TD 2005/D52 - Income tax: for the purposes of Division 376 of the Income Tax Assessment Act 1997, does film production expenditure include insurance premiums payable under 'extra expense' policies?

This document has been finalised by TD 2006/2.

Draft Taxation Determination

Income tax: for the purposes of Division 376 of the *Income Tax Assessment Act 1997*, does film production expenditure include insurance premiums payable under 'extra expense' policies?

Preamble

This document is a draft for industry and professional comment. As such, it represents the preliminary, though considered views of the Australian Taxation Office. This draft may not be relied on by taxpayers and practitioners as it is not a ruling for the purposes of Part IVAAA of the ***Taxation Administration Act 1953****. It is only final Taxation Determinations that represent authoritative statements by the Australian Taxation Office.*

1. No, film production expenditure for the purposes of Division 376 of the *Income Tax Assessment Act 1997* (ITAA 1997) does not include premiums for 'extra expense' policies.

2. 'Extra expense' policies are insurance policies that provide for the payment of a benefit to cover the additional production expense of further production activities likely to be required by the insured event, or the production expense lost because of the insured event. Examples include 'film producer's indemnity' insurance, paying for additional costs or losses in film-making resulting when sickness, injury or death prevent a named person from performing their duties in making the film; 'extra expense' insurance, paying for additional costs of film-making arising from interruption, postponement or cancellation of the film; 'negative film risk' insurance, paying for the additional costs of re-shooting due to loss or damage to exposed film or recorded tape; 'weather insurance', covering additional production costs resulting from adverse weather; and 'faulty stock, camera and processing' insurance, paying for additional costs of re-shooting due to stock, camera or processing faults. 'Cost blow-out' insurance, assuring additional funding to complete film-making if specific costs go over budget, is the most general kind of extra expense policy. Such policies may be specifically limited in their payout by reference to the expenses contemplated in the budget for the film.

3. Division 376 of the ITAA 1997 entitles an Australian film production company to a refundable tax offset for certain Australian production expenditure the company incurs in making a certified and completed film. The offset requires qualifying Australian production expenditure (QAPE) of at least $50 million, or if QAPE is at least 70% of total production expenditure then it need only exceed $15 million.

4. The amount of the tax offset is 12.5% of the company's QAPE on the film (section 376-10 of the ITAA 1997).

5. Generally speaking, QAPE is so much of the production company's production expenditure on the film as is on goods and services provided, land located, or goods used, in Australia. Some special Australian inclusions are added, and are added to production expenditure (section 376-45 of the ITAA 1997). Some expenditures are excluded, particularly all expenditures incurred when the production company is not Australian (section 376-50 of the ITAA 1997).

6. Similarly, production expenditure is incurred in or in relation to making the film, or is reasonably attributable to using equipment or facilities for making the film or activities in making the film. Making the film is defined, and a number of expenditures are specifically excluded from being production expenditure. Financing expenditure is excluded from production expenditure.

7. Financing expenditure, defined as expenditure incurred by way of or in relation to the financing of the film, and including returns payable on amounts invested in the film and expenditure in relation to raising or servicing finance for the film, is specifically excluded under Item 1 of the table in section 376-35 of the ITAA 1997.

8. Expenditure incurred in relation to raising the finance for a film would include the establishment costs of obtaining a loan, such as fees paid to intermediaries. This would also include expenditure incurred in relation to obtaining insurance cover that is a financing cost (such as brokers' fees).

9. Premiums for insurance that relates to finance that has been obtained, or that is obtained at the insistence of a financier in the course of obtaining finance and in order to obtain it, is clearly expenditure which 'relates' to obtaining finance. Where the financier intends to rely on the proceeds of the insurance policy to ensure repayment of its money, and requires the insurance to be taken out for that reason, the relationship between the premium and obtaining finance is even clearer. 'Completion guarantee' insurance is of this kind. The completion guarantor effectively uses its money to complete the film as originally agreed upon and generally pays the necessary production expenses directly. Often 'completion guarantee' cover will be obligatory to assure distributors, foreign talent, and financiers that the film will be completed and delivered.

10. Money received under an insurance policy may be sought both to indemnify loss and to provide finance (or in relation to the provision of finance). The question here is whether the purpose of the insurance is to finance the completion of the film (or the repayment of the financier) if the relevant circumstances arise. Where an insurance policy provides money to continue shooting the film in the event that costs exceed available finance, the premium is no more than a cost of obtaining contingent finance, and indistinguishable from an establishment fee for obtaining an overdraft or a draw-down facility. It is a payment in return for a right to have money, should it be needed, to be used to shoot the film. The premium for such insurance is expenditure incurred in relation to financing the film. The insurance is as a matter of substance to provide against the loss which would ensue to the financiers, as a result of an insured event preventing the producer from completing the film due to a lack of money.

11. Insurance policies such as: props, sets and wardrobes; miscellaneous equipment; money; and public liability have no particular connection with funding the film's completion or obtaining or servicing finance to do so. These policies apply to potential costs of risks to equipment or from events occurring in the course of making the film, and are limited to the period in which the film is being made. In a sense, all insured risks affect the film's budget, but these insured risks are not paid out to cover the waste of past production expenditures or paid to meet and measured against additional production costs in completion of the film. Hired wardrobe need not be accidentally destroyed and so paid for; other people's equipment need not suffer unintended damage needing compensation; money need not be lost or stolen so as to need replacement; harm need not be caused to third parties leading to public liability payouts. The premiums for these risks are expenditure in, or that relates to, making the film and are not expenditure in, or related to, obtaining finance.

12. Insurance policies for 'extra expense' such as: film producer's indemnity; negative film; faulty stock, camera and processing; and weather are mainly entered into for the purpose of ensuring that money or capital in excess of the film's budget will be available to complete the film if the budget is exceeded as the result of an occurrence of an insurable event. 'Extra expense' policies cover the additional cost of production where an insured event leads to that extra cost. The primary purpose for entering into the 'extra expense' policy is to ensure that sufficient capital will be available to make the film if an insurable event occurs, or to pay out the financier if the film is not completed.

13. The 'extra expense' insurance by its very terms shows the relationship between the loss insured against and the film's budget and finance, and expenditure for such insurance cover is financing expenditure.

Date of effect

14. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will 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 Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Your comments

15. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

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Commissioner of Taxation
9 November 2005

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/20

Subject references:

- Australian films
- film tax offset
- films
- insurance expense

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1997 Div 376
- ITAA 1997 376-10
- ITAA 1997 376-35
- ITAA 1997 376-45
- ITAA 1997 376-50

ATO references

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