



# ***PR 2002/40 - Income tax: Film Investment - 'Lost World 3' television series***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *17 April 2002*



## Product Ruling

### Income tax: Film Investment – ‘Lost World 3’ television series

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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 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.

## 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 laws' 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 'Lost World 3', 'the series' or 'the Project'.

### Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Division 5 of Part III of the *Income Tax Assessment Act 1936* ('ITAA 1936');
  - Section 995-1 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
  - Division 10B of Part III ITAA 1936;
  - Division 35 ITAA 1997;
  - Section 82KL ITAA 1936;
  - Part IVA ITAA 1936.

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* ('GST Act'). A person or entity is entitled to claim input tax credits for the GST included in its expenditure provided that the acquisition is for a creditable purpose under Division 11 of the GST Act.

### 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). In this Ruling, each of these persons, will have accepted an offer made under subsections 708(1)-(11) of the *Corporations Act 2001*.

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. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

10. 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 part may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to the Manager, Legislative Services, AusInfo, GPO Box 1920, Canberra ACT 2601.

## Date of effect

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11. This Ruling applies prospectively from 17 April 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private Ruling (which is legally binding), the taxpayer can rely on the private Ruling if the income year to which the private Ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private Ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, the Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

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13. This Product Ruling is withdrawn on 30 June 2005 and ceases to have effect on and from that date. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement, or the persons' involvement in the arrangement.

## Arrangement

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14. 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 together with associated documents, dated 28 September 2001, received from the Applicant's Representative on behalf of The Over The Hill Gang Pty Limited ('TOTHG');
- an Information Memorandum/Investment Proposal received by the ATO on 10 December 2001;

- the draft Production and Investment Joint Venture Deed, between TOTHG, the Investors and the Investors' Representative, dated 20 February 2002;
- a Distribution Licence Agreement between TOTHG as Licensor and Batrax Entertainment BV ('Batrax') as Licensee, dated 27 September 2001;
- amended draft Licence Agreement between TOTHG, Batrax, the Investors' Representative and Lost World Partners, LLC ('Lost World Partners') relating to the grant of world wide rights to Batrax, dated 20 February 2002;
- a Distribution Licence Agreement between TOTHG as the Licensor, Park Entertainment as the Agent and Independent International Television Inc as the Licensee, dated 19 October 2001;
- a draft Deed of Assignment between TOTHG, Batrax and Independent International Television Inc as the Distributor, dated 22 February 2002;
- a Distribution License Agreement between TOTHG as Licensor, Park Entertainment as the Agent and Videx International SA as the Licensee, dated 19 October 2001;
- a draft Deed of Assignment between TOTHG, Batrax and Videx International SA as the Distributor, dated 22 February 2002;
- a Distribution Licence Agreement between TOTHG as Licensor, Park Entertainment and Tele-Munchen Fernseh GmbH & Co as Licensee, dated 15 August 2001;
- a draft Deed of Assignment between TOTHG, Batrax and Tele-Munchen Fernseh GmbH & Co as the Distributor, dated 22 February 2002;
- a draft Deed of Assignment between TOTHG, Batrax and Filmlux SA as the Distributor, dated 22 February 2002;
- Revenue projections for Investors in LW3 received by the ATO on 10 December 2001;
- a Credit Agreement between TOTHG as the Borrower and The Lewis Horwitz Organisation ('LHO'), dated 31 October 2001;

- a Completion Guarantee from Film Finances Inc to LHO, dated 31 October 2001;
- an Equity Contribution Deed between TOTHG and Coote Hayes Production Services Pty Limited, dated 13 November 2001;
- the Production Agreement between Perfect Timing Media Corp. ('PTM') and Coote/Hayes Lost World III ('CH') dated 23 July 2001;
- an Assignment Agreement between PTM as Assignor and TOTHG as Assignee, dated 1 August 2001 and the relevant Shareholder Resolutions consenting to the assignment;
- a Certificate under subsection 124K(1) issued by the Department of Communications, Information Technology and the Arts dated 20 September 2001;
- Correspondence received by the ATO from the Applicant's Representative dated 10, 11, 14, and 18 December 2001, 7 and 11 January 2002, 1, 8, 11, 22, and 25 February 2002, 7 and 14 March 2002;
- Correspondence from the ATO to the Applicant's Representative dated 19 November 2001, 11 and 19 December 2001, 11 and 23 January 2002, 5 February 2002, 13 March 2002 and 2 April 2002.

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

15. In accordance with the above documents, the minimum investment is AUS\$500,000 except where an investor accepts an offer that was made under section 708 of the *Corporations Act 2001*. **This Ruling does not apply unless the investor:**

- invests a minimum of AUS \$500,000;
- has accepted a 'personal offer' under subsections 708(1)-(7) of the *Corporations Act 2001*;
- is a 'sophisticated investor' for the purposes of subsections 708(8)-(9) of the *Corporations Act 2001*;
- has accepted an offer made by a licensed dealer where the offer meets the requirements of subsection 708(10) of the *Corporations Act 2001*; or
- is a 'professional investor' for the purposes of paragraphs (a), (b) or (h) of subsection 708(11) of the *Corporations Act 2001*.

16. The above categories are explained in paragraphs 39 to 46 of this Product Ruling.

### **The Participants**

17. A suitably qualified and experienced person will act as the Investors' Representative. TOTHG will pay the Investors' Representative a fee in respect of the services provided.

18. TOTHG will act as the production company of the series. Coote Hayes Production Services Pty Limited will perform production services in respect of the series, and will have an equity interest in the revenue derived from the series.

19. Batrax will act as the head distributor of the series.

20. Park Entertainment Limited ('Park') has previously acted as agent for TOTHG and entered into various third party distribution agreements. Park/TOTHG will assign these third party distribution agreements to Batrax.

21. Lost World Partners will act as the sales agent for Batrax in securing further distribution agreements in the rest of the world territories.

### **The project**

22. The project involves the production of 22 one hour episodes for the third series of the television drama **The Lost World** ('LW3'), based on Sir Arthur Conan Doyle's classic tale of adventure **The Lost World**. The story centres around a British expedition which finds itself stranded on an isolated Amazonian plateau inhabited by dinosaurs.

23. LW3 is the third year of an ongoing television series. 44 episodes comprising series 1 ('LW1') and series 2 ('LW2') have already been completed. LW3 will comprise 22 episodes and has been produced by TOTHG.

24. A Certificate, number 804, for the film was issued by the Department of Communications, Information Technology and the Arts on 20 September 2001. The certificate states that for the purposes of subsection 124K(1) the film is a film that has been, or is to be made wholly or substantially in Australia or in an external Territory and has, or will have, a significant Australian content.

25. The budget for production of the television series is US\$750,827 per episode, or US\$16,518,194 in total. The budget has been locked in at a US dollar exchange rate of US\$0.51 to the Australian dollar. The total budget in Australian dollars is AUS\$32,388,616 and Investors will not be accepted into the Project

until a minimum amount of AUS\$18,000,000 has been raised from arm's length Investors. Where the full Budgeted Cost of AUS\$32,388,616 is not raised from arm's length Investors, the balance will be invested by a company associated with TOTHG. Where a company associated with TOTHG invests in the series it will become an Investor on the same terms and conditions as arm's length Investors.

### **Production Costs**

26. Filming of the LW3 series was completed on 19 February 2002 and was funded by way of loans provided by Dr Todd Makler, a shareholder of TOTHG, LHO and an equity contribution by Coote Hayes Production Services Pty Limited. TOTHG has entered into a Credit Agreement with LHO to enable it to borrow sufficient funds to complete production of LW3. Upon acceptance of the Investors' moneys, TOTHG will be reimbursed for the production costs incurred and will repay the outstanding balance on the LHO loan and repay the funds contributed by Dr Makler. Coote Hayes Production Services Pty Limited will receive a share of the Net Receipts that TOTHG is entitled to under the Disbursement Schedule in the Production and Investment Joint Venture Deed.

### **Production and Investment Joint Venture Deed**

27. The Joint Venture is between TOTHG as the production company, the Investors' Representative, and the Investors. Production of LW3 commenced on 13 August 2001 and filming was completed on 19 February 2002 with delivery scheduled by the end of May 2002.

28. The purpose of the Joint Venture is to fund the production of LW3, for TOTHG to assign 100% of the Copyright to the Investors, and to distribute the proceeds from the exploitation of LW3 (clause 2.2). In accordance with clause 21.1 each Investor will acquire an interest in the Copyright of the completed episodes from TOTHG in proportion to their contribution. TOTHG is the manager of the Joint Venture (clause 2.3) and is given exclusive rights to market the Copyright under clause 22.1. Under clause 21.3 TOTHG has an option to acquire an Investor's Copyright in LW3 for market value. This option can be exercised 7 years from the end of the financial year in which delivery of LW3 occurred.

29. Clause 2.9 states an Investor's investment will be returned if the minimum subscription is not achieved by the closing date. The Minimum Subscription amount is AUS\$32,388,616 of which a minimum of AUS\$18,000,000 is required to be raised from arm's length Investors. Potential Investors are to forward their investment funds and a completed Investment Agreement to the Investors'

Representative who will place the funds into a Trust Account operated by the Investors' Representative (clause 4). TOTHG can accept or reject an Investor's application (clause 9). TOTHG will open a Production Account (clause 15), and payments from the Trust Account to the Production Account will occur in accordance with clause 10.

30. Income generated from the commercial exploitation of LW3 is to be distributed in accordance with the Disbursement Schedule (clause 23.1). The Disbursement Schedule sets out the order and priority of the disbursement of the Net Receipts as follows:

- All Net Receipts shall be paid to the Investors until the Investors have recouped their Investments;
- Any expenses and commission liable to be paid by TOTHG to the Distributor, promoters or persons for the exploitation of the Merchandising Rights;
- Any Net Receipts collected in excess of Budgeted Cost of AUS\$32,288,616 (converted to US dollars at the Australian/US exchange rate at the date of financial closing of the transaction ('USD Budgeted Cost at Closing')) and any expenses or commissions mentioned above, will be distributed to the Investors according to the following division of profits in excess of the USD Budgeted Cost at Closing:
 

First US\$2M	9%
Second US\$2M	13.5%
Over US\$4M	18%
- The balance of the Net Receipts shall be paid to TOTHG, or as TOTHG directs.

31. The distribution revenues will flow to the Investors as Australian dollar amounts from Batrax to the Proceeds Account as per clause 5 of the Distribution Licence Agreement. The funds will be converted from US dollars to Australian dollars at the spot rate existing immediately before the transfer to the Proceeds Account.

### **Distribution Licence Agreement**

32. The Distribution Licence Agreement is between TOTHG as the Licensor, the Investors' Representative, Batrax as the Licensee, and Lost World Partners as the Sales Agent. Under clause 3 TOTHG grants Batrax the distribution rights for LW3 by way of an exclusive license for the world. Batrax appoints Lost World Partners as the exclusive agent for arranging the exploitation of the distribution rights

for the world (clause 4). Lost World Partners may appoint sub-sales agents as it considers necessary.

33. Various presale agreements have been entered into, and Batrax will be obliged to collect and provide the full presale payments as they are paid by the third party sub-distributors over time in respect of the various territories.

34. Page 11 of the Investment Proposal states the following guarantees that have been provided in respect of the revenue to be generated through distribution arrangements:

New Line Television Inc	US\$5,500,000
Tele-Munchen Fernseh GmbH & Co	US\$1,200,000
Filmlux SA	US\$264,000
Independent International Television Inc	US\$220,000
Videx International SA	US\$280,000

35. In addition, Lost World Partners will provide a security pledge to secure their rights as sales agent, which will be equal to AUS \$32,388,616 less the guaranteed revenues to be received from the sub-distributors. Numerous agreements are currently being negotiated with other third party distributors and to the extent that these agreements are concluded and further minimum guarantees secured, the security provided by Lost World Partners will be proportionately reduced (clause 8).

36. Batrax may enter into a credit insurance arrangement with an arm's length financial institution for the purpose of enhancing the credit obligations of the third party distributors and Lost World Partners. It is understood that the arrangement will be entered into with an OECD bank in the ordinary course of business and at commercial rates. The credit insurance will only protect Batrax from an insolvency issue or contractual default of a third party sub-distributor or Lost World Partners.

37. Batrax shall be entitled to retain one percent (1%) of all cash royalties it receives. Clause 4 states that on 8 July 2007, Batrax will pay 74% of the cash royalties to TOTHG as consideration for the granting of the worldwide distribution rights. Once funds equal to AUS \$32,288,616 have been deposited into the Batrax account, then the deferred sales agent fee of 25% of receipts will be paid to Lost World Partners.

## **Finance**

38. This Ruling does not apply if a finance arrangement entered into by an Investor to fund the Investor's investment in the arrangement includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the 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 mechanism, directly or indirectly) back to the lender or any associate of the lender.

### **Section 708 of the Corporations Act 2001**

39. For this Ruling to apply, an offer for an interest in the project must have been made to, and accepted by, an Investor under one of four exclusions in subsections 708(1)-(11) of the *Corporations Act 2001*. These provisions set out situations where a prospectus or similar disclosure document is not required.

40. Under subsections 708(1)-(7) an Investor may participate in the project by accepting a 'personal offer' for an interest in the project. Offers under these provisions cannot be accepted by more than 20 Investors in any 12 month period and these Investors, in aggregate, must not invest more than \$2 million dollars.

41. An offer will be a personal offer where it can only be accepted by the person to whom it is made, and it is made to a person who is likely to be interested in the offer because of previous contact, or professional or other connection with the person making the offer, or because they have indicated that they are interested in offers of that kind (subsection 708(2)).

42. Offers made under the other three exclusions in section 708 (see below) are not counted for the purposes of the 20 investors limit.

43. Alternatively, an Investor who is a 'sophisticated investor' may accept an offer for interests in the project under subsections 708(8) and (9). 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;
- 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.

44. 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.

45. 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.

46. Under subsection 708(11) an offer may be made to and accepted by a person who is considered to be a professional investor. An Investor who participates in the project under this provision will be, at the time the offer is made:

- a person who is a licensed or exempt dealer and who is acting as a principal;
- a person who is a licensed or exempt investment adviser and who is acting as a principal; or
- a person who controls at least \$10 million for the purposes of investment in securities.

## Ruling

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### Partnership

47. For the year ending 30 June 2002 and subsequent years of income, Investors who acquire 100% of the Copyright in LW3 from

TOTHG, will be in a tax law partnership for the purposes of Division 5 of Part III of the ITAA 1936 (see definition of 'partnership' in section 995-1 of the ITAA 1997). Investors will receive income jointly from their commercial exploitation of their Copyright interest in LW3. Section 90 of ITAA 1936 provides that the net income of a partnership is calculated as if the partnership were a resident taxpayer, and is the assessable income less all allowable deductions. The Partnership will be required to lodge a partnership return for each year of income, as required by section 91 of the ITAA 1936.

48. Each Investor will be a partner in the Partnership and, in accordance with section 92 of the ITAA 1936, where the Investor is a resident, will be required to include his or her individual interest in the net income of the Partnership in his or her assessable income. Where the Investor is a non-resident, he or she is required to include in his or her assessable income his or her individual interest in the net income of the Partnership as is derived from a source in Australia.

49. Each Investor will be entitled to a deduction under section 92 of so much of his or her individual interest in any loss of the Partnership as is attributable to a period when he or she was a resident. Where the Investor is a non-resident, he or she will be entitled to a deduction for so much of his or her individual interest in the Partnership loss as is attributable to sources in Australia.

### **Minimum subscription**

50. An Investor will not incur the expenditure they contribute to acquire their Copyright interest in LW3 for the purposes of Division 10B before the minimum subscription for the series is reached and the Investor's application to acquire their Copyright is accepted (the date the investment is made). Tax deductions are not allowable until this requirement is met.

### **Division 10B**

51. A deduction is available to the Investors under Division 10B for the acquisition cost of the Copyright in LW3. 50% of the amount invested is allowable in the year of income, excluding any amount of input tax credit, in which the film is first used to produce assessable income. The remaining 50% is allowable in the next succeeding year of income, excluding any amount of input tax credit.

## **Goods and Services Tax ('GST')**

52. For GST purposes, and other than for the payment for the acquisition of the Copyright, an Investor will be considered a partner in a partnership rather than an individual investor.

## **Division 35 ITAA 1997**

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

## **Section 82KL**

54. Section 82KL will not be applied to deny deductions otherwise allowable.

## **Part IVA**

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

## **Assumptions**

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

- (a) An Investor will incur capital expenditure on the purchase of Copyright in LW3 (paragraph 124L(1)(b));
- (b) An Investor's interest in the Copyright in LW3 amounts to ownership of the Copyright for the purposes of Division 10B (subsection 124K(1));
- (c) The series will be completed and the Partnership will use the Copyright for the purpose of producing assessable income (section 124L(1));
- (d) The Investors will not exercise the discretion contained in subsection 124UA(2);
- (e) The effective life of the Copyright in the series is two years (subsection 124UA(1));
- (f) No consideration will be payable to the Partnership as a result of the execution of distribution agreements in relation to the arrangement;
- (g) 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.

## **Explanations**

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### **Partnership for income tax purposes**

57. The Investors in LW3 will be considered to be a partnership for income tax purposes as they are in receipt of ordinary income or statutory income jointly (see the definition of 'partnership' in section 995-1 of the ITAA 1997). Consequently, Division 5 of Part III applies so that the assessable income of a partner includes so much of the individual interest of the partner in the net income of the partnership or, in the case of a partnership loss, a partner is entitled to a deduction for so much of his or her individual interest in any loss of the Partnership. It should be noted that the Partnership is not a common law partnership and consists only of the Investors who hold a Copyright interest in LW3. TOTHG and the Investors' Representative are not partners in the Partnership.

58. The Partnership will receive income from the exploitation of the LW3 Copyright. Under the Production and Investment Joint Venture Deed the Investors will acquire 100% of the Copyright in LW3 as tenants in common. The Investors will receive a share of the net income of the Partnership in proportion to the amount they contributed to acquire the Copyright. Where a partnership loss is incurred by a partnership in a year of income, there shall be an allowable deduction to a partner in the partnership based on their individual interest in the partnership.

59. Accordingly, a partnership return will be required to be furnished for each year of income as required by section 91. The Investors will be required to disclose their share of the Partnership net income or loss in their returns of income as required by section 92.

### **The Cost of a Unit of Industrial Property**

60. The cost of a unit of an Australian film for the purposes of Division 10B is determined under section 124R.

61. In our view the Investors and TOTHG are dealing at arm's length. The cost of the series will equal the amount payable by the Investors to acquire the Copyright, pursuant to the terms of the draft Production and Investment Joint Venture Deed.

## **Used for the purpose of producing assessable income**

62. For Division 10B to apply, section 124L requires the owner of a unit of industrial property to have used it in the year of income concerned or in a previous year of income for the purpose of producing assessable income.

63. Investors in LW3 will, pursuant to the Production and Investment Joint Venture Deed, licence their interest in the Copyright to TOTHG. TOTHG will enter into a Head Distribution Agreement with Batrax for all territories. Batrax will enter into various distribution agreements with third party distributors. The Partnership is to receive income generated from the commercial exploitation of LW3 in accordance with the Disbursement Schedule attached to the Production and Investment Joint Venture Deed.

64. We accept that the Partnership will have used the Copyright for the purposes of producing assessable income, and that a deduction will be first available to the Investors, in the year of income that the Investors purchase their Copyright interest in LW3.

## **Entitlement to annual deductions**

65. The amount of the annual deduction allowable to the owner of a unit of industrial property to whom Division 10B applies is determined in accordance with section 124M.

66. The amount of the annual deduction is calculated by dividing the residual value of the unit, in relation to each Investor, at the end of the income year by the number of whole years in the effective life of the unit, in relation to that particular Investor, as at the beginning of the year. The residual value of a unit is determined in accordance with section 124S and the effective life of a unit, being a copyright subsisting in an Australian film, is determined in accordance with section 124UA.

## **Residual Value**

67. Residual value is determined under section 124S. Generally speaking, the residual value, as per subsection 124S(1), is the cost of the unit to the owner less the sum of:

- (a) the deductions (if any) allowed or allowable to that person in respect of the unit in previous years; and
- (b) any consideration receivable by the owner in respect of any earlier part disposal of the unit.

**Effective life of a unit**

68. The effective life of a unit to which section 124UA applies, i.e., a copyright subsisting in an Australian film, will commence at the commencement of the year of income during which it is first used by the owner for the purpose of producing assessable income and shall end at the conclusion of the next succeeding year of income, or, where the unit was acquired for a specified period, the end of the year of income in which that specified period ends, whichever first occurs. Effectively this means that the cost of the unit is written off over two years except in circumstances where the unit is acquired for a specified period which expires within the same year of income in which the unit was acquired, in which case the capital cost of the unit will be fully deductible in that year.

69. Subsection 124UA(2) gives an owner of a unit of industrial property that relates to a copyright in an Australian film the right to elect to have the effective life of the unit determined under section 124U. If the owner makes such an election, the deductions allowable in respect of the cost to the owner will be determined under the general basis provided for in Division 10B, i.e., by way of annual deductions over 25 years or any shorter effective life as determined in accordance with section 124U.

70. Once minimum subscription is attained, TOTHG will assign 100% of the Copyright in LW3 to the Investors. The residual value for an Investor will be the capital expenditure incurred by that Investor to acquire his or her Copyright interest in LW3.

71. Given that no election in terms of subsection 124UA(2) has been made, the effective life of the series is two years. Consequently, the deduction available to an Investor in the year in which the Copyright is first used by the Partnership to produce assessable income is 50% of the capital expenditure incurred by that Investor to acquire his or her interest in the Copyright.

72. The deduction available in the following year will be the residual value of the film at that time, being the cost of the unit to the owner less the deductions allowed in previous years (again assuming that no consideration was received by the Partnership or the Investors when the Partnership enters into the distribution agreement(s)). The deduction available is therefore the remaining 50% being, the capital expenditure incurred (cost of unit) less the 50% deduction allowed in previous year.

**Interest deductibility**

73. The deductibility of interest incurred by Investors who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. Product Rulings

only deal with arrangements where all details and documentation have been provided to, and examined by, the Tax Office.

## **Section 82KL - recouped expenditure**

74. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deduction otherwise allowable under section 124M.

## **Part IVA**

75. 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'. An 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 10B, that would not have been obtained but for the scheme. It is not possible to conclude, from the arrangement outlined in this ruling, that the scheme will be entered into or carried out for the dominant purpose of obtaining a tax benefit.

## **Division 35 – deferral of losses from non-commercial business activities**

76. Subsection 35-5(1) of the ITAA 1997 says the object of Division 35 'is to improve the integrity of the taxation system by preventing losses from non-commercial activities that are carried on as businesses by individuals (alone or in partnership) being offset against other assessable income'. Division 35 is not intended to apply to activities that do not constitute a business, e.g., a 'passive investment' (subsection 35-5(2)).

77. Investors will acquire the Copyright in LW3 and will receive royalty income from the commercial exploitation of their Copyright. The Partnership is not considered to be carrying on a business and the income received will be from a passive investment for the purposes of subsection 35-5(2) of the ITAA 1997. Consequently, Division 35 of the ITAA 1997 will not apply to the Investors or to the Partnership.

## Detailed contents list

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**Commissioner of Taxation**

17 April 2002

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<i>Previous draft:</i>	– ITAA 1936 124R
Not previously released in draft form	– ITAA 1936 124S
	– ITAA 1936 124S(1)
	– ITAA 1936 124U
<i>Related Rulings/Determinations:</i>	– ITAA 1936 124UA
PR 1999/95; TR 92/1; TR 92/20;	– ITAA 1936 124UA(1)
TR 97/16; TR 98/22; TD 93/34	– ITAA 1936 124UA(2)
	– ITAA 1936 177A
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– Australian films	– ITAA 1936 177D
– film income	– ITAA 1997 Div 27
– film industry	– ITAA 1997 Div 35
– interest expenses	– ITAA 1997 35-5(1)
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	– Corporations Act 2001 708(1)
	– Corporations Act 2001 708(2)
	– Corporations Act 2001 708(3)
	– Corporations Act 2001 708(4)
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	– Corporations Act 2001 708(11)(a)
	– Corporations Act 2001 708(11)(b)
	– Corporations Act 2001 708(11)(h)
	– Copyright Act 1968
<i>Legislative references:</i>	
– ITAA 1936 82KL	
– ITAA 1936 Div 10B	
– ITAA 1936 Div 5 of Part III	
– ITAA 1936 82KL	
– ITAA 1936 90	
– ITAA 1936 91	
– ITAA 1936 92	
– ITAA 1936 Part IVA	
– ITAA 1936 124K(1)	
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