

# ***PR 2001/64 - Income tax: film investment - The Secret of a Glass of Water***

⚠ This cover sheet is provided for information only. It does not form part of *PR 2001/64 - Income tax: film investment - The Secret of a Glass of Water*

⚠ This document has changed over time. This is a consolidated version of the ruling which was published on *16 May 2001*



# Product Ruling

## Income tax: film investment - The Secret of a Glass of Water

Contents	Para
What this Product Ruling is about	1
Date of effect	14
Withdrawal	16
Arrangement	17
Ruling	47
Explanations	49
Detailed contents list	68

### Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including Tax law(s), Class of persons and Qualifications sections), **Date of effect, Withdrawal, Arrangement and Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the Taxation Administration Act 1953. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

### No guarantee of commercial success

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product as an investment. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential investors must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential investors by confirming that the tax benefits set out below in the **Ruling** part of this document are available, **provided that** the arrangement is carried out in accordance with the information we have been given, and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, investors lose the protection of this Product Ruling. Potential investors may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

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

### Terms of Use of this Product Ruling

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

Potential investors may wish to refer to the ATO's Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

## 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. In this Ruling this arrangement is sometimes referred to as 'The Secret Of A Glass Of Water', 'the Film', 'the Product' or as 'the Project'.

### Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Division 10BA of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936);
  - Section 26AG (ITAA 1936);
  - Part IVA (ITAA 1936);
  - Section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997);
  - Section 17-5 (ITAA 1997);
  - Division 27 (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 *New Tax System (Goods and Services Tax) Act 1999* ('the GST Act'). In order for a person or entity to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered, or required to be registered for GST under the GST Act and hold a valid tax invoice. GST is payable on a taxable supply by the person or entity making the taxable supply.

### Business Tax Reform

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the laws enacted at the time it was issued, future tax changes may affect the operation of those laws and, in particular, the tax deductions that are allowable. Where tax laws change, those changes will take precedence over the

application of this Ruling, and to that extent, this Ruling will be superseded.

5. Taxpayers who are considering investing in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

### **Note to promoters and advisers**

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for investors in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that potential investors are fully informed of any changes in tax laws that take place after the Ruling is issued. Such action should minimise suggestions that potential investors have been negligently or otherwise misled.

### **Class of persons**

7. The class of persons to which this Ruling applies is those persons who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed, i.e., being a party to the relevant agreements until their terms expire, and deriving assessable income from this involvement as a result (as set out in the description of the arrangement).

8. The class of persons to which this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

### **Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling.

10. 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, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

11. Note: without limiting the generality of the term, a 'material difference' this may arise in relation to a variation in the facts of the arrangement described in the Ruling. It may also arise in circumstances where additional transactions or arrangements

(including financing arrangements) are entered into that, when viewed as a whole with the arrangement described in the Ruling, will produce a different taxation consequence from the arrangement described in this Ruling.

12. This might include, for example, where the investor borrows to enter into the arrangement by way of a limited or non-recourse loan and the overall consequence might be that the arrangement is one that would have attracted the application of a tax avoidance provision. A material difference may also arise where an investor enters into or benefits from any device which limits or eliminates the risk in respect of the amount contributed by the investor.

13. A Product Ruling may only be reproduced in its entirety. Extracts may not be reproduced. As each Product Ruling is copyright, apart from any use as permitted under the *Copyright Act 1968*, no Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

## **Date of effect**

---

14. This Ruling applies prospectively from 16 May 2001, 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).

15. 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**

---

16. This Product Ruling is withdrawn on 30 June 2004 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

people, 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**

---

17. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Draft of the Product Ruling received electronically on 27 February 2001;
- Application for a product ruling and Product Ruling Checklist dated 9 October 2000, received from Clondy Pty Limited (Clondy);
- Draft Offer Information Statement;
- Draft Production and Distribution Agreement (P& D Agreement);
- Writer's Agreement between Clondy and Igor Grabovsky dated 15 September 2000;
- Composer's and Sound Recorder's Release between Clondy and Igor Grabovsky dated 15 September 2000;
- The Letters of Appointment of Executive Producers and Producer dated 14 September 2000;
- The Constitution of Clondy;
- The Production Budget dated 17 September 2000;
- Correspondence received from Clondy dated 27 November 2000, 14 December 2000, 6 January 2001, 26 January 2001, 2 February 2001, 20 February 2001;
- Correspondence from the ATO to Clondy dated 5 December 2000.

18. The details of the arrangement are summarised as follows:

## **The project**

19. The project involves the production and distribution of an Australian feature film for television entitled 'The Secret of a Glass of Water'. At the date of issue of this Ruling the title is provisional. The screenplay was written in 2000 by Igor Grabovsky and is based on a literary work of 18<sup>th</sup> century dramaturge Eugene Scribe.

20. A Provisional Certificate, number PO 5918, for the film was issued by the Department of Communications, Information Technology and the Arts on 26 September 2000. The certificate states that the film will, when completed, be a 'qualifying Australian film' for the purposes of Division 10BA of the ITAA 1936.

21. The total budgeted cost to produce the film is \$600,000. The entire budget will be raised from investors who are Australian residents for tax purposes. The minimum investment is \$30,000 with increments thereafter of \$15,000. No more than 20 Investors can invest in the Film.

22. The monies raised from investors will be made available to start production only upon reaching the minimum subscription of \$510,000. Until the date that the minimum subscription is reached, all such monies will be kept in the Film Production (Investment) Account of Clondy. All the interest accumulated from investors' monies will be allocated in the budget under the 'Contingency' clause and will be spent productively and directly into the production of the film.

23. In the event that the direct costs of the production of the film are lower than the estimated costs stated in the budget, any underages will be allocated in the budget under the 'Marketing' clause and will be spent on the promotion and distribution of the film. In the event that underages cannot be productively spent in distributing the film, they will be distributed back to the investors in proportion to their initial investments.

24. An Investor will not have expended capital money by way of contribution to the cost of producing the Film until after the minimum subscription has been achieved and the Investor has entered into the Production and Distribution Agreement.

25. In accordance with the budget, an amount of \$534,000 will be spent on the production of the film. The budget has been prepared in accordance with the standard industry format. No producer's profit margin is allocated in the budget. Clondy will start the production upon reaching the minimum subscription.

26. The 'non-deductible' expenditures outlined in the budget are not deductible in respect of Division 10BA, these expenses are:

Brokerage	\$60,000
Finance & Legal	\$ 5,000
Publicity	<u>\$ 1,000</u>
<u>TOTAL</u>	\$66,000

The estimated amount of \$66,000 represents 11% of the total budget of \$600,000.

27. The exact amount of non-deductible monies will be determined only after the audit upon completion of the film. The amount deducted for monies spent on non-deductible items in the budget will be adjusted with retrospective effect in the subsequent year.

28. The estimated completion date for the Film is July 2001. This date largely depends upon reaching the minimum subscription of \$510,000, but will be no later than 30 June 2003 in order to satisfy the two-year requirement of Division 10BA.

29. Investors are expected to earn assessable income from the exploitation of the rights of the film over a period of five years. This five-year period will commence with the completion of the film.

### **Production and Distribution Agreement**

30. Investors will deposit their contributions under the Offer document into the Film Production (Investment) Account of Clondy. This account is separate from any other accounts and a maximum total of \$600,000 will be deposited into the account.

31. No funds can be drawn upon until the minimum subscription of \$510,000 is reached (clause 1.17).

32. Each investor will sign and enter into a Production and Distribution Agreement with Clondy. Investments are irrevocable. Clondy will issue 40 (forty) Copyright Certificates for \$15,000 each. Each Certificate will represent 2.5% of the copyright in the film. Copyright Certificates will be sent out to investors upon reaching the subscription of \$510,000.00. In the event of a joint investment, when two or more persons make a minimum investment jointly, all entitlements, and revenue distribution, will be available to the participants in proportion to their contributions.

33. Upon reaching the subscription of \$510,000 Clondy will issue "A" Class Shares for \$1.00 each. Each "A" Class Share represents one vote at general meetings of the Company related to "A" Class Shares. In the event of a joint investment, when two or more persons make a minimum investment jointly, only the person whose name appears on the "A" Class Share first, has a voting right. A quorum for a General Meeting of "A" class shareholders is 100% and a resolution

is valid upon approval by 75% of "A" class shareholders (Clauses 1.56.4 and 1.56.5).

34. The Copyright Certificate and "A" Class Share are two separate documents. Copyright Certificates define Investors' entitlement in the Copyright of the Film and "A" Class shares regulate the relationship between participating parties in the project via the company's structure (Constitution).

35. The "A" Class Share cannot be issued to investors without obtaining the Copyright Certificate and vice-versa (clause 1.10).

36. Upon reaching the minimum subscription Clondy will pay \$21,000 to entitled parties for the script and music rights and it will repay loans, for budgeted items, provided by the Executive Producer(s) (clause 1.18).

37. Clondy will not charge Investors any management fee, apart from audit fees, until 30 June 2001 (clause 1.49). The audit fee for the financial year 2000-2001 is allocated in the budget.

38. After 30 June 2001 an annual management fee of \$10,000 will be paid to Clondy. The fee will be drawn from revenue earned by the film prior to that revenue being distributed to participating parties (clauses 1.50 and 1.51).

39. Upon completion of the film, the full audit will be carried out by an independent auditor for an opinion on the exact amount (percentage) of tax deductible capital expenditure (clause 2.34).

40. Clondy will notify Investors in writing of the date the Film is completed, the Delivery Date (clause 2.31). This will be the date Clondy assigns the copyright of the Film to Investors for the period of five years (clauses 1.30 and 1.31).

41. All revenue received from the exploitation of the rights of the film by a sub-distributor to various media on various territories, less expenses and relevant fees, will be deposited into the Distribution Account of Clondy (clauses 1.39 and 1.40).

42. Investors will receive distributions from the Distribution Account until their initial investment in the Film is 100% recouped (clause 1.43). After the Investors' contributions have been fully recouped future distributions will be split 60:40 between Investors (60%) and Clondy (40%) (clause 1.45).

## **The participants**

43. **Clondy Pty Limited (Clondy)** [ACN: 087 789 964] will act as 'the producer' and as 'the distributor' of the film, using respectively Distributor and Production arms. Mr Igor Grabovsky is a Director of

Clondy and Film Director. Mrs Inna Grabovsky is a Director of Clondy.

44. **Clondy Records** [partnership, registration number R5796111] will act as composer and sound recorder (musical score) for the film. Mr Igor Grabovsky and Mrs Inna Grabovsky are the partners of Clondy Records.

45. Mr Igor Grabovsky, Mr James Mitchell and Mr Nick Gillott are Executive Producers for the Film. Mr Igor Grabovsky is the Film director and screenplay writer.

### **Finance**

46. This Ruling does not apply if an Investor enters into a finance arrangement with any of the following features:

- there are split loan features of the type referred to in Taxation Ruling TR 98/22;
- entities associated with the Project are involved, or become involved, in the provision of finance to Investors for the Project;
- there are indemnity arrangements, or other collateral agreements, in relation to the loan, designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to a borrower, for the purposes of section 82KL, or 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 principal and payments of interest are linked to derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project, but will be transferred (by any means, and whether directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- the terms or conditions are not arm's length.

## Ruling

---

### Assessable income

47. Subject to the assumptions listed below at paragraph 48 of this Ruling:

- A deduction is available to an Investor in the Project under Division 10BA of the ITAA 1936 for 89% of the amount invested in the year that the investment is made. Where an Investor who is registered or required to be registered for GST is entitled to an input tax credit on their investment, then the tax deduction otherwise allowable will exclude any amounts of input tax credit (Division 27 of the ITAA 1997). For example, for each \$15,000 contribution, a deduction of \$13,350, less any GST input tax credit, will be allowable as a deduction.
- A deduction is not available until the minimum subscription of \$510,000 has been achieved and an Investor has entered into the Production and Distribution Agreement.
- Any amounts payable to the investors for the exploitation of their interest in the copyright and rights attached thereof, less any GST payable on these amounts, will be assessable to the investors as film income under section 26AG of the ITAA 1936. Section 17-5 excludes from assessable income an amount relating to GST payable on a taxable supply.
- Interest incurred in respect of funds borrowed by the investors to make their contributions will be deductible to the investors under section 8-1 of the ITAA 1997, but only to the extent of assessable film income for the year (subsection 124ZAO(2)). Any excess interest may be carried forward indefinitely and offset against future film income (subsection 124ZAO(3)).
- Upon completion of the film, after the audit has been carried out by an independent auditor, deductions will be withdrawn in respect of the monies spent on non-tax deductible items of the budget (subsection 124ZAG).
- The anti-avoidance provisions in Part IVA will not be applied to deny deductibility or to accelerate accessibility of the above amounts.

48. This Ruling is made subject to the following assumptions:

- (a) The Investor was a resident of Australia for tax purposes at the time the money was expended (subparagraph 124ZAF(1)(b)(i));
- (b) The investment moneys contributed by the Investors will be used by Clondy by way of contribution to the cost of producing the film. Moneys contributed by the Investors towards the cost of production of the film will be directly expended in the production of the film (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 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 final certificates will be issued;
- (i) The film will be completed and the Investors' interest in the copyright in the film will be used for income producing purposes within two years after the close of the financial year in which the contributions are made (subsection 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 2003;

- (k) In producing the film:
- where an amount is expended by a person ('the film producer') for the supply of goods or the provision of services; and
  - the Commissioner is satisfied that the film producer and the person supplying the goods or providing the services are not dealing with each other at arm's length in relation to the transaction;
- that the amount of moneys expended on the supply of those goods or the provision of those services will not exceed the amount of moneys that would have been expended by the film producer if the film producer and the person supplying the goods or providing the services had dealt with each other at arm's length (section 124ZAJ);
- (l) At the time the investor expends the capital moneys by way of contribution to the cost of producing the film, the investor is at risk, according to the definition of 'risk' in subsection 124ZAM(2), with respect to an amount equal to or greater than the amount of those capital moneys expended (subsection 124ZAM(1));
- (m) No pre-sale arrangements, distribution rights agreements, distribution guarantee agreements, or other like agreements, have been, or will be, entered into in circumstances where such agreements would put funds into the hands of the investors, by loan or otherwise, to enable them to expend capital moneys by way of contribution to the cost of producing the film;
- (n) In the event of any underage, 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 Films';
- (o) The dominant purpose of the investors is to make a commercial return from their investment in the film and the arrangements will be executed in the manner described in this Ruling;
- (p) Non-deductible expenditure associated with the Project in respect of Division 10BA will be paid to the extent of 11% by the investors.

---

## **Explanations**

---

### **The ‘directly expended’ requirement**

49. Subsection 124ZAA(6) requires that capital money contributed to the production of a film must be ‘expended directly in producing [the] film’ in order for a deduction under Division 10BA to be available.

50. Paragraph 8 of Taxation Ruling IT 2111 discusses this requirement. It states: ‘Direct expenses on a film production which qualify for a deduction under section 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).

51. Our view is that the ‘directly expended’ requirement is not met at the point in time when the Investors make payments to Clondy in respect of the budget for the Film. Rather, the extent of the application of the money by Clondy to elements of production will ultimately determine the portion of the Investors’ contribution that meets this requirement. Generally, this will not be known until after the completion of the Film.

52. The Investors will pay the application money to Clondy who will use 89% for application towards the production costs. In doing this, Clondy is to ensure that this proportion of funds contributed by Investors is only expended on items within the film production budget. The 11% balance of the application money will be for non-deductible expenditure.

53. In determining the amount that is ‘directly expended’ on the production of the Film, we will also consider the ultimate application of any funds obtained by Clondy as ‘underage’. In this regard, Clondy has agreed any underage will be first expended on the production of the Film.

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

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

### **The ‘at risk’ rule**

56. Section 124ZAM reduces claims for Division 10BA deductions where the Commissioner is satisfied that a taxpayer was not at risk in respect of any part of the expenditure of capital moneys the taxpayer made by way of contribution to the cost of producing a film. Subsection 124ZAM(2) specifies the amount of risk is the amount of loss that, in the Commissioner’s opinion, would be suffered by reason of the taxpayer’s said capital expenditure where no income is derived from the taxpayer’s interest in the copyright of the Film, other than excepted income as defined in subsection 124ZAM(3).

57. Paragraph 13 of Taxation Ruling IT 2111 discusses the ‘at risk’ rule and states the rule:

‘... does not operate to affect the deductions available to investors where pre-sale arrangements or the sale of distribution rights are effected prior to completion of the film unless the arrangements put funds into the hands of investors - by loan or otherwise - to enable them to make their contributions to the costs of film production. Similar considerations apply in respect of a distribution guarantee arrangement under which an amount may be paid to investors by a producer or another person in exchange for distribution rights, if a specified return is not achieved within a particular period (e.g., a specified percentage of the film budget within 2 years). Payments under an arrangement of that kind would also not offend the ‘at risk’ rule.’

58. The ‘at risk’ rule applies to an investor’s risk of loss before and after completion and distribution of the Film. Any arrangement which limits an investor’s risk of loss can breach the ‘at risk’ rule. Certain types of common industry arrangements affecting risk during production of the Film are accepted as not offending the ‘at risk’ rule. This acceptance does not extend to arrangements which put funds into the hands of Investors to enable them to make their contributions to the costs of film production. This 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.

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

**Non-arm's length transactions**

60. Where, in producing a film, an amount is expended by a person ('the film producer') for the supply of goods or the provision of services, subsection 124ZAJ(1) allows the Commissioner to reduce deductions under Division 10BA for such amounts where he is satisfied that:

- the film producer and the person supplying the goods or providing the services were not dealing with each other at arm's length in relation to the transaction; and
- the amount of moneys expended on the supply of those goods or the provision of those services exceeds the amount of moneys that would have been expended by the film producer if the film producer and the person supplying those goods or providing those services had dealt with each other at arm's length.

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

62. Accordingly, while a deduction should be available in respect of capital moneys expended by Investors by way of contribution to the cost of producing the Film of the Fund before the end of the financial year ending 30 June 2001, the deduction will be reduced with retrospective effect if the Commissioner determines that a producer of the Film of the Fund dealt with a supplier of goods or a provider of services, in the course of producing the Film, in circumstances where the parties were not dealing at arm's length and the producer paid more for the goods or the services than the producer would have paid had the transaction been at arm's length.

**Interest on borrowed funds**

63. Interest incurred in respect of funds borrowed by the Investors, if any, to make their contributions will only be deductible in any year to the extent of film income derived in that year (subsection 124ZAO(2) of the ITAA 1936). Any excess interest may be carried forward to succeeding years of income for offset against future film income (subsection 124ZAO(3)).

## **Payment of interest by an Investor where an assessment is amended**

64. Section 170AA 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.

65. 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 170AA will have application. There is a discretion in section 8AAG of the *Taxation Administration Act 1953* (TAA 1953) under which the Commissioner can remit, in appropriate circumstances, the whole or part of the charge.

## **Part IVA**

66. 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.

67. 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.

## **Detailed contents list**

---

68. Below is a detailed contents list for this Product Ruling:

	Paragraph
<b>What this Product Ruling is about</b>	<b>1</b>
Tax law(s)	2
Goods and Services Tax	3
Business Tax Reform	4
Note to promoters and advisers	6
Class of persons	7
Qualifications	9
<b>Date of effect</b>	<b>14</b>
<b>Withdrawal</b>	<b>16</b>
<b>Arrangement</b>	<b>17</b>
The project	19
Production and Distribution Agreement	30
The participants	43
Finance	46
<b>Ruling</b>	<b>47</b>
Assessable income	47
<b>Explanations</b>	<b>49</b>
The ‘directly expended’ requirement	49
The ‘at risk’ rule	56
Non-arm’s length transactions	60
Interest on borrowed funds	63
Payment of interest by an Investor where an assessment is amended	64
Part IVA	66
<b>Detailed contents list</b>	<b>68</b>

---

**Commissioner of Taxation**

16 May 2001

*Previous draft:*

Not previously issued in draft form

*Related Rulings/Determinations:*PR 1999/95; TR 92/1; TR 92/20;  
TR 97/16; TR 98/22; TD 93/34;  
IT 2111

# PR 2001/64

*Subject references:*

- Australian films
- film income
- film industry
- interest expenses
- product Rulings
- public Rulings
- tax avoidance
- tax administration

- ITAA 1936 124ZAF(1)(c)(i)
- ITAA 1936 124ZAF(1)(c)(ii)
- ITAA 1936 124ZAF(1)(d)(iii)
- ITAA 1936 124ZAF(2)
- ITAA 1936 124ZAG
- ITAA 1936 124ZAJ
- ITAA 1936 124ZAJ(1)
- ITAA 1936 124ZAM
- ITAA 1936 124ZAM(1)
- ITAA 1936 124ZAM(2)
- ITAA 1936 124ZAM(3)
- ITAA 1936 124ZAO(2)
- ITAA 1936 124ZAO(3)
- ITAA 1936 Part IVA
- ITAA 1936 170AA
- ITAA 1936 177A
- ITAA 1936 177C
- ITAA 1936 177D
- ITAA 1997 8-1
- ITAA 1997 17-5
- ITAA 1997 Div 27
- TAA 1953 8AAG

*Legislative references:*

- ITAA 1936 26AG
  - ITAA 1936 82KL
  - ITAA 1936 Div 10BA
  - ITAA 1936 124ZAA(6)
  - ITAA 1936 124ZAB
  - ITAA 1936 124ZAB(10)
  - ITAA 1936 124ZAC
  - ITAA 1936 124ZADA(1)
  - ITAA 1936 124ZADA(2)
  - ITAA 1936 124ZAF
  - ITAA 1936 124ZAF(1)(a)
  - ITAA 1936 124ZAF(1)(b)(i)
- 

ATO references:

NO 2001/016022  
BO  
FOI number: I 1024389  
ISSN: 1441-1172