



# ***PR 2001/68 - Income tax: "Liquid Bridge" Film Investment***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *23 May 2001*



## Product Ruling

### Income tax: “Liquid Bridge” Film Investment

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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.

#### *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 these products as investments. Further, we give no assurance that the products are 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 products. 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.

## What this Product Ruling is about

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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 'Liquid Bridge', '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 all fees and expenditure referred to include Goods and Services Tax (GST) of the *A New Tax System (Goods and Services Tax) Act 1999* ('the GST Act') where applicable. 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 whom 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 agreement until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of these persons, referred to as 'Investors', will have accepted an offer made under subsections 708(8)-(10) of the Corporations Law.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, 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. 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.

**Note:** without limiting the generality of the term, a 'material difference' 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.

10. 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.

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## Date of effect

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12. This Ruling applies prospectively from 23 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).

13. 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

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14. 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**

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15. 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:

- Application for a Product Ruling and Product Ruling Checklist dated 22 December 2000, received from the Applicant's representative;
- Budget summary for the Film 'Liquid Bridge' and its Financial analysis, received with the application dated 22 December 2000;
- Provisional Certificate under section 124ZAB;
- Production and Investment Deed and Schedules between 3 Spears Pty Limited (3 Spears), Intertropic Pty Limited (Intertropic), the Investor's Representative (the Representative) and the Investors dated 22 December 2000;
- Accession Deed between 3 Spears, Intertropic and the Representative;
- Film Distribution Agreement and Schedules between 3 Spears and Regent Entertainment International II, LLC, dated 21 December 2000;
- Draft Product Ruling received with the application dated 22 December 2000;
- The Constitution of 3 Spears dated 15 December 2000;
- Draft Offer Information Statement received by the ATO on 6 March 2001;
- Correspondence from the Applicant's representative to the ATO dated 25 January 2001, 31 January 2001, 6 March 2001, 30 March 2001; 2 April 2001, 1 May 2001, 2 May 2001, 10 May 2001 and 11 May 2001;
- Correspondence from the ATO to the Applicant's representative dated 29 March 2001 and 1 May 2001.

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

16. In accordance with the above documents, an Investor who participates in the arrangement must have accepted an offer that was made under subsections 708(8)-(10) of the Corporations Law, dealing with 'sophisticated investors'. **This Ruling does not apply unless the Investors are 'sophisticated investors'**. The term 'sophisticated investor' is explained in paragraphs 64 to 67 in the Explanations area of this Product Ruling.

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

## **The project**

18. The project involves the production of an Australian feature film to be titled 'Liquid Bridge' ('the Film') based on a script by Pim Hendrix from an idea by Phil Avalon. The story rights and script payment will be made to Summer City Pty Limited by 3 Spears Pty Limited in accordance with the budget. The payment will include \$173,000 for the story rights and script, \$197,000 for development expenses, \$7,000 for legal fees and \$500 for disbursements.

19. Provisional Certificate number P05046 has been issued by the Department of Communication, Information Technology and The Arts ('the Department') in respect of the film to Avalon Films Pty Limited. This certificate is currently in force in relation to the film and states that the proposed film will, when completed, be a 'qualifying Australian film' for the purposes of Division 10BA of the ITAA 1936.

20. The planned completion date is negotiable between the parties to the arrangement but will definitely be no later than 30 June 2003 in order to satisfy the two-year requirement in Division 10BA.

21. The film will be produced for a total cost of \$4.37 million to be raised from Australian resident investors. The investors will make capital contributions towards the production of the film, under a contract to be executed no later than 30 June 2002.

22. It is anticipated that each Investor will invest at least in the vicinity of \$200,000 and generally not less than \$100,000 will be accepted. No prospectus will be lodged and Investors will be Sophisticated Investors as set out in subsections 708(8)-(10) of the Corporations Law.

## **Production and Investment Deed**

23. The Production and Investment Deed is between 3 Spears (the Production Company), Intertropic (the Australian Head Distributor) and the Representative on behalf of the Investors.

24. Each Investor contributes its investment as a portion of the Budget before 30 June 2002 (clause 7). Each Investment is paid into a Production Account solely under the control of 3 Spears (clauses 7, 8 and Schedule 2 Part B). Under clause 8.3, 3 Spears must arrange for payment out of its own funds of costs which are not production costs under Division 10BA, and such costs may not be paid from the Production Account.

25. Within 30 days after the Completion Date of the Film 3 Spears is to establish the Ex Australian Collections Account and Intertropic is to establish the Australian Collections Account (paragraphs 8.1(b) & (c)).

26. Under clause 10.4 the Ex Australian Gross Receipts received by 3 Spears are to be distributed in accordance with Part A Schedule 4 as follows:

- 1<sup>st</sup> 1% of Gross Receipts to be paid to the Representative as its fee;
- 2<sup>nd</sup> to the Investors pro rata and pari passu until each has received 120% of the amount they have invested in the Film;
- 3<sup>rd</sup> to 3 Spears for the amount of Overages paid or borrowed by 3 Spears for Overages including any interest on loans;
- 4<sup>th</sup> to the Completion Guarantor to repay any moneys provided by the Completion Guarantor in relation to the Film;
- 5<sup>th</sup> (a) to the Production Company 50%;  
(b) to the Investors 50%, and to each Investor pari passu and pro rata that their Investment bears to the total of all Investments;
- 6<sup>th</sup> after the Expiry Date, all Ex Australian Gross Receipts are payable to the Production Company.

27. Under clause 10.5 the Australian Gross Receipts received by Intertropic are to be distributed in accordance with Part A Schedule 4 as follows:

- 1<sup>st</sup> 15% to Intertropic;
- 2<sup>nd</sup> in payment or reimbursement of all Australian Marketing Expenses, and repayment of loans to meet same and all interest thereon;
- 3<sup>rd</sup> 1% to the Representative as its fee;
- 4<sup>th</sup> to the Investors pro rata and pari passu until each has received 120% of the amount they have invested in the Film;



- 5<sup>th</sup> to the Production Company for the amount of Overages paid or borrowed by the Production Company for Overages;
- 6<sup>th</sup> to the Completion Guarantor to repay any moneys provided by the Completion Guarantor in relation to the Film;
- 7<sup>th</sup> (a) to the Production Company 50%;  
(b) to the Investors 50% that is to each Investor pro rata and pari passu that their investment bears to the total of all investments;
- 8<sup>th</sup> after the Expiry Date, all Australian Gross Receipts are payable to Intertropic which shall first deduct therefrom all moneys payable under the first two dot points in this paragraph above and next pay the balance to 3 Spears.

Please note the amounts distributed 4<sup>th</sup>, 5<sup>th</sup> and 6<sup>th</sup> above are only payable to the extent they have not been distributed at 2<sup>nd</sup>, 3<sup>rd</sup> and 4<sup>th</sup> in paragraph 26, and vice versa.

28. All the Investor's right, title and interest in the Project ceases on a day seven (7) years after the completion of the Film (Expiry Date).

## The participants

29. The following entities are participants in the Project:

- The Representative will act as 'the investors' representative'.
- 3 Spears Pty Limited will act as 'the producer' of the film. The film will be made exclusively in Australia. There will be no manager of the Film other than the producer.
- The Investors will appoint the producer as their agent to market the Film overseas.
- The producer will license Regent Entertainment International II, LLC, to act as distributor of the film worldwide except for Australia and New Zealand. There are no advances or guaranteed sums to be paid to the producer or the investors under this agreement.
- Intertropic Pty Limited which has the same shareholders and directors as the producer will distribute the film in Australia and New Zealand. There are no advances or guaranteed sums to be paid to the producer or the investors.

**Financing Arrangements**

30. The investors will deposit by 30 June 2002 with the investors' representative a total of \$4.37 million being their contribution to the cost of producing the film ('the investors' contributions').

31. The investors' representative will pay all the investors' contributions into the Production Account of the film once investors' contributions of \$4.37 million have been received by the investors' representative.

32. The \$4.37 million will be used by the producer to produce the film in accordance with a stipulated 'budget' that has been prepared in accordance with standard industry format.

33. The entire \$4.37 million must be expended so that there are no budget "underages".

34. 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

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35. Subject to the assumptions listed below at paragraph 36 of this Ruling:

- A deduction is available to an Investor in the Project under Division 10BA of the ITAA 1936 for 97.86% of the amount invested. 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 \$100,000 contribution, a deduction of \$97,860, less any GST input tax credit, will be allowed as a deduction.
- A deduction is not available until the production budget of \$4.37 million has been achieved and an Investor has entered into the Production and Investment Deed.
- 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 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.
- Interest in respect of funds borrowed and any other revenue outgoings relating to the investment incurred by the investors to make their contributions will 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 (subsection 124ZAO(2) of the ITAA 1936). Any excess interest and revenue outgoings may be carried forward indefinitely and offset against future film income (subsection 124ZAO(3) of the ITAA 1936).
- Upon completion of the film, after the audit has been carried out by an independent auditor, deductions will be withdrawn in respect of the moneys spent on non-tax deductible items of the budget (section 124ZAG of the ITAA 1936).
- The anti-avoidance provisions in Part IVA of the ITAA 1936 will not be applied to deny deductibility or to accelerate assessability of the above amounts.

36. 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 124ZAFA(1)(b)(i));
- (b) The investment moneys will be paid to the producer by way of contribution to the cost of producing the film under a contract entered into on or before the end of the financial year in which the capital moneys are to be expended, being 30 June 2002. The production contract will specify that the investment moneys contributed represent the estimated cost of production of the film (paragraph 124ZAFA (1)(a) and subparagraph 124ZAFA(1)(d)(iv)).
- (c) At the relevant time, a provisional certificate (section 124ZAB) or a final certificate (section 124ZAC) is in force in relation to the film;
- (d) Each Investor, at the relevant time, expects to become one of the first owners of the Copyright in the film when the copyright comes into force (subparagraph 124ZAFA(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 124ZAFA(1)(c)(ii);
- (f) There will be in force a declaration lodged in respect of the film in accordance with subsection 124ZADA(1) by a person accepted by the Commissioner under subsection 124ZADA(2) as an appropriate person to make such a declaration (subparagraph 124ZAFA(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 124ZAFA(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 out of funds other than Investors' contributions.

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## Explanations

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### The ‘directly expended’ requirement

37. 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.

38. 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).

39. Our view is that the ‘directly expended’ requirement is not met at the point in time when the Investors, make payments to 3 Spears in respect of the budget for the Film. Rather, the extent of the application of the money by 3 Spears 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.

40. The Investors will pay the application money to 3 Spears for application towards the production costs. In doing this, 3 Spears is to ensure that funds contributed by Investors are only expended on items within the film production budget, with non-deductible expenditure to be met by 3 Spears from its own funds.

41. 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 3 Spears as ‘underage’. In this regard, 3 Spears has agreed any underage will be expended on the production of the Film in a manner that will preserve the status of the Film as a Qualifying Australian Film.

42. 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.

43. 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**

44. 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).

45. 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.’

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

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

**Non-arm's length transactions**

48. 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.

49. 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.

50. 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 2002, 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**

51. 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)).

**Goods and Services Tax**

52. Investors involved in an 'enterprise' in relation to their film investment are entitled to be registered for the purposes of *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act). For



determining what constitutes 'carrying on an enterprise' you are referred to Goods and Services Determination GSTD 2000/8 and Miscellaneous Taxation Ruling MT 2000/1.

53. Investors in the Film are to receive a distribution of income from the Australian and overseas receipts from the film. That distribution is the consideration for the right or licence to the distributor to do what otherwise would be unlawful under the *Copyright Act 1968*. In this way it is the consideration for the grant of the right or licence. The distribution might ordinarily be referred to as a royalty.

54. Income received by investors from their grant of Australian distribution rights for the Film is consideration for the exploitation of the licence or right in Australia and constitutes consideration for the taxable supply of that right or licence.

55. Income received by investors from their grant of overseas distribution of the Film is consideration for the exploitation of the right or licence outside Australia and constitutes consideration for a GST-free supply (subsection 38-190(1), Item 4 of the GST Act).

56. An investor under this scheme, being an Australian resident, will on the screening of the film be deemed to have made a taxable supply, namely the right to screen the film which is his property. Distributions (royalties payable) for that right will be consideration for that supply.

57. A investor registered for GST purposes will have an obligation to remit to the ATO 1/11<sup>th</sup> of the amount of this distribution.

58. Unregistered investors will have no liability to remit GST. It should be noted, however, that unregistered investors whose turnover reaches or exceeds \$50,000(Australian) will have an obligation to register.

59. Where investors are unregistered they will be unable to provide a tax invoice. Where an entity, for example the Production Company, does not hold a tax invoice no input tax credits may be claimed for amounts invoiced without a tax invoice.

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

60. 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.

61. 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**

62. 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.

63. 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.

#### **Subsections 708(8) – (10) of the Corporations Law**

64. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by the Investor pursuant to the 'sophisticated investor' category in subsections 708(8)-(10) of the Corporations Law. These provisions set out situations where a prospectus or similar disclosure document is not required.

65. An Investor who is a 'sophisticated investor' may accept an offer for interests in the project pursuant to subsections 708(8)-(10). Under subsection 708(8), an investor in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will be a 'sophisticated investor' where:

- the minimum amount payable for the interests in the project 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 project on acceptance by the person to whom the offer is made

and the amounts previously paid by the person for interests in the project of the same class that are held by the person add up to at least \$500,000; or

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

66. An Investor may also participate in the project where the offer is made by a licensed dealer under subsection 708(10). Under this provision the dealer must be satisfied that the person to whom the offer is made has previous experience in investing which allows them to assess the merits of the offer, the value of the interests in the project, the risks involved in accepting the offer, their own information needs and the adequacy of the information provided.

67. The licensed dealer must provide a written statement of reasons for being so satisfied. Where an Investor is accepted into the project under this provision he or she must sign an acknowledgment that they did not receive a prospectus in relation to the offer.

## Detailed contents list

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**Commissioner of Taxation**

23 May 2001

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<i>Previous draft:</i>	- ITAA 1936 124ZADA(2)
Not previously released in draft form	- ITAA 1936 124ZAF A
	- ITAA 1936 124ZAF A(1)(a)
<i>Related Rulings/Determinations:</i>	- ITAA 1936 124ZAF A(1)(b)(i)
PR 98/1; PR 1999/95; TR 92/1;	- ITAA 1936 124ZAF A(1)(c)(i)
TR 92/20; TR 97/16; TR 98/22;	- ITAA 1936 124ZAF A(1)(c)(ii)
TD 93/34; IT 2111;	- ITAA 1936 124ZAF A(1)(d)(iii)
	- ITAA 1936 124ZAF A(1)(d)(iv)
<i>Subject references:</i>	- ITAA 1936 124ZAF A(2)
- Australian films	- ITAA 1936 124ZAG
- film income	- ITAA 1936 124ZAJ
- film industry	- ITAA 1936 124ZAJ(1)
- interest expenses	- ITAA 1936 124ZAM
- product Rulings	- ITAA 1936 124ZAM(1)
- public Rulings	- ITAA 1936 124ZAM(2)
- tax avoidance	- ITAA 1936 124ZAM(3)
	- ITAA 1936 124ZAO(2)
	- ITAA 1936 124ZAO(3)
<i>Legislative references:</i>	- ITAA 1936 Part IVA
- ITAA 1936 Div 10BA	- ITAA 1936 Part III
- ITAA 1936 26AG	- ITAA 1936 170AA
- ITAA 1936 82KL	- ITAA 1936 177A
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- Corporations Law 708(8)
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ATO references:

NO 2001/001507

BO

FOI number: I 1024465

ISSN: 1441-1172