



PR 2005/114 - Income tax: Film Investment - 'Vista Bay'

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 This document has changed over time. This is a consolidated version of the ruling which was published on *19 April 2006*



Product Ruling

Income tax: Film Investment – ‘Vista Bay’

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Preamble

*The number, subject heading, **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.*

*[**Note:** This is a consolidated version of this document. Refer to the Tax Office Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]*

Potential participants may wish to refer to the Tax Office website at www.ato.gov.au or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

No guarantee of commercial success

The Tax Office **does not** sanction or guarantee this product. 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 participants 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 and how the product fits an existing portfolio. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

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

Terms of use of this Product Ruling

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

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- section 26AG of the *Income Tax Assessment Act 1936* (ITAA 1936);
 - section 79D of the ITAA 1936;
 - section 82KL of the ITAA 1936;
 - Division 5 of Part III of the ITAA 1936;
 - Division 10BA of Part III of the ITAA 1936;
 - section 124ZAO of the ITAA 1936;
 - Part IVA of the ITAA 1936;
 - section 995-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Unless otherwise stated, all legislative references that follow are in relation to the ITAA 1936.

Goods and Services Tax

3. In this Ruling, where applicable, all fees and expenditure referred to include Goods and Services Tax (GST) set out in the *A New Tax System (Goods and Services Tax) Act 1999* (GST ACT). An entity is entitled to claim input tax credits for the GST included in its expenditure provided that the acquisition is a creditable acquisition under Division 11 of the GST Act.

Changes in the Law

4. Although this Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.
5. Taxpayers who are considering participating 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 participants in Produced Films such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

Class of persons

7. The class of persons to whom this Ruling applies is those persons more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (that is, being a party to the relevant agreements until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of these persons, referred to as Investors will have accepted an offer which qualifies as a small scale offer for the purpose of the *Corporations Act 2001* (refer to paragraphs 57 to 60).

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, who otherwise do not intend to derive assessable income from it or are non-residents of Australia for the purposes of the ITAA 1936 or ITAA 1997.

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. This work 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:

Commonwealth Copyright Administration
Attorney General's Department
Robert Garran Offices
National Circuit
Barton ACT 2600

or posted at: <http://www.ag.gov.au/cca>

Date of effect

11. This Ruling applies prospectively from 7 December 2005, 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 commenced and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Note: The Addendum to this Ruling that issued on 19 April 2006, applies on and from 5 April 2006.

Withdrawal

13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

14. The arrangement is the Vista Bay film investment and is described below. This arrangement incorporates the following documents:

- Application for a Product Ruling as constituted by correspondence and documents from the Applicant dated 10, 12 and 30 August 2005, 13 and 27 September 2005, 25 and 26 October 2005;
- Correspondence from the Tax Office to the Applicant dated 25 August 2005, 16 September 2005 and 21 October 2005;
- A draft **Investment Deed** between Vista Bay Productions Pty Limited, the Agent for the Investors and each Investor;

- A draft **Production and Investment Agreement (PIA)**, between Film Finance Corporation Australia Limited (FFC), Vista Bay Productions Pty Ltd and the Investors, received by the Tax Office on 8 September 2005;
- A Deal Memo between Rod Puskar Enterprises Pty Limited and Edgecliff Media Pty Limited, executed on 24 June 2005;
- The Deed of Variation #1 to the above Deal Memo, executed on 6 July 2005;
- A letter from Conquistador Entertainment, Inc. to the Distributor dated 20 April 2005;
- A letter from Film Finances, Inc. to the Production Company dated 30 June 2005; and
- Correspondence from the FFC to the Production Company dated 15 July 2005 and 30 September 2005.
- Correspondence from the FFC to the Production Company dated 4 April 2006;
- The Deed of Variation #2 to the above Deal Memo, executed on 5 April 2006; and
- An amended budget summary received by the Tax Office on 5 April 2006.

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 a 'personal offer' of a small scale offering for the purpose of the Corporations Act. This Ruling does not apply unless this occurs. A small scale offering is explained in paragraphs 57 to 60 in the Explanations area of this Product Ruling.

16. The documents highlighted are those that the Investors enter into. There are no other agreements, whether formal or informal, and whether or not legally enforceable, which an Investor, or an associate of the Investor will be a party to that are part of the arrangement to which this Ruling applies. The effect of the agreements is summarised as follows.

Background

17. A Provisional Certificate number 5322, dated 14 April 1998, was issued by the Department of Communications, Information Technology and the Arts (DCITA) in respect of a proposed film entitled 'Betrayed'. On 1 July 2005 DCITA amended their records to change the title of the proposed film to 'Vista Bay' (the Film). DCITA also confirmed the Provisional Certificate is currently in force.

18. The total budgeted cost of the Film is \$2,434,134 (GST exclusive) which comprises direct production costs of \$2,071,276 (GST exclusive) and non-deductible expenses of \$362,858 (GST exclusive).

19. In order to allow production of the Film to commence capital contributions equal to \$2,626,978 (GST inclusive) needs to be secured and the Production and Investment Agreement executed on or before 30 June 2006. To enable this to occur each Investor will be required to sign an irrevocable intention to invest letter in a form approved by the FFC. The signed irrevocable letters of intent are to be received by the Agent on or before 7 June 2006 and the total capital contribution commitment from Investors needs to equal \$1,495,407.

20. Once the irrevocable letters of intent have been received the FFC Board will meet to determine if they will invest \$1,182,140 toward the production of the film. If the FFC funding is approved the arrangement will proceed. If the FFC funding is not approved the irrevocable letters of intent will lapse, no funds will be received from Investors and the arrangement will not proceed.

The Participants

21. The parties involved in the arrangement are:
- **Investor:** A person, other than the FFC, who signs an Investment Deed, incurs capital expenditure in acquiring an interest in the Copyright in the Film and is listed as an Investor in Schedule 10 of the PIA.
 - **Film Finance Corporation Australia Limited (FFC):** The FFC have been approached to invest in the Film. The FFC investment is conditional on Investor funds being secured and final approval from the FFC Board. If the FFC funding is approved the FFC will incur capital expenditure in acquiring an interest in the Copyright in the Film in accordance with the terms of the PIA.
 - **Agent:** Christopher Coote & Co is prepared to be the Investors Agent, to act on behalf of the Investors.
 - **Cinematographic Rights Owner:** Edgecliff Media Pty Ltd owns all the intellectual property rights to the screenplay, Vista Bay. Provided the production budget is secured from the Investors and the FFC, Edgecliff Media Pty Ltd will assign the cinematographic rights to Vista Bay Productions Pty Ltd.
 - **Production Company:** Vista Bay Productions Pty Ltd will produce the Film in accordance with the terms of the PIA. Under the PIA the Investors and the FFC grant the Production Company an exclusive licence to

Market the Film throughout the world. The Production Company grants the Distribution Rights throughout the world to the Distributor under the terms of the Deal Memo.

- **Distributor:** Subject to Investor and FFC finance being obtained, Rod Puskar Enterprises Pty Ltd (RPE) will incorporate a new company, RP Film Distributors Pty Ltd. This company will obtain the Distribution Rights from the Production Company, for a period of 10 years from delivery of the Film, in accordance with the terms of the Deal Memo.
- **Sub-Distributor:** RP Film Distributors Pty Ltd will contract with Conquistador Entertainment, Inc. as the sales agent for the world excluding Australia and New Zealand (ROW Territory) on the terms and conditions in the letter from Conquistador Entertainment, Inc. to the Distributor, dated 20 April 2005.
- **Completion Guarantor:** Film Finances, Inc. is prepared in principle to give a guarantee of completion subject to their normal terms and conditions as per their letter dated 30 June 2005.
- **Collection Account Manager:** A Collection Account Manager (CAM) will be appointed in respect of the collection and disbursement of proceeds from the exploitation of the Film from the ROW Territory. All Gross Receipts for the ROW Territory will be paid into a ROW Collection Account. The CAM will pay amounts that Investors are entitled to receive into the Collections Account.

Defined terms

22. Terms which have been defined within the relevant documents to the arrangement include the following:

- **ANZ Gross Receipts** means all Gross Receipts derived from the Marketing of the Film throughout the ANZ Territory.
- **ANZ Territory** means the territories of Australia and New Zealand and their respective possessions.
- **Collections Account** means the Australian bank account into which Investor funds from the CAM and the Distributor are deposited for the ROW Territory and the ANZ Territory respectively. The account is counter signed by the Agent and the Production Company.
- **Collection Agreement** means the agreement between some or all of those persons entitled to Gross Receipts from the Marketing of the Film throughout the ROW

Territory and the CAM in respect of the disbursement of those receipts on terms approved by the FFC.

- **Copyright** means:
 - (a) Copyright in the Film under section 86 of the Copyright Act;
 - (b) Copyright in the Film under the law of a country other than Australia; and
 - (c) rights in the Film in the nature of or analogous to the rights in (a) and (b) of this paragraph under the law of Australia or any other country.
 - **Distribution Guarantee** means an amount equivalent to 25% of the cash budget of the Film, namely the sum of \$608,534 (GST exclusive).
 - **Distribution Rights** means the following sole and exclusive rights:
 - (a) All rights to exploit the Film in all media now known or hereinafter invented, including but not limited to: theatrical, non-theatrical, hotel video rights, video rights (home rental video, home sell through video, commercial video, video-on-demand, near video-on-demand), all video types including: cassette, videodisc, DVD, all video formats including: ntse and pal, basic cable television (cable, analog, and digital), free tv (terrestrial, cable satellite, analogue and digital), premium cable, closed circuit rights, pay television rights, linear new technology rights and, the right to market any 'making of' production. For the avoidance of doubt the foregoing licence of rights does not include any ancillary rights except to the extent licensed in paragraph (b);
 - (b) the following ancillary rights in respect of or in connection with the Film (ancillary rights): merchandising rights and soundtrack album rights, interactive new technology rights, clip rights (subject to clearance of cast, musicians, composers and music publishers);
- BUT does not include the spin off rights or the reserved rights.
- **Film Assets** means the underlying rights, the Film, the Copyright, the production assets (other than hired or leased assets) and the Marketing Materials.

- **Gross Receipts** means all money resulting from Marketing the Film whether arising under an agreement that came into effect before or after the date of the PIA and received by the Production Company, and/or any replacement appointed under clause 15.1 of the PIA, and includes without limitation:
 - (a) money received under insurances relating to Marketing the Film and payments into the Collections Account according to clause 7.5 of the PIA;
 - (b) money obtained in connection with any claim relating to the Film Assets;
 - (c) awards or prizes other than:
 - (i) those made to individuals for contributions to the making the Film; and
 - (ii) those made to the Film but customarily paid to individuals for contributions to the making of the Film;
 - (d) Intentionally deleted;
 - (e) money obtained from statutory licences under the Copyright Act and collection agencies such as the Audio-Visual Copyright Society Limited (AVCS); and
 - (f) interest accruing on money in the Collections Account.

Gross Receipts shall not include approved residuals, which shall be paid to the appropriate recipient.

- **Investment Account** means an Australian bank account described as the Investment Account in Schedule 3 of the PIA or an Australian account established as the Investment Account. This account will be countersigned by the Agent and the Production Company.
- **Major Territory** means Australia; North America; world as one territory including or excluding Australia; Europe (as one territory); Scandinavia (as one territory); UK; Spain; Italy; France; and Germany.
- **Market the Film (Marketing)** includes:
 - (a) promotion and exploitation of the Copyright and the underlying rights;
 - (b) securing to the Investors the Copyright and the underlying rights;
 - (c) protecting and prosecuting infringements of the Copyright and the underlying rights;

- (d) obtaining any benefit from statutory licences under the Copyright Act in relation to the Film;
 - (e) enforcement and ensuring compliance with the terms of sublicenses to Market the Film; and
 - (f) creation and use of the Marketing Materials.
- **Marketing Materials** means materials created to Market the Film, including posters, still photographs and artwork.
 - **Overage** means any sum over the budgeted cost required to complete, deliver and Market the Film as contemplated by the budget and the PIA, after deduction of any sum paid by the Completion Guarantor.
 - **Production Account** means an Australian bank account described as the Production Account in Schedule 3 of the PIA. This account will have two signatories nominated by the Production Company.
 - **ROW Collection Account** means the bank account in favour of the parties to the Collection Agreement (other than the CAM) established by the CAM according to the Collection Agreement in respect of ROW Gross Receipts (which shall be an interest bearing account) during the term of the Collection Agreement. The CAM will pay Gross Receipts into the Collections Account.
 - **ROW Gross Receipts** means all Gross Receipts derived from the Marketing of the Film throughout the world excluding the ANZ Territory.
 - **ROW Territory** means the world excluding the ANZ Territory.
 - **RPE** means Rod Puskar Enterprises Pty Ltd.
 - **RPE ANZ Distribution Guarantee** means the sum of \$121,707 (exclusive of GST).
 - **RPE Distribution Guarantee** means the sum of \$608,534 (exclusive of GST), comprised of the RPE ANZ Distribution Guarantee and the RPE ROW Distribution Guarantee.
 - **RPE ROW Distribution Guarantee** means the sum of \$486,827 (exclusive of GST).
 - **Security Interest** includes any:
 - (a) mortgage, pledge, lien, charge, encumbrance, option or third party security;
 - (b) contractual, proprietary or preferential interest or arrangement of any kind; and

- (c) right of or arrangement with any creditor to have its claims satisfied before other creditors from any asset.
- **Term** of the Distribution Rights granted to the Distributor means the period commencing on the date of the Deal Memo and continuing until the expiration of (10) years following due delivery of the Film to the Distributor.
- **Underage** means any part of the budgeted cost not spent on production of the Film and includes any sum treated or applied as Underage under the PIA.

Investor Agent Agreement

23. The Agent has agreed to act on behalf of the Investors and execute the relevant transaction documents. The Agent will be entitled to a fee of \$5,000 (GST exclusive). No fee will be payable to the Agent if the arrangement does not proceed.

Investment Deed

24. The Investment Deed is between the Production Company, the Agent on behalf of the Investors and each Investor specified at Item 1 of the Schedule.

25. The Investment Deed will only be executed on the conditions that the FFC funding is approved and the Investors irrevocable letters of intent equal \$1,495,407 (GST inclusive). Each investor will be required to pay their respective investment into the Agent's Investment Account.

26. Under clause 5 an Investor will be entitled to a share of the Film Assets, including the Copyright in the Film, as per item 3 of the Schedule. Pursuant to the PIA the Investors and the FFC licence the Production Company with their share of the Film Assets, including Copyright, to produce and Market the Film in accordance with the PIA (clause 8).

27. An Investor's share of Gross Receipts will be determined in accordance with Schedule 5 of the PIA (clause 6 and Item 4 of the Schedule). At clause 9 each Investor authorises the Agent or the Production Company to receive Gross Receipts on behalf of the Investor into the Collections Account. Gross Receipts are to be disbursed to the Investor within 60 days after receipt into the Collections Account. A detailed statement will issue with each disbursement to an Investor.

Production and Investment Agreement

28. The agreement is between the FFC, the Production Company and the Investors as listed in Schedule 10. The Agent, on behalf of the Investors, will pay the Investor contributions into the Production Account (clause 10.1).

29. On execution of the agreement the Production Company must have established the Production Account. If the Production Account is not interest bearing, clause 11.1 requires the Production Company to also establish an Investment Account. In accordance with clause 11.6 and Schedule 2 Part E, any interest that accrues from these deposits will be applied 45% to the FFC and 55% to the Investors.

30. In accordance with clause 3.1 the Production Company will assign each Investor and the FFC, free of any Security Interest, an interest in the Copyright, future Copyright and production assets and Marketing Materials of the Film when each Investor makes its payment into the Production Account. The Investors will own 55% of the Copyright as tenants in common and the FFC will own the remaining 45% (clause 3.2 and Schedule 2 Part A). The Investors will licence the Production Company to use the Copyright to produce and complete the Film (clause 4.1). The Investors interest in the Copyright will be for a term of 10 years, commencing from delivery of the Film, and the FFC will own their Copyright interest in perpetuity. The Investors interest in the Copyright reverts to the Production Company at the end of the ten year term.

31. The Production Company is to meet any Overage from its own resources (clause 12.1). Any Underage is to be paid to the FFC and it shall be deemed to apply towards recoupment of the FFC investment (clause 12.2 and Schedule 2 Part F).

32. On execution of the Collection Agreement the Production Company must have established the Collections Account and the CAM must have established the ROW Collection Account (clause 11.1 (a)).

33. At clause 15.1(a) the Investors appoint the Production Company to receive Gross Receipts derived from the ANZ Territories and to pay them into the Collections Account. At clause 15.1(b) the Investors appoint the CAM to receive and disburse all money derived from the ROW Territory and to operate the ROW Collection Account and undertake the Production Company's obligations under clause 14.7 according to the terms of the Collection Agreement. All payments Investors are entitled to receive under the Collection Agreement will be paid by the CAM from the ROW Collection Account into the Collections Account.

34. Under clause 15.2 the Production Company must issue irrevocable instructions to sub-licensees that ANZ Gross Receipts are to be paid into the Collections Account and ROW Gross Receipts are to be paid into the ROW Collection Account. The CAM will pay amounts Investors are entitled to receive into the Collections Account.

Distribution – PIA

35. At clause 14.1 of the PIA the Investors and the FFC grant the Production Company an exclusive licence of the Copyright, the underlying rights and the Marketing Materials for Marketing the Film throughout the world. The exclusive licence will commence on the date of the PIA and continue for the term of the Copyright. The Production Company may not receive any commissions from Marketing the Film (clause 14.5). In accordance with clause 14.3 the Production Company and the Distributor may not sub-licence its rights in Major Territories without the consent of the FFC.

Distribution – Deal Memo

36. The Deal Memo is between the Production Company and RPE as the Distributor. Under clause 2.1 the Production Company will licence to the Distributor the Distribution Rights throughout the world for a period of 10 years from delivery of the Film. At clause 2.3 the Distributor may sub-licence the Distribution Rights in accordance with the Deal Memo and with prior written approval of the Production Company and the FFC.

37. In consideration for the rights licensed to the Distributor, the Distributor agrees to pay a Distribution Guarantee equal to 25% of the production budget. This equals \$608,534 (GST exclusive) of which 20%, or \$119,408 (GST exclusive), is for the ANZ Territory rights and 80%, or \$486,827 (GST exclusive), is for the ROW Territory rights. The Distribution Guarantee is payable into the Collections Account, without deductions by the Distributor, as follows:

- 30% on delivery of the Film to the Distributor;
- 30% three months following delivery of the Film; and
- 40% six months after delivery of the Film.

38. At clause 2.4 the Distributor shall distribute the Film in the ANZ Territory on standard terms, including the following:

- Distributor to provide prints and advertising of at least \$120,000 (GST exclusive) for the Australian theatrical release of the Film;
- All theatrical receipts to be shared 50/50 between the Production Company and the Distributor, after the payment of prints and advertising; and
- The Distributor will be entitled to commissions of 20% from DVD/video, free to air, pay TV and ancillary rights.

39. The Distributor will be entitled to recoup its prints and advertising expenses, distribution expenses, commissions, fees and the ANZ portion of the Distribution Guarantee. The Distributor shall pay the balance to the Production Company who will disburse them in accordance with Schedule 5 of the PIA. Under clause 3.2 the Distributor will be entitled to recoup the ROW Distribution Guarantee from the ROW Territory Gross Receipts, after payment of the fees and expenses of the CAM and the fees and expenses of licensees in respect of the ROW Territory.

Sub Distribution

40. Under clause 2.3 of the Deal Memo the Distributor intends to enter into a sales agency agreement with a US sales agent, Conquistador Entertainment, Inc., for the ROW Territory. Conquistador Entertainment, Inc. will obtain the Distribution Rights for ten years in all media and will be entitled to sales commission of 20% plus Marketing expenses.

Collections Account Manager (CAM)

41. Under clause 4.1 of the Deal Memo the CAM will be appointed, as agent of the Production Company and Distributor, to collect and disburse Gross Receipts for the ROW Territory. The Distributor shall require all licensees for the ROW Territory to make payments directly to the CAM in accordance with their respective licence agreements.

42. The CAM, in its capacity as agent, will distribute Gross Receipts in the manner and the order as provided for in the PIA (clause 4.3 of the Deal Memo).

Distribution of Gross Receipts

43. Clause 15.3 and Schedule 5 Part A of the PIA outlines how Gross Receipts are to be disbursed:

- First: the RPE Distribution Guarantee to the Investors;
- Second all Gross Receipts to the FFC until it has recouped \$608,534 (GST exclusive) in total from all sources;
- Third all further Gross Receipts from all territories at the same time and in the following proportions to:
 - Investors: 60%
 - FFC: 40%until each of the FFC and Investors have recouped their investment in the Film;
- Fourth in payment, with the FFC's prior consent, to the Production Company of a sum equal to any Overage met by the Production Company;

Fifth	in payment of \$478,000 (GST exclusive) for cast, crew and facility provision as per the budget;	
Sixth	in payment of any sum due to the Completion Guarantor pursuant to the Completion Guarantee; and	
Seventh	to the following parties at the same time and in the following proportions:	
	FFC	22.5%
	Investors	27.5%
	Production Company	50%

44. Clause 15.4 of the PIA states that when the FFC has received Gross Receipts in accordance with Schedule 5 Part A, the Production Company is entitled to a share of the FFC's Gross Receipts until the FFC has recouped its investment. The Production Company's share of the FFC's Gross Receipts is outlined at Schedule 5 Part B of the PIA, as follows:

FFC:	80%
Production Company:	20%

Finance

45. Prospective Investors may make their own arrangements to obtain finance to invest in the Film. No assistance with the financing of investments will be offered by any parties involved in the arrangement.

46. This Ruling does not apply if a finance arrangement entered into by an Investor to fund the Investor's Investment in the Film 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;
- 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;
- 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;

- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved, in the provision of finance to Investors for the Project.

Ruling

Conditions precedent

47. No tax deductions will be available to Investors and the arrangement will not proceed unless the following conditions precedent are satisfied.

- The Agent will receive, by 7 June 2006, irrevocable letters of intent from Investors to contribute \$1,444,838 (GST inclusive) towards the production of the Film.
- The FFC will agree to invest \$1,182,140 (GST inclusive) toward the production of the Film.
- Investment funds totalling \$2,677,547 (GST inclusive) will be secured and the Investment Deed and Production and Investment Agreement will be executed on or before 30 June 2006.

Division 10BA

48. A deduction is available to an Investor in the Film under Division 10BA for the amount contributed toward the direct production costs of the Film.

Partnership and section 26AG

49. For the year ending 30 June 2006 and subsequent years of income, Investors who initially acquire 55% of the Copyright in the Film 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). The partners will receive income jointly from the commercial exploitation of their Copyright interest in the Film.

50. All amounts received by the Partnership in respect of the Film are assessable income of the Partnership under section 26AG in the income year in which they are received. 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. Any income derived will be taken to be the income of each Investor in proportion to their share in the partnership.

Section 124ZAO

51. Interest in respect of investment 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 from the Film (subsection 124ZAO(2)). Any excess interest and revenue outgoings may be carried forward indefinitely and offset against future income from the Film (subsection 124ZAO(3)).

52. The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling. Refer to paragraphs 76 and 77 for further information.

Section 79D

53. Section 79D does not apply to deny or defer the deductions otherwise allowable.

Section 82KL

54. Section 82KL will not be applied to deny deductions otherwise allowable.

Part IVA

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

Assumptions

56. 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 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 2006. 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 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 a final certificate 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 124ZAF(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 2007;
- (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, the Underage will be paid to the FFC in a manner that will preserve the status of the Film as a 'qualifying Australian Film'; and
- (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.

Explanation

Corporations Act

57. For this Ruling to apply, an offer for an interest in the Film must: be an offer which qualifies as a small scale offering as defined in section 1012E of the Corporations Act.

58. Small scale offers do not require a prospectus or product disclosure statement.

59. Under section 1012E, an Investor may participate in the project by accepting a 'personal offer' for an interest in the project. Offers made under section 1012E cannot be accepted by more than 20 investors in any 12 month period and these investors, in aggregate, must not invest more than \$2 million dollars (subsection 1012E(2)).

60. An offer will be a 'personal offer' where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 1012E(5)).

Division 10BA

The 'directly expended' requirement

61. 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.

62. Paragraph 8 of Taxation Ruling IT 2111 discusses this requirement. It states: 'Direct expenses on a film production which qualify for a deduction under section 124ZAA can generally be described as **those relating to the production process** as distinct from those associated with financing or marketing of the Film. Such expenses would **typically include amounts paid for the acquisition of story rights and the surveying of locations, payments to the producers, directors and cast, and the costs of insurance of production associated risks, drawing up performers' contracts and the building of sets and scenery**' (emphasis added).

63. The Tax Office 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 Budget 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.

64. The Investors will pay the Investment Amount to the Production Company who will deposit the money into a trust account controlled by the Investors Agent. The money will be held in the trust account until the Minimum Subscription is reached. When Minimum Subscription is reached the money will be transferred to the Production Account.

65. 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 parties have agreed that any Underage will be paid to the FFC.

66. 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 a producer (known as an audit of the Film) is considered inadequate in this regard.

67. 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

68. 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).

69. 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 (for example, 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.

70. 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.

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

Non-arm's length transactions

72. 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.

73. 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 fund would normally be required.

74. 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 2006 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.

Partnership and assessable income

75. The Investors in the Film 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). All amounts received by a Partnership of Investors in a Film 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.

Interest on borrowed funds

76. Investors should note that the deductibility of interest is outside the scope of this Ruling (refer to paragraph 46). However, interest incurred on borrowed funds should be deductible provided the finance arrangement does not contain any of the features identified in paragraphs 45 and 46.

77. 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 from the Film (subsection 124ZAO(2)). Any excess interest may be carried forward to succeeding years of income for offset against future film income from the Film (subsection 124ZAO(3)).

Section 79D

78. Section 79D does not apply where there are no 'foreign income deductions' (as defined in subsection 160AFD(9)).

79. The transactions covered by the arrangement do not give rise to 'foreign income deductions' because the deductions under Division 10BA do not relate to any 'assessable foreign income' (as defined in subsection 160AFD(9)). The income derived by the Investors under arrangement will have an Australian source and will not be 'assessable foreign income'.

Section 82KL – recouped expenditure

80. Section 82KL has no application to Division 10BA arrangements and is therefore not relevant to any deductions properly allowable to the Investors under Division 10BA.

Part IVA

81. 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.

82. 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

83. 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.

84. 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.

Detailed contents list

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- Not previously issued as a draft
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- Subject references:*
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 - film income
 - film industry
 - interest expenses
 - product rulings
 - public rulings
 - schemes and shams
 - tax administration
 - tax avoidance
- Legislative references:*
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