



PR 2005/98 - Income tax: film investment - Becker Filmed Entertainment Fund

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 This document has changed over time. This is a consolidated version of the ruling which was published on *29 June 2005*



Product Ruling

Income tax: film investment – Becker Filmed Entertainment Fund

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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.

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.*

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 124ZAG of the ITAA 1936;
- section 124ZAO of the ITAA 1936;
- Part IVA of the ITAA 1936;
- Division 35 of the *Income Tax Assessment Act 1997* (ITAA 1997), and;
- section 995-1 of the 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). A person or 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 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, (that is 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, referred to as 'Investors', will be wholesale clients for the purposes of the *Corporations Act 2001* (refer to paragraphs 62 to 66).

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, 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 29 June 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 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 2007 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 the Becker Filmed Entertainment Fund (the Fund) and is described below. This description incorporates the following relevant documents or parts of documents lodged with the Australian Taxation Office:

- Application for a Product Ruling that became valid on 15 April 2005 as constituted by documents received by the Tax Office on 1 April 2005, 15 April 2005, 11 May 2005, 18 May 2005, 19 May 2005, 30 May 2005 and 20 June 2005;
- Correspondence received from the Applicant dated 10 May 2005, 17 May 2005, 30 May 2005 and 20 June 2005;

- Draft **Becker Filmed Entertainment Fund Information Memorandum** including the **Application Form** and the **Fund Deed** between the Investors and BGL dated 13 April 2005 and received by the Tax Office on 15 April 2005, as amended on 30 May 2005 and 20 June 2005;
- Draft **Film Investment Deed** between Becker Group Limited (BGL), the Investors and the Producer for each Film in the Fund, in the form received by the Tax Office on 1 April 2005, as amended on 30 May 2005; and
- Draft Production & Investment Agreements between the Producer and Third Party Participants for each Film in the Fund, in the form received by the Tax Office on 18 May 2005;

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

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

16. In accordance with the above documents, an Investor who participates in the arrangement must be a wholesale client as defined in section 761G of the *Corporations Act 2001*. An explanation of the types of Investors that qualify as wholesale clients is provided in paragraphs 62 to 66 in the Explanation area of this Product Ruling.

The Participants

17. The parties involved in the arrangement are:

Investor: A person who signs the Application Form, becomes a first owner of a Copyright interest in the Selected Films and who uses that Copyright interest to derive assessable income by way of licence fees.

BGL: Becker Group Limited, upon signing of the Application Form by the Investors, will undertake a number of duties and responsibilities in the managing of the Fund. BGL's duties and responsibilities are as follows:

- accepting or rejecting applications from potential Investors;
- ensuring correct allocation of Fund Account moneys to individual Films pre 30 June 2005 to ensure 10BA deductibility;
- sourcing and negotiating appropriate Films for Fund investment, and making the final selection of the Selected Films as at the Closing Date;

- to sign Film Investment Deeds in respect of each Selected Film, as attorney for the Investors;
- entering into the Film Investment Deed for each Selected Film;
- establishing and maintaining the register of Investors;
- managing ongoing drawdown payments in accordance with the Film Production and Investment Agreements;
- reporting to Investors on all significant developments in the Films' production;
- sending, where required accounts of the Gross Receipts Share to Investors; and
- performing a Film supervisory and executive producer function through the approval rights contained in the Film Investment Deeds.

BGL will also undertake the following activities:

- BGL will be granted an exclusive licence in respect of the Investor Copyright Share, in consideration for payments of the Minimum Guaranteed Return and any Additional Returns to be made in accordance with the terms outlined in the Fund Deed and the Information Memorandum;
- guaranteeing to pay the Minimum Guaranteed Return and any Additional Returns to Investors under the terms of the Fund Deed;
- BGL will grant a sub-licence of the Investor Copyright Share to the Producer, in consideration for the right to receive the Gross Receipts Share; and
- obtaining, at any date on or after the Maturity Date, an independent valuation of the Films in the Fund and having the option of purchasing Investors' interests in the Copyright, and then disbursing the sales proceeds (if any) to Investors.

Producer: Each Film will be produced by a different Producer which will be responsible for producing, completing and delivering their Film pursuant to the Production and Investment Agreement for that Film. In the event that a related entity of BGL acts as the Producer, these arrangements will be on arms length terms and are disclosed in the Information Memorandum in relation to each individual Film.

Completion Guarantor: A Completion Guarantor will be appointed to act as Completion Guarantor for each of the Films under the terms of the Completion Guarantee prior to the commencement of production of the Films.

Defined terms

18. The terms which have been defined within the relevant documents to the arrangement include the following:

Additional Return means the licence fees payable by BGL to each Investor equal to the Gross Receipts Share, less the Minimum Guaranteed Return already paid to Investors, less the applicable manager and executive producer fees, and less any tax or other applicable deductions and expenses in accordance with clause 12 of the Fund Deed.

Application Fee means 2.2% for the first \$100,000 of the Investor Subscription Amount and 1.1% for all further Investor Subscription Amounts over \$100,000.

Available Copyright means the Copyright in each Selected Film available to be allocated and assigned to the Investors under a Film Investment Deed.

Closing Date means the date when BGL has accepted Total Subscriptions exceeding the Minimum Subscription and ceases to accept further applications, and being 28 June 2005 unless brought forward or extended by BGL (but no later than 30 June 2005).

Collection Account means the bank account(s) for each Film as described in each film's Production and Investment Agreement.

Completion Guarantee means the insurance-type arrangement under which the Completion Guarantor will guarantee that the Selected Film will be completed and delivered on time and on budget subject to certain exclusions for a fee payable out of the Production Budget of a Selected Film.

Copyright means at any relevant time, the copyright subsisting (or, if the context requires, expected to arise) in each part of the world in relation to each Selected Film, as a cinematograph film pursuant to the Copyright Act, including the right to do or authorise the doing of all or any of the acts specified in section 86 of the Copyright Act together with all rights necessary to enable, facilitate and authorise the distribution and exploitation of the Selected Film throughout the world, in any and all media.

Distributor means the party responsible for exploitation of the Copyright and related rights in the Selected Film for any defined territory, who may derive those rights for the International Sales Agent.

Film means a film or television project under consideration by the Fund.

Fund Account means a bank account opened and operated by BGL to hold Total Subscriptions.

Fund Agreements means in relation to the Investor:

- the Application Form;
- the Fund Deed; and
- each Film Investment Deed.

Gross Receipts means Gross Revenues less applicable Distributor and International Sales Agent marketing costs and commissions and other related deductions such as withholding tax. Gross Receipts are disbursed in accordance with the Production and Investment Agreement for each Selected Film.

Gross Receipts Share means BGL's share of Gross Receipts (pursuant to the Film Investment Deed) for each Selected Film actually received by BGL. Gross Receipts Share specifically excludes money received by BGL other than pursuant to the Film Investment Deed, such as consideration received by BGL for acting in the capacity of producer, distributor or sales agent in respect of a Selected Film.

Gross Revenues means all revenues from the marketing and exploitation of each Selected Film from all available sources including theatrical box office receipts, DVD/video sales and rentals, free to air, pay and satellite TV licensing, merchandising and all other media obtained by the International Sales Agent and/or the domestic Distributor.

Independent Expert means an independent third party valuer appointed by BGL in accordance with the procedure set out in the Fund Deed who will provide an independent valuation of the Investor Interests prior to the termination of the Fund in accordance with clause 19 of the Fund Deed.

International Sales Agent means the party responsible for international exploitation of the Copyright and related rights in the Selected Film for defined territories.

Investor Copyright Share means the Investor Share of Available Copyright held by each Investor in each Selected Film.

Investor Interests means the Investor's entire right, title and interest under the Fund Agreements, including the Investor Copyright Share.

Investor Subscription Amount means the amount nominated by each Investor in the Application Form as the Investor's Subscription Amount and actually paid to and accepted by BGL, excluding the Application Fee.

Maturity Date means 30 June 2011, the date when BGL pays the final instalment of the Minimum Guaranteed Return.

Minimum Guaranteed Return means licence fees equal to 82.5% (GST inclusive – see paragraphs 47 to 50) of Investor Subscription Amount, provided the Selected Films are completed and delivered, and regardless of actual total Selected Film revenues, or such greater amount up to 99% (GST inclusive – see paragraphs 47 to 50) advised by BGL at its sole discretion prior to the Closing Date based on pre-sales achieved, and payable by BGL to the Investor under Clause 11 of the Fund Deed.

Minimum Subscription means \$1,500,000 (exclusive of GST), or lesser amount as may be determined by BGL.

Non-Deductible Expenses means any expenses in connection with the production of the Film which are not capital moneys expended by way of contribution to the cost of production of the Film, as defined under Division 10BA.

Production Budget means the budget for each Film set out in the Production and Investment Agreement.

Selected Film means each Film nominated by BGL in accordance with the Fund Deed on or before 30 June 2005 ('December Boys', 'Feed' and/or 'Like Minds').

Third Party Participants means funding parties who have rights or entitlements in connection with a Selected Film but who are not the Investors.

Total Subscription means the total of the Investor Subscription Amounts.

The Fund

19. BGL will make an invitation to Investors, who are wholesale clients as defined in section 761G of the *Corporations Act 2001*, to invest in the Fund. Investment will involve an Investor paying to BGL the Investor Subscription Amount prior to the Closing Date.

20. The minimum amount an investor may invest in the Fund is \$25,000 (exclusive of GST), and in tranches of \$5,000 (exclusive of GST) thereafter. The Application Fee is charged in addition to this amount.

21. On acceptance of an application, BGL will take each Investor Subscription Amount and place the Funds in the Fund Account.

22. On or before the Closing Date, BGL will apply each Investor Subscription Amount to invest in the Selected Films which are 'qualifying Australian films' for the purposes of Division 10BA. The Films are itemised in the Information Memorandum. Depending on the level of funds raised under the offer, a varying number of Films will be funded and produced with the relevant agreements being entered into no later than the Closing Date between BGL and the relevant Producer. At that time BGL will allocate the production moneys for the production of those Selected Films.

23. BGL has the final decision as to which Films are selected and funded, as long as they meet the criteria set out in the Information Memorandum and Fund Deed. It is possible that in relation to one or more of the Films there may be investment or funding from Third Party Participants outside the Fund.

24. An Investor will not have expended capital moneys by way of contribution to the cost of producing a Selected Film until the Minimum Subscription for the Fund has been achieved, and the Film Investment Deed and the Production and Investment Agreement in respect of each Selected Film has been signed. Investors will make capital contributions towards the direct production costs of each Selected Film. If the Minimum Subscription is not reached then the Investors' money including the Application Fee, will be returned.

25. Each Investor will be entitled to become one of the first owners in the Copyright of each Selected Film. Each individual Investor's share in the Copyright of the Selected Film will be determined by the amount of money subscribed by the Investor and the amount allocated by the Fund in each Selected Film. The remaining balance of the Copyright in each Film will be owned by the Producer, BGL and/or Third Party Participants.

26. In the event that the direct costs of the production of a Film are lower than the estimated costs stated in the Production Budget, any underages will be firstly expended on other areas of production of the Film. Any remaining underages will be shared equally by BGL (as executive producer) and the Producer for that Film as an additional executive producer and/or producer's fee of up to 5.5% of the Production Budget of the Film.

27. Any Non-Deductible Expenses will be met directly by BGL or Third Party Participants. It will not be met out of the portion of the Production Budgets for the Films that the Investors' are funding. The exact amount of Non-Deductible Expenses will be determined only after the audit upon completion of the Film. Any amount deducted for moneys spent on Non-Deductible Expenses in the Production Budget paid for by Investors will be adjusted with retrospective effect in the subsequent year.

28. The estimated completion date for each of the Films depends upon a number of factors (principally the starting date and the length of filming required), but will be no later than 30 June 2007 in order to satisfy the two-year completion requirement of Division 10BA.

29. The Producer for each Film will enter into marketplace distribution agreements and will provide for the Distributors and International Sales Agents to pay revenues received to each Selected Film's Collection Account based on the sales performance of the Selected Films. BGL will receive the Gross Receipts Share paid from the Collection Accounts in accordance with the Film Investment Deeds.

30. BGL will be granted a licence for the Investor Copyright Share and pay licence fees to Investors of 8.8% (GST inclusive – see paragraphs 47 to 50) of their Investor Subscription Amount per annum for the years ending 30 June 2006, 2007, 2008, 2009, 2010, with a further 38.5% (GST inclusive – see paragraphs 47 to 50) of their Investor Subscription Amount by the Maturity Date, for a cumulative total 82.5% (GST inclusive – see paragraphs 47 to 50) of the Investor Subscription Amount, provided the Selected Films are completed and delivered, and regardless of actual total Film

revenues. These initial licence fees, or such greater amount advised by BGL prior to the Closing Date based on pre-sales achieved, are the Minimum Guaranteed Return. Investors will be advised of any increase in the Minimum Guaranteed Return in accordance with Clause 11.1(f) of the Fund Deed. The Minimum Guaranteed Return will not exceed 99% (GST inclusive – see paragraphs 47 to 50) of the Investor Subscription Amount. In the event that BGL defaults on the payment of the Minimum Guaranteed Return for any reason, then Investors may take a charge over future Gross Receipts Share. Further details regarding the Minimum Guaranteed Return are set out in the Information Memorandum and the Fund Deed.

31. BGL will pay any Additional Returns to Investors by 30 September 2011, and by that date in any year thereafter, unless and until the Investor Interests have been sold and the Fund is wound up as described in paragraphs 42, 43 and 44.

32. BGL will be entitled to various fees in respect of the establishment and management of the Fund. These fees will be met out of Gross Receipts Share arising from commercialisation of the Films, and not out of the Investor Subscription Amounts. Payment of these fees will not affect payment of the Minimum Guaranteed Return to Investors. Further details of the fees are set out in the Information Memorandum and the Fund Deed.

33. BGL may also perform an executive producer function in relation to certain production management and supervisory roles, through BGL's approval rights contained in the Films' Production and Investment Agreements. The executive producer fee will be taken from the Film's Production Budget, however for some Films, BGL may agree to defer the fee, in which case they will recover the fee from Gross Receipts Share, as described in the Information Memorandum and the Fund Deed. The executive producer fee will not affect the Investors' Minimum Guaranteed Return.

34. Investors are expected to derive assessable income from the Films from the year ending 30 June 2006 through to the year ending 30 June 2012.

Information Memorandum

35. Interests in the Fund are offered to Investors through an Information Memorandum which will have the Application Form and the Fund Deed attached.

Application Form

36. The Application Form is included in the Information Memorandum. By signing the Application Form the Investor becomes bound under the terms of the Fund Deed and gives Power of Attorney to BGL to enter into the relevant Film Investment Deeds for each Selected Film on their behalf, and agrees to appoint BGL to perform the various functions in managing and administering the Fund.

Fund Deed

37. The Fund Deed is included in the Information Memorandum. This Deed sets out the terms under which BGL will manage the Fund and perform certain functions. It sets out how BGL is granted discretion by the Investors to select the Films. It also sets out the terms under which, by way of the Film Investment Deed for each Film, the Investor will become the first owner of Copyright in the Films and receive the Investor Copyright Share, and will license the Copyright to BGL for commercialisation purposes, in return for the Minimum Guaranteed Return and any Additional Returns. It sets out how the Fund can be terminated at any time after the Maturity Date and the payment to Investors in respect of the sale of the Investor Interests. It also sets out the terms under which BGL will charge and receive certain fees for their management and executive producer role in the Fund and Films.

Film Investment Deed

38. The Film Investment Deed will be entered into on or before the Closing Date in respect of each Selected Film. This agreement between the Investor, BGL and the Producer sets out how the Investor will become entitled to be one of the first owners of Copyright in respect of the Film and receive the Investor Copyright Share. Investors will grant a licence of Investor Copyright Share to BGL, in return for the right to receive licence fee income. BGL will grant a sub-licence of the Investor Copyright Share to the Producer, to enable them to complete and commercialise the film under the terms of the Production and Investment Agreement. In consideration for this sub-licence, BGL will be entitled to receive from the sub-licencee all of the Gross Receipts Share arising from commercialisation of the Investor Copyright Share in the Film.

Production and Investment Agreement

39. The Producer will enter into a Production and Investment Agreement for each Film in the Fund with the Third Party Participants for each Film in the Fund. BGL, or related bodies corporate may also be party to this Agreement.

40. The Production and Investment Agreement for each Film sets out the terms and provisions under which:

- the Producer agrees to produce and complete the Film;
- the Producer will enter into marketplace distribution agreement(s); and
- the Copyright interests in the film are allocated.

41. The Producer will submit a drawdown request and provided the terms and conditions of the Production and Investment Agreement are satisfied then BGL will arrange for payment from the Fund Account to the Producer.

Sale of Copyright and Termination of the Fund

42. At any time after the Maturity Date, BGL may elect to purchase the Investor Interests at the value determined by the Independent Expert.

43. Once Investor Interests are sold, the Fund will be wound up with any final revenue due to Investors, after the deduction of the Independent Expert's costs, to be treated and disbursed to Investors as described in the Fund Deed.

44. In the event that BGL does not purchase the Investor Interests, then BGL continues to pay Investors by 30 September of each year any further Additional Returns due for each year ending 30 June.

Finance

45. There is no finance facility offered by BGL or any other party to the arrangement. Investors can fund their Investor Subscription Amount in the Fund themselves, or borrow from an independent lender. Regardless of the source of loan funds, this Ruling will not apply to Investors if BGL accepts their Investor Subscription Amount subject to finance approval by a lending institution and the full amount payable at the time of the investment is not paid to BGL on or before the signing of the Application Form and the execution of the Production and Investment Agreement or Film Investment Deed.

46. This Ruling will not apply if a finance arrangement entered into by an Investor to fund the Investor Subscription Amount if the arrangement includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Film 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 Film;

- the funds borrowed, or any part of them, will not be available for the conduct of the Film 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 Film are involved or become involved in the provision of finance to Investors for the Film.

Ruling

Assessable income

47. In relation to each Film, the Investors who acquire Copyright will comprise a tax law partnership for the purposes of Division 5 of Part III of the ITAA 1936 (see definition of 'partnership' in section 995-1 of the ITAA 1997) as they will be in the receipt of income jointly from the commercial exploitation of their Copyright interest in the Films.

48. All amounts received by a Partnership in respect of the Films, including the Minimum Guaranteed Return, the Additional Returns and any amounts paid for the acquisition of the Investor Copyright Share, less any GST on those licence fees, are assessable income of the Partnership under section 26AG of the ITAA 1936 in the income year in which they are paid to the Partnership. 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.

49. The licence fees received by BGL, from the producer under the terms of the sub-licence, less any GST payable on those licence fees, will be assessable income of BGL in the income year in which they are received.

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

Division 10BA

51. An Investor in the Fund is entitled to a deduction under Division 10BA. At or before the Closing Date, Film Investment Deeds and Production and Investment Agreements for each Film will be entered into under which moneys are allocated to the Film to produce the Project. At that point, provided the whole of the expected cost of producing the Film is contracted prior to 30 June 2005, the Investor will be entitled to a 100% deduction in respect of the moneys contributed to the cost of producing the Film.

52. In respect of each of the Films, each Investor will be entitled to become one of the first owners in the Copyright.

53. A deduction is not available until the Minimum Subscription for the Fund has been achieved and an Investor has entered into the Film Investment Deed and the Production and Investment Agreement has been signed.

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

Section 124ZAO

55. Interest in respect of investment funds borrowed and any other revenue outgoings relating to the Investor Subscription Amount 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)). Film income includes the Minimum Guaranteed Return, the Additional Returns and any amounts paid for the acquisition of the Investor Copyright Share.

56. The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling. Refer to paragraphs 84 and 85 for further information.

Division 35

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

Section 79D

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

Section 82KL

59. Section 82KL does not apply to deny or defer the deductions otherwise allowable.

Part IVA

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

Assumptions

61. 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) all of the investment moneys contributed by the Investors will be used by way of contribution to the cost of producing the Division 10BA Film. Moneys contributed by the Investors towards the cost of production of the Film will be directly expended in the production of the Film and will not be used by BGL, the Producer and/or distributor for any other purpose including funding distribution guarantees (paragraph 124ZAF(1)(a) read in conjunction with subsection 124ZA(6));
- (c) at the relevant time, a provisional certificate (section 124ZAB) or a final certificate (section 124ZAC) is in force in relation to the Film;
- (d) each Investor, at the relevant time, expects to become one of the first owners of the Copyright in the Film when the Copyright comes into existence (subparagraph 124ZAF(1)(c)(i));
- (e) each Investor, at the relevant time, intends to use the interest in the Copyright of the Film for the purpose of producing assessable income from the exhibition of the Film as mentioned in subparagraph 124ZAF(1)(c)(ii);
- (f) there will be in force a declaration lodged in respect of the Film in accordance with subsection 124ZAD(1) by a person accepted by the Commissioner under subsection 124ZAD(2) as an appropriate person to make such a declaration (subparagraph 124ZAF(1)(d)(iii));

- (g) before the expiration of six months after the time when the Film is completed, an application will be made for a final certificate in accordance with section 124ZAC, otherwise the provisional certificate shall be deemed never to have been in force (subsection 124ZAB(10));
- (h) all requirements of the Department of Communications, Information Technology and the Arts will be met and final certificates will be issued;
- (i) the Film will be completed and 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 first 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 Producer') for the supply of goods or the provision of services; and
 - the Commissioner is satisfied that the 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 Producer if the Producer and the person supplying the goods or providing the services had dealt with each other at arm's length (section 124ZAJ);
- (l) at the time the Investor expends the capital moneys by way of contribution to the cost of producing the Film, the Investor is at risk, according to the definition of 'risk' in subsection 124ZAM(2), with respect to an amount equal to or greater than the amount of those capital moneys expended (subsection 124ZAM(1));
- (m) no pre-sale arrangements, distribution rights agreements, distribution guarantee agreements, or other like agreements, have been, or will be, entered into in circumstances where such agreements would put funds into the hands of the Investors, by loan or otherwise, to enable them to expend capital moneys by way of contribution to the cost of producing the Film;

- (n) in the event of any underage, the Producer will expend the underage amount on the production and marketing of the Film in a manner that will preserve the status of the Film as 'qualifying Australian film';
- (o) the dominant purpose of the Investors is to make a commercial return from their investment in the Film and the arrangements will be executed in the manner described in this Ruling; and
- (p) non-deductible Expenses associated with the Film in respect of Division 10BA will not be paid by the Investors.

Explanation

Corporations Act 2001

62. For this Ruling to apply, an offer for an interest in the Fund must have been made to, and accepted by an Investor, who qualifies as a wholesale client as defined in section 761G of the *Corporations Act 2001*.

63. An Investor in the Fund may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the person satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c)); or
- the 'professional investor test' (paragraph 761G(7)(d)).

64. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' where:

- the minimum amount payable for the interests in the Fund on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the Fund on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the Fund of the same class that are held by the person add up to at least \$500,000.

65. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'individual wealth test' where, 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:

- has net assets of at least \$2.5 million; or
- has a gross income for each of the last 2 financial years of at least \$250,000 a year.

66. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'professional investor test' where:

- the person is a financial services licensee; or
- the person controls at least \$10 million for the purposes of investment in securities.

Partnership and assessable income

67. All amounts received by a Partnership of Investors in a Film, including the Minimum Guaranteed Return, the Additional Returns and any amounts paid for any acquisition of the Investor Copyright Share less any GST payable on those licence fees, will be assessable income of the Investors under section 26AG of the ITAA 1936 in the income year in which they are received. Although there exists a tax law partnership, subsection 26AG(9) provides that income of a partnership assessable under section 26AG is taken to be income derived by the partners/Investors. The amounts received as income are payments for the right to use the rights attaching to a 'qualifying Australian film' possessed by the Investors in respect of a particular period.

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

Division 10BA

The 'directly expended' requirement

69. 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.

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

71. The Tax Office view is that the 'directly expended' requirement is not met at the point in time when the Investors make payments to BGL in respect of the Production Budgets for the Films. Rather, the extent of the application of the money by the Producer to elements of production will ultimately determine the portion of the Investors' contribution that meets this requirement. Generally, this will not be known until after the completion of the Films. This ruling is based on an estimate of what this amount will be.

72. Each of the Investors will pay their Investor Subscription Amount to BGL, who will hold the money in the Fund Account. BGL will make the payments into each Film Production Account in accordance with each of the Production & Investment Agreements. In turn each Producer will use the total moneys received for application towards the production costs. In doing this, BGL is to ensure that the funds contributed by Investors are only expended on items within the Film's Production Budget.

73. In determining the amount that is 'directly expended' on the production of the Films, we will also consider the ultimate application of any funds obtained by the Producer as 'underage'. In this regard, the Producer has agreed any underage will be first expended on the production of the Films. In this instance, the executive producer and Producer will be entitled to a combined further amount not exceeding 5% of the Production Budget as additional producer's fees which will preserve the status of the Film as a 'qualifying Australian film'.

74. Quantification of the amount of money directly expended on the production of a film, and consequently the deduction available under Division 10BA, can only be determined after a film has been produced. To do this, a full audit of the application of the film production funds would normally be required. The practice of conducting an audit of the contribution account that is held by Producer (known as an audit of the 'film fund') is considered inadequate in this regard.

75. Accordingly, whilst this Ruling identifies a deduction for 100% of the contributions made by Australian Investors, the deduction can be withdrawn under the taxation law with retrospective effect if the amounts contributed and previously allowed as deductions are not directly expended on the production of the Films.

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

The 'at risk' rule

77. 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).

78. 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.

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

80. The arrangement ruled on involves a Minimum Guaranteed Return which will result in moneys equalling a minimum of 82.5% to 99% of the Investor Subscription Amount having been paid to them by the Maturity Date of the Fund. These guarantees do not attract the operation of section 124ZAM to the arrangement because firstly, they do not result in funds being placed into the hands of Investors to enable them to make their contributions to the costs of production of the Films, and secondly, Investors are at risk in relation to their total Investor Subscription Amount up until the time of completion of production of the Films. In addition, if BGL is unable to pay the Minimum Guaranteed Return, Investors will become unsecured creditors of BGL, although they may take a charge over future Film Gross Receipts Share.

Non-arm's length transactions

81. 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.

82. The Commissioner will not be in a position to determine whether his discretion in subsection 124ZAJ(1) ought to be exercised until such time as the Films have been produced. Furthermore, to make such a determination, a full audit of the Films' application and production funds would normally be required.

83. Accordingly, while a deduction should be available in respect of capital moneys expended by Investors by way of contribution to the cost of producing the Films of the Fund before the end of the financial year ending 30 June 2005, the deduction will be reduced with retrospective effect if the Commissioner determines that a producer of the Films of the Fund dealt with a supplier of goods or a provider of services, in the course of producing the Films, in circumstances where the parties were not dealing at arm's length and the producer paid more for the goods or the services than the producer would have paid had the transaction been at arm's length.

Interest on borrowed funds

84. Investors should note that the deductibility of interest is outside the scope of this Ruling (refer to paragraph 56). 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.

85. 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 (subsection 124ZAO(3)).

Division 35

86. Subsection 35-5(2) of the ITAA 1997 specifically provides that Division 35 of the ITAA1997, which regulates the deduction of losses from non-commercial business activities, is not intended to apply to 'activities that do not constitute carrying on a business, for example, the receipt of income from passive investments'.

87. The transactions covered by the arrangement amount to an acquisition of passive investments and the deriving of income from those investments. Hence, Division 35 of the ITAA1997 does not apply to the Fund.

Section 79D

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

89. 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 the Film Investment Deed for each Film will have an Australian source and will not be 'assessable foreign income'.

90. The Investors have no beneficial interest in the Gross Receipts Share received by BGL. The Investors are only entitled to the Licence Fees paid to them by BGL.

Section 82KL

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

Part IVA

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

93. 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 Films. There are no facts that would suggest that Investors have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing with each other at arm's length, or if any parties are not at arm's length, that any adverse tax consequences result. Further, there are no features of the Films, as described in the arrangement set out above, that suggest that the Films are so 'tax driven' and 'so designed to produce a tax deduction of a certain magnitude', that the operation of Part IVA is attracted.

Payment of interest by an Investor where an assessment is amended

94. 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.

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

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- Australian films
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- film industry
- interest expenses
- product rulings
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- schemes and shams
- tax administration
- tax avoidance

Legislative references:

- ITAA 1936 26AG
- ITAA 1936 26AG(9)
- ITAA 1936 79D
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 5
- ITAA 1936 Pt III Div 10BA
- ITAA 1936 124ZAA(6)
- ITAA 1936 124ZAB
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- ITAA 1936 124ZAFA(1)(b)(i)
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- ITAA 1936 124ZAFA(1)(c)(ii)
- ITAA 1936 124ZAFA(1)(d)(iii)
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- ITAA 1936 124ZAJ(1)
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