

# ***PR 2004/73 - Income tax: The Complete History of Cricket - The Origins***

 This cover sheet is provided for information only. It does not form part of *PR 2004/73 - Income tax: The Complete History of Cricket - The Origins*

 This document has changed over time. This is a consolidated version of the ruling which was published on *9 June 2004*



## Product Ruling

# Income tax: The Complete History of Cricket – The Origins

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### **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 IVA 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 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 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.

Potential 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.

## What this Product Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as 'The Complete History of Cricket – The Origins' or simply as 'the Film'.

### 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 5 of Part III ITAA 1936;
  - Section 995-1 ITAA 1997;
  - Section 26AG ITAA 1936;
  - Section 124ZAO ITAA 1936;
  - Section 124ZAG 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. All fees and expenditure referred to in this Ruling include the Goods and Services Tax (GST) where applicable. A person or entity is entitled to claim input tax credits for the GST included in its expenditure provided that the acquisition is a creditable acquisition under Division 11 of the GST Act.

### Changes in the Law

4. Although this Ruling deals with the laws enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating 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 participants in Produced Films such as this. In keeping with that intention the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

**Class of persons**

7. The class of persons to whom this Ruling applies is those persons who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (that is, being a party to the relevant agreement until their term expires), and deriving assessable income from this involvement as set out in the description of the arrangement. In this Ruling, each of these persons, referred to as 'Investors', will be wholesale clients for the purpose of the *Corporations Act 2001* or will have accepted an offer which qualifies as a small scale offer for the purpose of the *Corporations Act 2001*.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, who otherwise do not intend to derive assessable income from it or are non-residents of Australia for the purposes on the ITAA 1936 or ITAA 1997.

**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 Product Ruling may be reproduced by any process without prior written permission from the Commonwealth. Requests and inquiries concerning reproduction and rights should be addressed to:

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

or by email to: [commonwealth.copyright@dcita.gov.au](mailto:commonwealth.copyright@dcita.gov.au).

## Date of effect

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11. This Ruling applies prospectively from 9 June 2004, 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 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

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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 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 incorporates the following relevant documents or parts of documents lodged with the Tax Office:

- Application for a Product Ruling that became valid on 15 April 2004 as constituted by documents provided on: 25 February 2004, 15 April 2004, 25 April 2004, 3 May 2004, 18 May 2004; and additional correspondence dated 24 February 2004, 1 March 2004, 13 April 2004, 16 April 2004, 30 April 2004, 14 May 2004 and 1 June 2004;
- Correspondence from the ATO to the Applicant dated 26 February 2004, 16 April 2004, 27 April 2004 and 27 May 2004;
- Budget for the Film 'The Complete History of Cricket – The Origins', received by the ATO on 15 April 2004;

- Provisional Certificate under section 124ZAB dated 21st November 2003 and received by the ATO on 25 February 2004;
- Draft Information Memorandum received by the ATO on 21 April 2004;
- Draft **Subscription Agreement** between Dawn To Stumps Pty Ltd ('Manager'), Colin James Oberg ('Representative') and the Applicant, received by the ATO on 21 April 2004;
- Draft **Film Investment Deed** between the Representative and the Manager, received by the ATO on 25 February 2004;
- Draft **Production Agreement** between the Representative, the Manager and Jousting Sticks Pty Ltd ('Principal Production Company'), received by the ATO on 25 February 2004;
- The Constitution of the Manager dated 12th April 2002, received by the ATO on 25 February 2004;
- Draft **Licence Agreement** between the Manager and Media 2100 Pty Ltd ('Distributor'), received by the ATO on 15 April 2004.

**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 be a wholesale client or have accepted an offer that is a small scale offering. **This Ruling does not apply unless:**

- the Investor is a wholesale client as defined in section 761G of the Corporations Act 2001, or
- not being a retail client, the Investor has accepted a 'personal offer' of a small scale offering for the purpose of the Corporations Act 2001.

16. Each of these categories is explained in paragraphs 46 to 52 in the Explanations area of this Product Ruling.

17. The documents highlighted are those that Investors may enter into. For the purposes of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an Investor or any associate of an Investor, will be a party to, which are a part of the arrangement. The effect of these agreements is summarised as follows.

## The Participants

18. The following entities are participants in the project:
- **Investors:** Each Investor will contribute its subscription towards the making of the Film, will be one of the first owners of the Copyright as a tenant in common and will be entitled to participate in the benefits resulting from investment in the Film on the terms and conditions of the Film Investment Agreement.
  - **Representative:** Colin James Oberg will be the Representative and act on behalf of the Investors.
  - **Manager:** Dawn to Stumps Pty Ltd will act as the Manager of the Film project.
  - **Principal Production Company:** Jousting Sticks Pty Ltd will act as the Principal Production Company for the Film.
  - **Distributor:** Dawn to Stumps Pty Ltd (as Licensor) will licence Media 2100 Pty Ltd (as Licensee) to act as Distributor of the Film worldwide.

## Defined Terms

19. Terms which have been defined within the relevant documents to the arrangement include the following:
- **Ancillary Rights** in relation to a Film means all rights of any and every kind or character whatsoever, whether now or subsequently devised, which the Principal Production Company of the Film will at any time have or be entitled to in or in respect of that Film, the script in relation to that Film and the manuscript in relation to that Film and any and all other materials embodied in the Film or upon which the Film is based but subject to and limited by the Production Agreement and which, subject to the foregoing, may include, without limiting the generality of the foregoing:
    - (a) the right to deal with the copyright in the manuscript or any music made or developed or substantially made or developed in the course of production of the Film and any sound or other recording or reproduction thereof (including in written or electronic form);
    - (b) the right to deal with the copyright in the script or any scenario or a shooting script from which the Film is produced;

- (c) the first right to negotiate to make or to license the making of:
- (i) any other film or films (whether for television or the cinema) purporting to be a sequel to or spin off from or remake of the Film or to develop any other the characters or situations in the script or the Film;
  - (ii) a stage play or other dramatic work based on the script;
  - (iii) any film about production of the Film; and
  - (iv) any book or novel relating to or developed from the script or the Film or relating to a film or a stage play or dramatic work mentioned in (i), (ii) or (iii) above;
- (d) (the right to use or to license the use of the words comprising the title of the Film or any part thereof as a trade mark, service mark, style or business name;
- (e) the right to deal with the rights in respect of the work, to the extent acquired; and
- (f) merchandising rights,
- but specifically excludes:
- (g) the right to exploit the Copyright by doing all or any of the acts specified in section 86 of the *Copyright Act*;
  - (h) all rights specifically reserved to the producer in the Production Agreement.
  - (i) advertising and sponsorship rights.
- **Applicant's Contribution** means the amount paid by an applicant to the Representative in respect of the subscription for an Interest.
  - **Applicant's Contribution Return Date** means the date specified in the Offer Document as being the final date on which Applicant's Contributions must be returned if the minimum subscription is not reached.
  - **Authorised Investments** means investment in a deposit account with an Australian ADI or in a cash management trust.
  - **Completion Guarantee Agreements** means the agreements to be entered into between the relevant Principal Production Company, the relevant Completion Guarantor, the Manager and the Representative or any two or more of them whereby

the Completion Guarantor guarantees completion of the Film upon stated terms.

- **Completion Guarantor** means a completion guarantor under a Completion Guarantee Agreement.
- **Contributions** means moneys received by the Representative from time to time as subscriptions and accepted by the Manager in respect of the issue of Interests (which may include moneys from an underwriter).
- **Copyright** means the copyright (as defined by subsection 124ZAA(1) subsisting in each part of the universe in any film, but does not include the Ancillary Rights.
- **Deductible Moneys** means moneys to be expended in accordance with a Production Agreement towards that portion of the budgeted cost of the Film which is reasonably expected to constitute eligible capital expenditure in relation to that Film for the purposes of Division 10BA.
- **Distribution of Gross Receipts.** The Licensee (Distributor) shall retain as its distribution fee 30% of the gross receipts derived from the exploitation of the property (Film) under the Distribution Licence Agreement. The 30% distribution fee shall be exclusive of distribution expenses.
- **Expiry Date** means the date on which this Film project is to conclude, being 30 June 2009.
- **Holding Statement** means a holding statement substantially in the form agreed by the Manager and the Representative to be issued pursuant to clause 17 of the Film Investment Deed.
- **Interest** means the undivided interests as provided for in the Film Investment Deed for the Film, the Applicant's Contributions and other property and benefits arising from the investment of such Applicants' Contributions (including, without limiting the generality of the foregoing, a legal and beneficial ownership in the initial Copyright in the Film).
- **Marketing Expenses** means all of the costs and expenses incurred by a Distributor with the approval of the Manager (if required) or the Manager in relation to marketing of the Film including without limiting the generality of the foregoing (other than those provided for in the budget):
  - (a) the cost of master materials (including the interpositive, internegative and M & E tracks),

- prints and tapes, including standards conversion, editing and transferring the relevant film or part thereof from one medium to another, including costs of materials;
- (b) the cost of ancillary service materials, including storylines, synopses, photographic material and similar materials;
  - (c) travel expenses, freight, insurances, customs agents fees and censorship fees;
  - (d) dubbing expenses;
  - (e) any residuals and deferments;
  - (f) publicity, prints and advertising and promotional expenses;
  - (g) costs associated with the preparation of applications for export market development grants or export expansion grants;
  - (h) costs in respect of collecting, converting, accounting for and disbursing Proceeds and auditing and maintaining all bank accounts;
  - (i) costs associated with the storage of the Film in any film vault or otherwise;
  - (j) costs of re-editing permitted under the relevant production or distribution agreements;
  - (k) distributors and agents commissions and expenses
  - (l) any expenses expressly permitted under any agreement which is entered into with the express approval of the Representative or which is set out in the Offer Document; and
  - (m) such other expenses (including without limitation, litigation expenses and excesses under any policy relating to errors and omissions insurance) as are approved by the Manager and the Representative.
- **Non-Deductibles Account** means a bank account established pursuant to clause 7.2 of the Film Investment Deed and into which Non-Deductible Moneys for the Film are deposited.
  - **Non-Deductible Items** means items of the budget which are not reasonably expected to constitute eligible capital expenditure in relation to the Film for the purposes of subsection 124ZAF(1).

- **Non-Deductible Moneys** means moneys to be expended in accordance with a Production Agreement towards that portion of the budgeted cost of the Film which is not reasonably expected to constitute eligible capital expenditure in relation to the Film for the purposes of subsection 124ZAF(1).
- **Offer Document** means an information memorandum to be provided to Investors containing an offer to investors to invest in the Film which does not require a disclosure document to be prepared under Part 6D.2 of the *Corporations Act 2001*.
- **Overage** means the amount by which the aggregate of the amount required to produce, complete and deliver the Film as contemplated by the budget of the Film exceeds the budgeted cost of the Film.
- **Proceeds** means all or any of the proceeds received by the Representative or any person on behalf of the Representative or Manager for the Investors and includes, without limitation, proceeds:
  - (a) from the exploitation of rights with respect to marketing the Film including the proceeds of any letter of credit or other credit enhancement issued to the Representative or Manager or any person on behalf of the Representative or Manager with respect to moneys to be received from marketing of the Film or as support for payments to be made in respect of the Film by a distributor or sales agent as a distribution advance, distribution guarantee or otherwise;
  - (b) under any policy of insurance in respect of the Film or its production and deposited into the Proceeds Account for the Film;
  - (c) as proceeds of any action, suit or proceeding relating to the maintenance or protection of the Film, the Copyright, or any right therein or thereto in respect of the Film;
  - (d) by way of awards or prizes other than:
  - (e) those made to persons for contributions of merit in making the Film; and
  - (f) those made to the Film but customarily paid by production companies to any individual or individuals who worked on the Film;
  - (g) from export market development grants or export expansion schemes to the extent (either in whole or in part) related to or arising out of the Film;

- (h) as proceeds of any action, suit or proceeding relating to the maintenance or protection of the Film, the Copyright or any right therein or thereto in respect of the Film;
  - (i) as proceeds of sale of any production assets required to be sold under a Production Agreement relevant to the Film deposited into the Proceeds Account;
  - (j) as special receipts envisaged in any Production Agreement deposited into the Proceeds Account; and
  - (k) as proceeds of any statutory licence payment under the Copyright Act or otherwise.
- **Proceeds Account** means the bank account opened as contemplated under the terms of clause 7 of the Film Investment Deed, into which will be deposited the Applicant's Contributions and the Proceeds for disbursement by the Representative.
  - **Production Account** means one or more bank accounts established pursuant to a Production Agreement and into which the moneys for the pre-production, production and post-production of the Film are from time to time paid.
  - **Register** means the registers of Interests maintained under clause 17 of the Film Investment Deed.
  - **Relevant Period** means the period from the date of the Film Investment Deed to the date the Film project is determined being 30 June 2009.
  - **Territory** means the world and each and every country, territory, state and part thereof.
  - **Total Interests** means as at the relevant time all of the Interests then on issue under the Film Investment Deed.
  - **Underage** means an amount equal to the difference between the production budget and the lesser actual cost of making and delivering the completed Film.

## **The Film project**

20. The Film project involves the production of a documentary film to be titled 'The Complete History of Cricket – The Origins' (the Film).

21. Provisional Certificate number P06592 dated 21 November 2003 has been issued by the Department of Communications, Information Technology and the Arts in respect of the Film to be made by the Principal Production Company. The 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. The estimated completion date for the Film is August 2005.

22. The budgeted cost of the Film is \$1,861,233 with an amount of \$1,720,898 (92.46%) being allocated to deductible expenses and \$140,335 (7.54%) to non-deductible expenses under Division 10BA.

23. Investors will make capital contributions towards the budgeted cost of the Film under a contract entered into on or before 30 June 2004 or 30 June 2005. The minimum subscription is the budgeted cost of the Film. It is anticipated that each Investor will invest at least \$130,000 and generally not less than \$94,000 will be accepted. No prospectus will be lodged and Investors will be wholesale clients as defined in section 761G of the *Corporations Act 2001* or will have accepted an offer which qualifies as a small scale offer for the purpose of the *Corporations Act 2001*.

## **Subscription Agreement**

24. The Subscription Agreement is attached to the Offer Document and is shown as Schedule 3 of the Film Investment Deed. The Subscription Agreement is between the Manager, the Representative and the Investor. Under the terms and conditions of the Subscription Agreement an Investor agrees to be bound by the provisions of the Film Investment Deed. An Investor will forward a cheque for their capital contribution to the Manager drawn in favour of the Representative.

25. An Investors application to invest in the Film cannot be accepted until the minimum subscription of \$1,861,233, which is the Film budget, has been raised. On acceptance of their application an Investor will be entitled to share in the Film Copyright and Film Proceeds as outlined in the Film Investment Deed.

## **Film Investment Deed**

26. The Film Investment Deed is between the Manager and the Representative. Clause 2.2 states that where the Manager and/or the Representative enter into any agreements relating to the Film Copyright they do so as agent on behalf of the Investors.

27. An Investor will contribute their investment as a portion of the budget prior to the 30 June 2004 or 30 June 2005. In accordance with clause 7 each investment will be paid into a Proceeds Account under the control of the Representative. Upon attaining the minimum subscription the Representative is to pay \$1,720,898 into the Production Account and \$140,335 into the Non Deductibles Account. The Production Account is controlled by the Manager and the Principal Production Company, and is for the deductible Division 10BA production costs of the Film. The Non Deductibles Account is controlled by the Representative and is for budget costs that are not deductible under the provisions of Division 10BA.

28. Under clause 12.1 Investors will be entitled to become one of the first owners in 50% of the Copyright. Each individual Investor's share in the Copyright of the Film will be determined by the amount of money contributed by the Investor compared to the total Investor contributions. The remaining 50% of the Copyright will be owned by the Manager. The Ancillary Rights will be owned by the Principal Production Company (clause 12).

29. Each Investor will have a Copyright interest which is limited in that it expires on 30 June 2009 (clause 12 and definition of Relevant Period). Upon the expiry of the Investors' share of the Copyright, 100% of the Copyright will be owned by the Manager.

30. Clause 8.1 outlines the manner and order in which the Film Proceeds paid or payable to the Proceeds Account are to be applied. These are as follows:

- (a) first, in repayment of any moneys (if any) raised by the Completion Guarantor, the Principal Production Company or the Distributor to complete, finalise or enhance the Film, and any interest and associated expenses paid or payable with respect to these matters;
- (b) second, in payment of any remuneration deferrals (if any) of the Manager, Representative, the Principal Production Company or the Distributor or any person or company contracted to assist in the completion of the Film;

- (c) third, in repayment to the Principal Production Company for any Overage (if any) paid for by the Principal Production Company from its own resources or from loans obtained by the Principal Production Company either in its own name or from any Investor who *qualifies as a wholesale client under section 761G* of the Corporations Act 2001 together with interest and costs of the loans, and if repaying moneys advanced by the Principal Production Company to pay for Overage, interest at the Westpac Banking Corporation indicator rate for loans in excess of \$100,000 calculated on a daily basis, the interest being payable before principal;
- (d) fourth, in payment or repayment of any ongoing costs (including but not limited to administrative costs and any fees set out in the Offer Document) of the Film *project* and in the setting aside moneys to meet the reserve requirements, storage and library maintenance costs, and in payment to the relevant distribution account for ongoing sales activities of an amount of \$20,000 or as from time to time determined by the executive producer and the Distributor;
- (e) fifth, as a licence fee for granting the licence of its interest in the Copyright under clause 12, each Investor shall be entitled to a share of the Proceeds in the proportion that its Interest or Interests bears to the Total Interests until each Investor has received a sum equal to 120% of its Applicants' Contribution (less the Goods and Services Tax relating to the Applicants' Contribution) for its Interest or Interests;
- (f) sixth, the balance of the Proceeds in payment to the following persons in the following percentages: 50% to the Investors and 50% to the Manager.

31. The Manager will make payments due under clause 8.1 within two months after the end of June and December in each year where there are Proceeds received and paid into the Proceeds Account (clause 8.2). The Manager will not be obliged to disburse any Proceeds at the end of any December period unless the Proceeds received in that period exceed \$100,000.

### **Production Agreement**

32. The Production Agreement is between the Manager, the Principal Production Company and the Representative. Under the agreement the Principal Production Company undertakes to produce the Film as a 'qualifying Australian film' as defined in subsection 124ZAA(1).

33. The Manager shall direct the Principal Production Company, upon the attaining of minimum subscription, to establish an interest bearing Production Account (clause 6). The Deductible Moneys of \$1,720,898 will be transferred into this account (clause 2). The Principal Production Company will pay the production costs of the Film from this account. Any interest earned on the account, if not required for any Overages of the film, are to be paid into the Non-Deductibles Account and may be applied toward the cost of marketing (clause 6.2).

34. Under clause 9 the Principal Production Company is entitled to receive any Underages remaining on completion of the Film to a maximum amount of 5% of the Deductible Moneys. Clause 10.3 states that in the event an Underage occurs any completion guarantee rebate shall be treated as Underage for the purposes of the calculation in clause 9. Underages in excess of the 5% will be expended on the marketing of the Film or transferred to the Proceeds Account.

35. Clause 12.1 states the Copyright shall be Australian owned absolutely and beneficially in equal proportions by the Investors and the Manager as tenants in common, in undivided shares until 30 June 2009. From 1 July 2009 the ownership of the Copyright will pass to the Manager. Clause 12.3 entitles the Principal Production Company to be the sole and absolute owner of the Ancillary Rights.

### **Licence (Distribution) Agreement**

36. The agreement is between the Manager as Licensor and the Distributor as Licensee. The Film will be distributed worldwide. The term of the agreement will be 15 years and is renewable for a further 15 year period. The Film is to be delivered to the Distributor no later than August 2005. The Distributor will be entitled to a Distribution Fee equal to 30% of gross receipts plus distribution expenses and the remaining proceeds will be paid to the Manager and deposited in the Proceeds Account.

### **Finance**

37. 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;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project are involved or become involved, in the provision of finance to Investors for the Project.

## Ruling

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38. A deduction is available to an Investor in the Film under Division 10BA for 92.46% of the amount contributed to the cost of producing the Film. For example, for each \$100,000 contribution to the cost of producing the Film, a deduction of \$92,460 will be allowed as a deduction.

39. A deduction is not available until the production budget of \$1,861,233 has been achieved, the Investor has entered into the Subscription Agreement and the Film Investment Deed and Production Agreement have been executed.

40. 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 Proceeds received by a Partnership in respect of the 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 the Proceeds Account. 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. Any income derived will be taken to be the income of each Investor in proportion to their share in the partnership.

41. 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)).

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

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

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

## **Assumptions**

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45. This Ruling is made subject to the following assumptions:
- (a) The Investor was a resident of Australia for tax purposes at the time the money was expended (subparagraph 124ZAF(1)(b)(i));
  - (b) The investment moneys will be paid to the Principal 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 2004 or 30 June 2005. The production contract will specify that the investment moneys contributed represent the estimated cost of production of the Film (paragraph 124ZAF(1)(a) and subparagraph 124ZAF(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 124ZAF(1)(c)(i));
  - (e) Each Investor, at the relevant time, intends to use the interest in the Copyright for the purpose of producing assessable income from the exhibition of the Film as mentioned in subparagraph 124ZAF(1)(c)(ii);

- (f) There will be in force a declaration lodged in respect of the Film in accordance with subsection 124ZADA(1) by a person accepted by the Commissioner under subsection 124ZADA(2) as an appropriate person to make such a declaration (subparagraph 124ZAF(1)(d)(iii));
- (g) Before the expiration of six months after the time when the Film is completed, an application will be made for a final certificate in accordance with section 124ZAC, otherwise the provisional certificate shall be deemed never to have been in force (subsection 124ZAB(10));
- (h) All requirements of the Department of Communications, Information Technology and the Arts will be met and final certificates will be issued;
- (i) The Film will be completed and the Investors' interest in the Copyright in the Film will be used for income producing purposes within two years after the close of the financial year in which the contributions are made (subsection 124ZAF(2));
- (j) By reason of the said capital moneys being expended, the Investor will become one of the first owners of the Copyright in the Film before 1 July 2006, where moneys are first expended on or before 30 June 2004 or 1 July 2007 where moneys are first expended on or before 30 June 2005;
- (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 Principal Production Company will expend the Underage 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; and
- (p) Non-deductible expenditure associated with the Film in respect of Division 10BA will be met from the Non-Deductibles Account.

## Explanation

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### Corporations Act 2001

46. For this Ruling to apply, an offer for an interest in the Film must:

- have been made to, and accepted by an Investor, who qualifies as a wholesale client as defined in section 761G of the Corporations Act 2001; or
- be an offer which qualifies as a small scale offering as defined in section 1012E *Corporations Act 2001*.

Small scale offers and offers to wholesale clients do not require a prospectus or product disclosure statement.

47. An Investor in the Film may be a person who is a wholesale client within the definition in section 761G. A person will be a wholesale client where the persons satisfies one of the following tests:

- the 'product value test' (paragraph 761G(7)(a));
- the 'individual wealth test' (paragraph 761G(7)(c));
- the 'professional investor test' (paragraph 761G(7)(d)).

48. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'product value test' where :

- the minimum amount payable for the interests in the Film on acceptance of the offer by the person to whom the offer is made is at least \$500,000; or
- the amount payable for the interests in the Film on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the Film of the same class that are held by the person add up to at least \$500,000.

49. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'individual wealth test' where, 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:

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

50. A participant in a managed investment scheme, referred to below as 'the person' or 'the person to whom the offer is made', will satisfy the 'professional investor test' where:

- the person is a financial services licensee; or
- the person controls at least \$10 million for the purposes of investment in securities.

51. Alternatively, under section 1012E, an Investor may participate in the project by accepting a 'personal offer' for an interest in the project. Offers made under section 1012E 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 (subsection 1012E(2)).

52. 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 1012E(5)).

## **Division 10BA**

### ***The 'directly expended' requirement***

53. 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.

54. 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 A 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).

55. Our view is that the 'directly expended' requirement is not met at the point in time when the Investors make payments to the Manager in respect of the budget for the Film. Rather, the extent of the application of the money by the Principal Production Company 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.

56. The Investors contributions will be paid into the Production Account and the Non-Deductibles Account once the production budget is achieved. The funds in the Production Account will be applied towards the production costs of the Film. In doing this, the Manager and Principal Production Company are to ensure that funds in the Production Account and Non Deductibles Account are only expended on the deductible and non-deductible items within the Film production budget respectively.

57. 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 the Principal Production Company as Underage. The Principal Production Company will be entitled to any Underage to a maximum of 5% as additional consideration for its obligations under the Production Agreement. Underage in excess of 5% are to be used by the Manager for Marketing Expenses, and if none, treated as Proceeds and distributed as provided for in the Film Investment Deed. Underage applied towards Marketing Expenses and/or treated as Proceeds would not be considered amounts that are directly expended on the production of the Film.

58. 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 a production company (known as an audit of the Film) is considered inadequate in this regard.

59. 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***

60. 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).

61. 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 (for example, 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.'

62. 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 Films 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.

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

## ***Non-arm's length transactions***

64. 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.

65. 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 Films would normally be required.

66. 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 or 30 June 2005, depending on when minimum subscription is achieved, 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**

67. 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**

68. The Investors in the Film 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 Proceeds 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 Proceeds Account. 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.

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

**Part IVA**

70. 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.

71. 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 Film project, as described in the said arrangement, that suggest that the Film 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**

72. 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.

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

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**Commissioner of Taxation**

9 June 2004

*Previous draft:*

Not previously released in draft form

*Related Rulings/Determinations:*

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

*Subject references:*

- Australian films
  - film income
  - film industry
  - interest expenses
  - Product Rulings
  - Public Rulings
  - tax avoidance
  - tax administration
- ITAA 1936 124ZAF(2)
  - ITAA 1936 124ZAG
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  - ITAA 1936 124ZAO(2)
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  - ITAA 1936 Part IVA
  - ITAA 1936 177A
  - ITAA 1936 177C
  - ITAA 1936 177D
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- ITAA 1936 26AG
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