



PR 2003/43 - Income tax: Slag Film Fund

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 This document has changed over time. This is a consolidated version of the ruling which was published on *18 June 2003*



Product Ruling

Income tax: Slag Film Fund

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Participants 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. 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 participants 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 this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants 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, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants 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 refers. In this Ruling this arrangement is sometimes referred to as the Slag Film Fund or simply as 'the Film' or 'the Project'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Division 27 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
 - Section 995-1 (ITAA 1997);
 - Division 10BA of Part III of the *Income Tax Assessment Act 1936* ('ITAA 1936');
 - Section 26AG (ITAA 1936);
 - Section 124ZAG (ITAA 1936);
 - Section 124ZAO (ITAA 1936);
 - Division 5 of Part III (ITAA 1936); and
 - Part IVA (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 *A New Tax System (Goods and Services Tax) Act 1999* ('GST Act'). A person or entity is entitled to claim input credits for the GST included in its expenditure provided that the acquisition is a creditable acquisition 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 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 term expires), 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, referred to as 'Investors', 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*, the Product Ruling cannot be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

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Commonwealth Copyright Administration
Intellectual Property Branch
Department of Communications, Information Technology
and the Arts
GPO Box 2154
Canberra ACT 2601

or by e-mail: commonwealth.copyright@dcita.gov.au.

Date of effect

11. This Ruling applies prospectively from 18 June 2003, 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 that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this 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 and ceases to have effect after 30 June 2006. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's 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 the documents incorporated into this description of the arrangement are:

- Application for a Product Ruling and Product Ruling Checklist dated 4 April 2003 from the 60 Films Pty Ltd in respect of the Slag Film Fund as constituted by documents provided on 4 April 2003, 7 April 2003, 29 May 2003, 30 May 2003, 4 June 2003 and 6 June 2003 and additional correspondence dated 23 April 2003, 2 May 2003, 8 May 2003, 13 May 2003, 19 May 2003, 20 May 2003, 4 June 2003, 5 June 2003 and 6 June 2003;
- Budget summary for the film ‘Slag’ and it’s financial analysis, received with the application;
- Provisional Certificate P05808 issued under section 124ZAB;
- Production Agreement between 60 Films Pty Ltd (‘the Production Company’), Cinevest Pty Ltd (‘the Executive Producer’), Duncan Dovico Chartered Accountants (‘the Investor’s Representative’) and Film and Television Entertainment Pty Ltd trading as 60 Distribution (‘the Principal Distributor’) dated 3 April 2003;
- Offer Document for the Slag Film Fund;
- Application Form incorporating a Subscription Agreement, between the Investors and the Investors’ Representative, received with the application for Product Ruling;
- Draft Product Ruling received with the application; and
- The Constitution of 60 Films Pty Ltd.

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, this Ruling only applies where an Investor who participates in the arrangement has accepted an offer that was made under subsections 708 (1) – (11) of the *Corporations Act 2001*. The provisions of subsections 708 (1) to (11) of the *Corporations Act 2001* are explained in Paragraphs 34 to 40 of this Product Ruling.

The Participants

16. The following entities are participants in the Project:

- Duncan Dovico Chartered Accountants, the 'Investors' Representative', who will act on behalf of the investors;
- 60 Films Pty Ltd will act as the 'Producer' of the film. The film will be made exclusively in Australia;
- Cinevest Pty Ltd, the 'Executive Producer', will act as 'Manager' of the Slag Film Fund; and
- The Investor's Representative, on behalf of investors, and the Executive Producer has granted a licence to 60 Distribution, the Principal Distributor, to market the film.

The Project

17. The Project involves the production of a qualifying Australian film entitled 'Slag' ('the Film'). The story rights and script payment will be made by 60 Films Pty Ltd in accordance with the budget.

18. Provisional Certificate number P05808 has been issued by the Department of Communication, Information Technology and The Arts ('the Department') in respect of the film to 60 Films Pty Ltd. This certificate is currently in force in relation to the film and states that the proposed film, when completed, will be a 'qualifying Australian film' for the purposes of Division 10BA of the ITAA 1936.

19. The planned completion date is negotiable between the parties to the arrangement but will definitely be no later than 30 June two years after the commencement of the Project, in order to satisfy the two-year requirement in Division 10BA (Clause 2.9 of the Production Agreement).

20. The film will be produced for a total cost of \$2.5 million to be raised from investors. The investors will make capital contributions towards the production of the film, under a contract to be executed no later than 30 June 2004. A Minimum Subscription of \$2.2 million is required before the Project will commence. Units may be allotted after Minimum Subscription has been achieved until 30 June 2004, unless the Executive Producer closes the Offer at an earlier date. The minimum investment per Investor is \$10,000, comprising ten Units, thereafter in multiples of \$1,000. No prospectus will be lodged and Investors will invest under Section 708 of the *Corporations Act 2001*.

21. Each Investor will acquire an undivided legal and beneficial interest in common in the Copyright of the Film made pursuant to the Offer until termination of the Fund. Each Investor will be a first holder of Copyright. All the Investor's right, title and interest in the Project ceases on a day five (5) years after the completion of the Film, subject to 1 year extension each time the Proceeds Account receives a minimum of \$60,000 in the preceding financial year.

Production Agreement, Distribution Agreement and Disbursements Schedule

22. The Production Agreement is signed by the Production Company, the Executive Producer, the Investors' Representative (on behalf of the Investors) and the Principal Distributor.

23. Each Investor contributes its investment before 30 June 2004. Each investment is paid into a Proceeds Account, which is managed jointly by the Investor's Representative and the Production Company (Part A, Clauses 5.1(a) and (b)). Upon Minimum Subscription being reached and at the request of the Producers, amounts required for the final Budget of the Film may be drawn down by the Investor's Representative and the Production Company into a Production Account No1. The Budget, comprised of Deductible Moneys, should comprise 95% of Total Budgeted Costs.

24. The Principal Distributor will open a Marketing Account which will receive funds from the Proceeds Account deemed not to be Deductible Moneys (Part B - Clause 5.2, 'Non-Deductible Moneys'), which will constitute the remaining 5% of the Budget.

25. Under the Distribution Agreement, the Principal Distributor has been granted exclusive rights to market and distribute the film in all territories and mediums of the World. The Principal Distributor may appoint sub-licensees or agents in relation to any of its rights and benefits under the Distribution Agreement (Clause 6.3).

26. Clause 8 of the Distribution Agreement directs the Principal Distributor to pay Licence Fees into the Proceeds account, being amounts to be calculated as the sum of:

- (i) 95% of revenues generated by the Principal Distributor in exploitation of the licensed right to distribute, exhibit and exploit the Copyright of the Film and Underlying Rights where such revenues are generated by engagement of sub-distributors or agents;
- (ii) 75% of revenues generated where direct sales are made or Marketing Agreement is entered into directly by the Principal Distributor; and

- (iii) less any Marketing Expenses, moneys paid by the Principal Distributor for marketing enhancements to sub-distributors and fees together with interest on said fees and Marketing Expenses (inclusive of all Non-Deductible Moneys expended by the Principal Distributor) at the Westpac Bank indicator rate for loans in excess of \$100,000 calculated on daily balances, such interest is to be recouped before principal.

27. Disbursements are to be made from the Proceeds account in accordance with the Disbursements Schedule as follows:

- (a) Firstly, in repayment, if any, of any moneys raised and expended by the Completion Guarantor, the Production Company or the Principal Distributor to complete, finalise or enhance the Film, and any interest and associated expenses payable thereon, including but not limited to deferments, Overage, Extraordinary Labour Costs or ongoing costs of the Fund;
- (b) Secondly, in setting aside moneys, a minimum of \$25,000, until the Completion Date for payment of potential Extraordinary Labour Costs, if any;
- (c) Thirdly, in repayment of 120% of the Investors' initial contribution to the Budget + Costs; and
- (d) Fourthly, in pari-passu payment to:
 - Investors 50.0% of Proceeds;
 - the Production Company 35.0% of Proceeds;
 - the Executive Producer 10.0% of Proceeds; and
 - the Investors Representative 5.0% of Proceeds.

Application Form and Subscription Agreement

28. The Subscription Agreement is printed on the reverse side of the Application Form. As a result of the acceptance by the Investors' Representative of a signed Application Form the investor, amongst other things, irrevocably:

- acknowledges and accepts the appointment of the Investors Representative as the Investor's Representative;
- adopts and ratifies the Investors Representative entering into past and future Material Contracts on behalf of the Investor;

- appoints the Investors Representative as agent of the Investor, in particular to accept assignment of future Copyright in the Film/s on behalf of the Investor and to licence such rights to the Distributor;
- acknowledges that the Investors' Representative acts as Trustee of the Fund, holding all property of the Fund for the benefit of the Investors; and
- acknowledges that entitlement of the Investor to receive Proceeds is governed by the provisions of the Material Contracts.

Financing Arrangements

29. The investors will deposit up to a total of \$2.5 million into a Proceeds Account by 30 June 2004 to be established by the Investor's Representative, being their contribution to the cost of producing the film ('Applicants Contributions'). The Investors' Representative will pay, on request of the Producers, four draw-downs into a Production Account No1 comprising moneys which are deemed by the Executive Producer to constitute eligible capital expenditure for the purposes of section 124ZAFA (1) (Clause 5.1(d) of the Production Agreement).

30. The Investors' Representative will also pay moneys deemed not to be Deductible Moneys, ('Non-deductible Moneys') into a Marketing Account, to be established by the Principal Distributor.

31. The Deductible Funds will be used by the Production Company for the production of the Film in accordance with a stipulated Budget that has been prepared in accordance with standard industry format. Any Underage, up to a maximum 5% of total funds raised, may be paid to the Production Company as a bonus. Any Underage in excess of 5% will be deemed to be Non-deductible Moneys and transferred to the Marketing Account (Part A, clause 8 of the Production Agreement).

32. There is no finance facility offered by the Investors' Representative or any other party to the arrangement. Investors can fund their investment in the Fund themselves, or borrow from an independent lender. Regardless of the source of loan funds, this Ruling will not apply to Investors if the Investors' Representative accepts their investment subject to finance approval by a lending institution and the full amount payable at the time of the investment is not paid to the Investors' Representative on or before 30 June 2003, for Investors investing on or before 30 June 2003, or before 30 June 2004 for Investors investing on or before 30 June 2004.

33. 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.

Corporations Act 2001

34. For this Ruling to apply, an offer for an interest in the Projects 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.

35. Under subsections 708(1)-(7), an Investor may participate in the Projects by accepting a 'personal offer' for an interest in the Projects. 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.

36. 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)).

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

38. 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 Projects 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 Projects 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.

39. 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.

40. 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. 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:

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- 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

Division 10BA

41. A deduction is not available until the Minimum Subscription of \$2.2 million has been achieved and the Investors adopt and ratify the Investors' Representative entering into the Slag Film Fund Agreement on behalf of the Investors. The Investors' Representative will advise Investors of the date this occurs.

42. A deduction is available in the year ended 30 June 2003 for Investors, whose subscriptions have been accepted on or before 30 June 2003 and where the Minimum Subscription has been achieved on or before 30 June 2003.

43. A deduction is available in the year ended 30 June 2004 for Investors, whose subscriptions have been accepted after 30 June 2003 and where the Minimum Subscription has been achieved on or before 30 June 2003.

44. A deduction is available in the year ended 30 June 2004 for all Investors, whose subscriptions have been accepted and where the Minimum Subscription has been achieved after 30 June 2003 and on or before 30 June 2004.

45. A deduction is available to an Investor in the Film under Division 10BA for 95% of the amount contributed to the cost of producing the Film. For example, for each \$10,000 contribution to the cost of producing the Film, a deduction of \$9,500 will be allowed as a deduction.

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, as per section 124ZAG. Additionally, any underage in excess of 5% of the Production Budget will be expended on non-tax deductible items and will be withdrawn from Division 10BA deductions. The Investors' Representative will advise Investors of the amount of moneys spent on non-tax deductible items.

Interest

47. The deductibility or otherwise of interest arising on funds borrowed from financiers is outside the scope of this Ruling.

Assessable Income

48. 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. The licence fees received by a Partnership in respect of the Australian Film, less any GST on those licence fees, are assessable income of the Partnership under section 26AG in the income year in which they are received from 60 Distribution. However, 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. 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.

49. Section 17-5 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

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 2003 or 30 June 2004. 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 2005 where investments are accepted and minimum subscription is achieved on or before 30 June 2003 or 1 July 2006 where investments are accepted and minimum subscription is achieved after 30 June 2003 and on or before 30 June 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) 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; and
- o) non-deductible expenditure in relation to administrative items associated with the Film in respect of Division 10BA, not allowed for in the Film budget, will be paid by the Production Company 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 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'.

54. Our view is that the 'directly expended' requirement is not met at the point in time when the Investors make payments, through the Investors' Representative, to 60 Films in respect of the budget for the Film. Rather, the extent of the application of the money by 60 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 the Investors' Representative for application towards the production costs. In doing this, the Investors' Representative is to ensure that funds contributed by Investors are only expended on items within the film production budget.

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 60 Films as 'underage'. In this regard, under the arrangement, provided there is no Overage in Slag, 60 Films will be entitled to retain the Underage up to a maximum 5% of budget, in accordance with Clause 8 of the Production Agreement. Where entitled to be retained, this amount is an additional consideration for 60 Films' performance of its obligations under the Production Agreement and 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. Amounts of Underage in excess of 5% will be transferred to the Marketing Account and expended on non-deductible items.

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 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 2004, 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.

Assessable Income

66. The Investors in The Slag Film Fund 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 Representative. 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.

67. Section 17-5 of the ITAA 1997 excludes from assessable income an amount relating to GST payable on a taxable supply.

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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Commissioner of Taxation

18 June 2003

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations:

IT 2111; TR 92/1; TR 92/20;
TD 93/34; TR 97/16; TR 98/22;
PR 1999/95

Subject references:

- NCL provisions
- product rulings
- schemes and shams
- tax avoidance
- Australian films
- film income
- film industry
- tax administration

Legislative references:

- ITAA 1936 section 26AG
- ITAA 1936 subsection 26AG(9)
- ITAA 1936 82KL
- ITAA 1936 Div 5 of Part III
- ITAA 1936 Div 10BA
- ITAA 1936 Div 10BA of Part III
- ITAA 1936 124ZAA(6)
- ITAA 1936 124ZAB
- ITAA 1936 124ZAB(10)
- ITAA 1936 124ZAC
- ITAA 1936 124ZADA(1)
- ITAA 1936 124ZADA(2)
- ITAA 1936 124ZAF A
- ITAA 1936 124ZAF A(1)
- ITAA 1936 124ZAF A(1)(a)
- ITAA 1936 124ZAF A(1)(b)(i)
- ITAA 1936 124ZAF A(1)(c)(i)
- ITAA 1936 124ZAF A(1)(c)(ii)
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| - ITAA 1936 124ZAFA(1)(d)(iv) | - ITAA 1997 Div 27 |
| - ITAA 1936 124ZAFA(2) | - ITAA 1997 Div 35 |
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| - ITAA 1936 124ZAJ | - Corporations Act 2001 |
| - ITAA 1936 124ZAJ(1) | - Corporations Act 2001 708 |
| - ITAA 1936 124ZAM | - Corporations Act 2001 708(1)-(11) |
| - ITAA 1936 124ZAM(1) | - Corporations Act 2001 708(1)-(7) |
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| - ITAA 1936 Part IVA | - Corporations Act 2001 708(11) |
| - ITAA 1936 section 177A | - TAA 1953 Part IVAAA |
| - ITAA 1936 section 177C | - TAA 1953 section 8AAG |
| - ITAA 1936 section 177D | - ANTS(GST)A 99 Div 11 |
| - ITAA 1936 section 204 | - Copyright Act 1968 |
| - ITAA 1997 section 17-5 | |
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ATO references:

NO: 2003/001901

ISSN: 1441 1172