


TD 2001/D6 - Income tax: what characteristics of financial arrangements regarding investment in Australian films preclude a Division 10B tax concession?

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Draft Taxation Determination

Income tax: what characteristics of financial arrangements regarding investment in Australian films preclude a Division 10B tax concession?

Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered, views of the Australian Taxation Office. DTDs should not be relied on; only final Taxation Determinations represent authoritative statements by the Australian Taxation Office.

1. A number of financial arrangements have been established or proposed whereby a taxpayer, usually being a special purpose company created by an investor, incurs expenditure of a capital nature when purchasing a unit of industrial property which relates to copyright in an Australian film.
2. The characteristics of these arrangements are such that a deduction is not available pursuant to Division 10B of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936). These arrangements feature some or all of the following:
 - the contrived transfer of a tax benefit;
 - the immediate disposal of copyright, on non-arm's length terms, upon its acquisition;
 - the complete or substantial removal of any 'film success risk' to an investor, and the manner in which the removal is achieved;
 - the use of the consideration for purchase of the copyright to fund guaranteed returns to an investor or an associate;
 - the matching of such returns with the liabilities of an investor or an associate;
 - the effective presence of non-recourse loans;
 - the potential to claim two tax benefits in relation to one amount outlaid;
 - the realisation of a commercial return by means of a tax concession; and
 - the presence of dealings, which are not at arm's length, between the parties.

3. Such financial arrangements have many common characteristics. Typically, the investor makes a capital contribution to the special purpose company. This, together with a loan taken out by the company, funds the purchase of copyright from a film studio. The loan is guaranteed by the studio or by an entity nominated by the studio. At the time that the company acquires copyright, it licenses an associate of the studio to exclusively distribute the film under a distribution agreement. The fee formula under the distribution agreement is such that little, if any, licensing fee is paid to the company with most of the film receipts being retained by the studio or associate. The studio separately ensures that a minimum income, commensurate with the company's interest commitment in respect of its borrowing, will flow to the company. At the expiration of a set term, a put option is available such that the investor may dispose of the company at a substantial loss by selling its shares for a nominal sum to the studio or to an entity nominated by the studio. In the event that the put option is exercised the loan is essentially repaid by the guarantor.
4. The integrated nature of the various transactions and agreements entered into in connection with these arrangements and the terms of the agreements indicate that the parties to the arrangements are not dealing at arm's length in relation to the acquisition of copyright by the company and the licensing of the copyright under the distribution agreements.
5. The attraction of these schemes to a potential investor is founded upon the assumption that the Division 10B deductions equal to the cost of the film to the company are available to the company and the resulting tax loss can be transferred to the investor under Subdivision 170-A of the *Income Tax Assessment Act 1997*. Under the schemes the tax saving applicable to the transfer of the tax loss exceeds the investor's effective net outlay and the investor will profit regardless of how the film performs. The practical reality is that the company is not purchasing a film in order to commercially exploit the film. Rather, the investor participates in the schemes in order to obtain a substantial tax saving.
6. In cases we have examined, the company cannot be said to ever truly possess copyright. Therefore, it is not 'the owner' as defined in subsection 124K(1) of the ITAA 1936, and Division 10B has no application.
7. Alternatively, on the assumption that the company does become 'the owner', the key transaction documents lead to the conclusion that the company has acquired and then disposed of the copyright. In particular, the general tenor of the distribution agreement constitutes an in substance disposal of the copyright to the distributor. In these cases subsection 124M(4) of the ITAA 1936 applies and no section 124M deduction is allowable.
8. Similarly, no deduction is allowable under section 124N of the ITAA 1936. Since the relevant parties in this scheme are not dealing with each other at arm's length in respect of transactions concerning copyright, the allowable deduction is determined having regard to the provisions of subsection 124R(3), section 124S, and subsection 124T(2). As the value of the copyright does not change between the time of its acquisition by the company and its immediate disposal, the consideration for the disposal by the company is equal to the residual value.
9. Even if there has been a disposal of copyright in part, there can be no residual value for the purposes of section 124M. The residual value is determined having regard to subsection 124R(3), section 124S, and subsection 124T(2). In a practical sense the whole of the exploitable rights in relation to the film have been transferred to the distributor and the company retains no residual exploitable rights. For the purposes of section 124S the cost of the copyright to the company is equal to the consideration for the disposal in part.
10. Alternatively, if the company has not disposed of copyright, a section 124M deduction considerably less than the nominal cost of the copyright may, *prima facie*, be available. The cost of the copyright would be taken to be its value pursuant to subsection 124R(3). Given that the company's use of the copyright is restricted to its dealings with the associate of the film studio by means of the distribution agreement, the value of the copyright acquired would reflect its value to the company pursuant to the distribution agreement.

11. In any event, section 82KL and/or Part IVA of the ITAA 1936 apply to the situations set out above to deny any deduction otherwise allowable under Division 10B. Matters relevant to the application of section 82KL and Part IVA include the characteristics set out above in paragraph 2.

Note:

This draft Taxation Determination has no implications for investments under the Film Licensed Investment Company measures.

Your comments

12. We invite you to comment on this draft Taxation Determination. We are allowing 4 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

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Commissioner of Taxation

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Previous draft:

Not previously issued in draft form

Related Rulings:

IT 2629; TR 2000/8

Subject references:

- investment in Australian films
- copyright
- purpose of obtaining tax benefit

Legislative references:

- ITAA 1936 82KL
 - ITAA 1936 Part III Div 10B
 - ITAA 1936 124K(1)
 - ITAA 1936 124M
 - ITAA 1936 124M(4)
 - ITAA 1936 124N
 - ITAA 1936 124R(3)
 - ITAA 1936 124S
 - ITAA 1936 124T(2)
 - ITAA 1936 Part IVA
 - ITAA 1997 Subdiv 170-A
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ATO references:

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