be transferred into this account (clause 2). Jousting Sticks Productions Pty Ltd will pay the production costs of the Film from this account. Any interest earned on the account, if not required for any Overages of the film, are to be paid into the Non Deductible Account and may be applied toward the cost of marketing (clause 6.2).

32. Under clause 9 Jousting Sticks Productions Pty Ltd is entitled to receive any Underage remaining on completion of the Film to a maximum amount of 5% of the deductible Division 10BA production cost. Clause 10.3 states that in the event an Underage occurs any Completion Guarantee Rebate shall be treated as Underage for the purposes of the calculation in clause 9. Underage in excess of 5% will be expended on the marketing of the Film or transferred to the Proceeds Account.

33. Clause 12.1 states the Copyright shall be Australian owned absolutely and beneficially in equal proportions by the Investors and Dawn to Stumps Pty Ltd as tenants in common, in undivided shares until 30 June 2007. From 1 July 2007 the ownership of the Copyright will pass to Dawn to Stumps Pty Ltd. Clause 12.3 entitles Jousting Sticks Productions Pty Ltd to be the sole and absolute owner of the Ancillary Rights.

Distribution Licence Agreement

34. The Agreement is between Dawn to Stumps Pty Ltd as Licensor and Off The Fence BV as licensee. The Film will be distributed worldwide, except for Australia and New Zealand, in respect of television and video media. The term of the Agreement will be 15 years and is renewable for a further 15 year period. The Film is to be delivered to Off the Fence BV by no later than August 2003. Off The Fence BV will be entitled to a Distribution Fee equal to 30% of Gross Receipts plus Distribution Expenses and the remaining proceeds will be paid to Dawn to Stumps Pty Ltd and deposited into the Proceeds Account.

35. There has been no Licence Agreement entered into with respect to Australia and New Zealand, however an agreement is expected to be entered into on similar terms and conditions as the Licence Agreement with Off The Fence BV.

Finance

36. 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 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 a borrower's risk;
- the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- 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.

Section 708 of the *Corporations Act 2001*

37. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by, an Investor under one of the exclusions in subsections 708(8)-(10) of the *Corporations Act 2001*. These provisions set out situations where a prospectus or similar disclosure document is not required.

38. An Investor who is a 'sophisticated investor' may accept an offer for interests in the project under subsections 708(8) and (9). 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;
- 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.

39. 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.

40. 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.

Ruling

Division 10BA

41. A deduction is available to an Investor in the Film under Division 10BA for 88% of the amount invested. Where an Investor who is registered or required to be registered for GST is entitled to an input tax credit on their investment, the tax deduction otherwise allowable will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). For example, for each \$100,000 contribution, a deduction of \$88,000, less any GST input tax credit, will be allowed as a deduction.

42. A deduction is not available until the production budget of \$6,872,360 has been achieved and the Investor has entered into the Subscription Application Agreement and the Film Investment Deed. The Investors Representative will advise Investors of the date this occurs.

43. Upon completion of the Film, after the audit has been carried out by an independent auditor, Division 10BA deductions will be withdrawn from Division 10BA Investors in respect of the moneys spent on non-tax deductible items, as per section 124ZAG.

44. Interest in respect of funds borrowed and any other revenue outgoings relating to the investment incurred by the Investors to make their contributions may be deductible to the Investors in accordance with section 8-1 of the ITAA 1997, but only to the extent of film income which is derived, as per subsection 124ZAO(2). Any excess interest and revenue outgoings may be carried forward indefinitely and offset against future film income, as per subsection 124ZAO(3).

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

Assessable Income

46. 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

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

Assumptions

48. 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) the investment moneys will be paid to the Principal Production Company by way of contribution to the cost of producing the Film under a contract entered into on or before the end of the financial year in which the capital moneys are to be expended, being 30 June 2002 or 30 June 2003, depending on when minimum subscription is reached. The production contract will specify that the investment moneys contributed represent the estimated cost of production of the Film (paragraph 124ZAF(1)(a) and subparagraph 124ZAF(1)(d)(iv));
 - (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 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 2004 where investments are accepted on or before 30 June 2002, or before 1 July 2005 where investments are accepted on or before 30 June 2003.
- (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;

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 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, Jousting Sticks Productions Pty Ltd will be entitled to a maximum amount of 5% of the deductible Division 10BA productions costs. Amounts in excess of 5% are to be expended on the marketing of the Film, or transferred to the Proceeds Account, 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 Film in respect of Division 10BA will be paid by the Investors' Representative from the Non Deductible Account.

Explanations

Division 10BA

The 'directly expended' requirement

49. 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.

50. 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 124ZAF A 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).

51. Our view is that the 'directly expended' requirement is not met at the point in time when the Investors make payments to Dawn to Stumps Pty Ltd in respect of the budget for the Film. Rather, the extent of the application of the money by Dawn to Stumps Pty Ltd 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.

52. The Investors will pay the application money to the Investors Representative who will transfer 88% of total application moneys to the Production Account for use towards the production costs. In doing this, the Principal Production Company is to ensure that this proportion of funds contributed by Investors is only expended on items within the Film's production budget.

53. 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 Jousting Sticks Productions Pty Ltd as 'underage'. In this regard, Jousting Sticks Productions Pty Ltd has agreed any underage they receive will be no greater than 5% of the deductible Division 10BA production costs. Amounts in excess of 5% will be expended on the marketing of the Film or transferred to the Proceeds Account.

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

55. Accordingly, while a deduction should be available in respect of the contributions made by Australian Investors, the deduction will be withdrawn with retrospective effect if the amounts contributed are not directly expended on the Film.

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 cannot be taken to mean that post-completion arrangements are also acceptable if they do not put funds into the hands of Investors to enable them to make their contributions. The position in paragraph 13 of IT 2111 is limited to the situations expressly mentioned.

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

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 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.

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 Film before the end of the financial year ending 30 June 2002 or 30 June 2003, depending on when Minimum subscription is achieved, 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

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)). Any excess interest may be carried forward to succeeding years of income for offset against future film income (subsection 124ZAO(3)).

Assessable Income

64. The Investors in *The Complete History of Cricket – From Dawn to Stumps* 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 a 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 from the Investors' Representative. 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

65. 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.

66. 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

67. 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.

68. 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.

Detailed contents list

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Commissioner of Taxation

19 June 2002

<i>Previous draft:</i>	- ITAA 1936 124ZAF(1)(a)
Not previously released in draft form	- ITAA 1936 124ZAF(1)(b)(i)
	- ITAA 1936 124ZAF(1)(c)(i)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 124ZAF(1)(c)(ii)
PR 1999/95; TR 92/1; TR 92/20;	- ITAA 1936 124ZAF(1)(d)(iii)
TR 97/16; TR 98/22; TD 93/34;	- ITAA 1936 124ZAF(1)(d)(iv)
IT 2111	- ITAA 1936 124ZAF(2)
	- ITAA 1936 124ZAG
<i>Subject references:</i>	- ITAA 1936 124ZAJ
- Australian films	- ITAA 1936 124ZAJ(1)
- film income	- ITAA 1936 124ZAM
- film industry	- ITAA 1936 124ZAM(1)
- interest expenses	- ITAA 1936 124ZAM(2)
- Product Rulings	- ITAA 1936 124ZAM(3)
- Public Rulings	- ITAA 1936 124ZAO
- tax avoidance	- ITAA 1936 124ZAO(2)
- tax administration	- ITAA 1936 124ZAO(3)
	- ITAA 1936 Part IVA
	- ITAA 1936 177A
<i>Legislative references:</i>	- ITAA 1936 177C
- ITAA 1936 26AG	- ITAA 1936 177D
- ITAA 1936 26AG(9)	- ITAA 1936 204
- ITAA 1936 Div 5 of Pt III	- ITAA 1997 8-1
- ITAA 1936 Div 10BA	- ITAA 1997 Div 27
- ITAA 1936 124ZAA(1)	- ITAA 1997 995-1
- ITAA 1936 124ZAA(6)	- Corporation Act 2001 708(8)
- ITAA 1936 124ZAB	- Corporation Act 2001 708(9)
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