



PR 2002/70 - Income tax: Film Investment - 'Hating Alison Ashley'

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Product Ruling

Income tax: Film Investment – ‘Hating Alison Ashley’

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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

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 'Hating Alison Ashley', 'the Film' or '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');
 - Division 27 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 124ZAG ITAA 1936;
 - Section 124ZAO ITAA 1936;
 - Division 5 of Part III ITAA 1936;
 - Section 995-1 ITAA 1997;
 - Section 26AG 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'). An entity, which includes a person, is able 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; the entity is registered, or required to be registered for GST; and the entity holds a tax invoice.

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.

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Date of effect

11. This Ruling applies prospectively from 22 May 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

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

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 dated 18 March 2002, together with associated documents, received from the Applicant;
- Budget summary for the Film and its financial analysis, received electronically by the ATO on 9 April 2002;
- Provisional Certificate number P05361 under section 124ZAB dated 4 June 1998;
- Draft Joint Venture and Production and Investment Agreement and Schedules between Top Cat Films Pty Limited ('Top Cat Films'), and the Investors' Representative on behalf of the Investors, received electronically by the ATO on 13 May 2002;
- Undated Accession Deed between Top Cat Films and the Investors' Representative received electronically by the ATO on 9 April 2002;
- Draft Production Budget received electronically by the ATO on 9 April 2002;
- Draft Film Distribution Agreement and Schedules between Top Cat Films and Ocean Pictures Pty Ltd ('Ocean Pictures') received by the ATO on 30 April 2002;
- Draft Sales Agency Agreement and Schedules between Top Cat Films and Ocean Pictures received by the ATO on 30 April 2002;
- Draft Product Ruling received electronically by the ATO on 13 May 2002;
- The Constitution of Top Cat Films dated 8 February 2002 and received by the ATO on 2 May 2002;
- Draft Offer Information Statement received by the ATO with the application dated 18 March 2002.
- Correspondence received by the ATO from the Applicant dated 9, 22 and 29 April 2002 and 13 May 2002;
- Correspondence from the ATO to the Applicant dated 28 March 2002, and 18 and 29 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, an Investor who participates in the arrangement must have accepted an offer that was made under subsections 708(8)-(10) of the *Corporations Act 2001*.

This Ruling does not apply unless the Investors are ‘sophisticated investors’. The term ‘sophisticated investor’ is explained in paragraphs 40 to 43 below.

The participants

16. A suitably qualified and experienced person will act as the Investors’ Representative.

17. Elizabeth Howatt-Jackman is the producer and sole director and shareholder of Top Cat Films. Top Cat Films will act as the Production Company of the Film. The Film will be made exclusively in Australia. There will be no manager of the Film other than Top Cat Films. The Investors will appoint Top Cat Films as their agent to market the Film worldwide.

18. Top Cat Films will license Ocean Pictures to act as distributor of the Film worldwide. There will be a licence Agreement to market the Film throughout the world excluding Australasia and a Licence Agreement to market the Film in Australasia. No advances or guaranteed sums will be paid to the producer or the Investors under the agreements.

19. Fintage Royalty Management & Collection BV (‘Fintage House’) will act as Collection Account Manager in relation to the Film.

The project

20. The project involves the production of an Australian feature film to be titled ‘Hating Alison Ashley’.

21. Provisional Certificate number P05351, dated 4 June 1998, has been issued by the Department of Communications, Information Technology and the Arts in respect of the Film to Elizabeth Howatt. 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.

22. The planned completion date is negotiable between the parties to the arrangement but will definitely be no later than 30 June 2004 in order to satisfy the two-year requirement in Division 10BA.

23. The minimum production budget for the Film is \$7,000,000 and the maximum budget is \$8,500,000. The final production budget will equal the contributions received by 30 June 2002. Top Cat Films will contribute \$350,000 from its own funds toward the production budget for the non deductible Division 10BA costs. Funds raised in excess of the minimum budget of \$7,000,000 are to be expended on Above the Line Cast to enhance the Film's international marketability.

24. Investors will make capital contributions towards the production of the Film under a contract to be executed no later than 30 June 2002. It is anticipated that each Investor will invest at least \$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.

25. After 1 July 2002, the Production Company will obtain \$350,000 from a non-Division 10BA investor or will provide \$350,000 from its own resources.

Accession Deed

26. Once the production budget for the Film has been attained each Investor will enter into an Accession Deed with Top Cat Films, as the Production Company, and the Investors' Representative. At clause 2(f) each Investor irrevocably and exclusively appoints the Investors' Representative to represent them in all dealings with Top Cat Films.

27. Clause 2(c) entitles Investors to share in the Copyright of the Film as follows:

<u>The Investor's Investment</u>	x	50%
The Total of all Investments		

Top Cat Films will hold the remaining 50% interest in the Copyright and may be entitled to an additional share of the Copyright should it make the 'non-deductible' contribution of \$350,000 as indicated at paragraph 25 above.

28. Under clause 2(d) each Investor grants an irrevocable exclusive licence of their interest in the Copyright to Top Cat Films and each Investor will be entitled to receive a share of the Gross Receipts as determined in accordance with the Joint Venture Production and Investment Agreement.

Joint Venture Production and Investment Agreement (PIA)

29. The PIA is between Top Cat Films, as the Production Company, and the Investors' Representative on behalf of the Investors. Each Investor is required to contribute their investment into the Trust Account, established by the Investors' Representative, by 30 June 2002 (clause 10.1). Under clause 10.2 Top Cat Films is to obtain \$350,000 from a non-Division 10BA investor or will provide \$350,000 from its own resources. This contribution will be made after 1 July 2002 and is for non deductible production costs.

30. Under Part C of Schedule 3 Top Cat Films is entitled to draw down funds from the Trust Account into the Production Account. Clause 11.3 enables funds held in the Trust Account or Production Account to be deposited on term deposit or invested in government securities. In accordance with clause 11.6 any interest that accrues from these deposits will be used first in meeting the cost of production to the extent the costs are not provided from the budgeted cost or by the Completion Guarantor and, second, to meet marketing expenses of the Film. Any interest not expended will be paid into the Collections Account on completion of the Film.

31. In accordance with clause 3 Top Cat Films will assign each Investor an interest in the copyright, and future copyright, of the Film. The Investors will hold the copyright as tenants in common in the proportion that their contribution bears to 50% of the total budget until the Expiry Date. The Expiry Date is defined in clause 1.1 to be on 30 June in the year immediately following the date of seven years after completion of the Film.

32. Top Cat Films is to meet any Overages from its own resources and may use money provided by the Completion Guarantor or third party lenders (clause 12.1). Any funds remaining in the Production Account at the completion of the Film will be applied, firstly, towards the enhancement of music and special effects and, lastly, to the Production Company as an additional Producer's fee (clause 12.2).

33. Within 14 days after the Completion Date of the Film, Top Cat Films is to establish the Collections Account (clause 11.1 (b)).

34. At clause 1 Gross Receipts means all money resulting from marketing actually received by Top Cat Films by the Expiry Date. Under clause 15.3 Gross Receipts received by Top Cat Films are to be distributed in accordance with Schedule 4 as follows:

1st Marketing expenses pursuant to Schedule 5; Administration expenses, comprising a fee of 0.75% of Gross Receipts to be paid to the Representative; and a fee of 1.5% of Gross Receipts to be paid to the Collections Agent;

- 2nd** \$350,000 to the non-Division 10BA investor as a priority recoupment of 100% of the non deductible production costs;
 - 3rd** to the Division 10BA Investors pro rata and pari passu until each has received 120% of the amount they have invested in the Film;
 - 4th** to the Production Company for the amount of Overages paid or borrowed for Overages including any interest on loans;
 - 5th** to the Completion Guarantor to repay any moneys provided by the Completion Guarantor in relation to the Film;
 - 6th**
 - (a) to the Investors 50%, and to each Investor pari passu and pro rata that their Investment bears to the total of all Investments. The non-Division 10BA Investor will be entitled to share in this income in the proportion its \$350,000 contribution bears to the final production budget;
 - (b) to the Production Company 50%. Any share of proceeds which the Production Company agrees to give to any other party will be paid from the Production Company's share of Proceeds.
35. After the Expiry Date, all Gross Receipts are payable to the Production Company
36. All the Investor's right, title and interest in the Project ceases on 30 June in the year immediately following the date of seven years after the completion of the Film (Expiry Date).

Distribution

37. Under clause 14.1 of the PIA, each Investor grants Top Cat Films an exclusive licence to market the Film throughout the world for their interest in the Underlying Rights and the Copyright.
38. Top Cat Films, acting as agent for the Investors, will enter into a Distribution Agreement with Ocean Pictures for distribution in Australasia and with Ocean Pictures for the licensing of all international rights in the Film for fifteen years from the delivery of the Film. The distributor and the sales agent will be entitled to a distribution fee plus expenses from all receipts from any media included in the Agreements.

Finance

39. 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 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 a borrower's risk;
- the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- 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.

Section 708 of the Corporations Act 2001

40. 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 the exclusions in subsections 708(8)-(10) of the *Corporations Act 2001*. These provisions set out situations where a prospectus or similar disclosure document is not required.

41. 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.

42. 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.

43. 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.

Ruling

Division 10BA

44. A deduction is available to an Investor in the Film under Division 10BA for 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, 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 \$100,000, less any GST input tax credit, will be allowed as a deduction.

45. A deduction is not available until the final production budget has been achieved and the Investor has entered into the Accession Deed.

46. Upon completion of the Film, after the audit has been carried out by an independent auditor, Division 10BA deductions will be withdrawn from Division 10BA Investors in respect of the moneys spent on non-tax deductible items, section 124ZAG.

47. Interest in respect of funds borrowed and any other revenue outgoings relating to the investment incurred by the Investors to make their contributions may 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). Any excess interest and revenue outgoings may be carried forward indefinitely and offset against future film income, subsection 124ZAO(3).

48. The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling.

Assessable Income

49. The investors who acquire Copyright will comprise a tax law partnership for the purposes of Division 5 of Part III (see definition of 'partnership' in section 995-1 of the ITAA 1997) as they will be in receipt of income jointly from the commercial exploitation of their Copyright interest. Pursuant to subsection 26AG(9), any income received by a Partnership from the use of, or the right to use, the Copyright is taken to have been derived by the partners. The licence fees derived by each investor as a partner in the Partnership are assessable income of the investor. No such income is taken into account for the purposes of calculating the net income or loss of the Partnership of any year of income and, if this is the only income derived by the Partnership, it will not be necessary to lodge partnership income tax returns. If the Partnership is liable for GST the Partnership would be required to lodge a Business Activity Statement.

Part IVA

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

Assumptions

51. 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 Production Company 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 2004;
- (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 a 'qualifying Australian Film';
- (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 met by Top Cat Films from its own funds.

Explanations

Division 10BA

The 'directly expended' requirement

52. 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.

53. 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 124ZAF 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).

54. Our view is that the 'directly expended' requirement is not met at the point in time when the Investors make payments to Top Cat Films in respect of the budget for the Film. Rather, the extent of the application of the money by Top Cat Films 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.

55. The Investors will pay the application money to Top Cat Films for application towards the production costs. In doing this, Top Cat Films 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 Top Cat Films from its own funds.

56. 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 Top Cat Films as 'underage'. In this regard, Top Cat Films 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.

57. 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.

58. 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

59. 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).

60. 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.'

61. 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.

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

Non-arm's length transactions

63. 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.

64. 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.

65. 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 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 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

66. 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)). Any excess interest may be carried forward to succeeding years of income for offset against future film income (subsection 124ZAO(3)).

Assessable Income

67. The Investors in Hating Alison Ashley 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). The licence fees received by a Partnership of Investors in a Film, less any GST payable on those

licence fees, will be assessable income of the Investors under section 26AG in the income year in which they are received from the Collections Agent. Although there exists a tax law partnership, subsection 26AG(9) provides that income of a partnership assessable under section 26AG is taken to be income derived by the partners/Investors. The amounts received as income are payments for the right to use the rights attaching to a 'qualifying Australian film' possessed by the Investors in respect of a particular period.

Part IVA

68. 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.

69. 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.

Payment of interest by an Investor where an assessment is amended

70. Section 204 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.

71. 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 204 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.

Detailed contents list

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