



PR 2004/94 - Income tax: Burbank Film and Television Fund

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 This document has changed over time. This is a consolidated version of the ruling which was published on *22 September 2004*



Product Ruling

Income tax: Burbank Film and Television Fund

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Potential participants may wish to refer to the Tax Office website at www.ato.gov.au or contact the Tax Office directly to confirm the currency of this Product Ruling or any other Product Ruling that the Tax Office has issued.

Preamble

*The number, subject heading, **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Previous Rulings**, **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 Tax Office **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 and how the product fits an existing portfolio. 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 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, 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 Tax Office 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 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 'Burbank Film and Television Fund' or simply as 'the Fund'.

Tax law(s)

2. The tax laws dealt with in this Ruling are:

- section 79D of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 82KL of the ITAA 1936;
- section 90 of the ITAA 1936;
- section 91 of the ITAA 1936;
- section 92 of the ITAA 1936;
- Division 10B of Part III of the ITAA 1936;
- subsection 124K(1) of the ITAA 1936;
- Division 11A of Part III of the ITAA 1936;
- Part IVA of the ITAA 1936;
- section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Part 3-1 of the ITAA 1997;
- section 110-45 of the ITAA 1997; and
- section 995-1 of the ITAA 1997.

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. In order for an entity (referred to in this Ruling as an 'Investor') to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

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

or by email to: commonwealth.copyright@dcita.gov.au

Date of effect

11. This Ruling applies prospectively from 22 September 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

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.

Previous Ruling

14. This Ruling replaces Product Ruling PR 2004/67 which is withdrawn on and from the date this Ruling is made 22 September 2004. Product Ruling PR 2004/67 has no application to Investors as the minimum subscription for the Fund was not achieved by 30 June 2004.

Arrangement

15. 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 dated 25 August 2004 as constituted by documents provided on 30 August 2004; and additional correspondence dated 6 September 2004;
- Correspondence from the ATO to the Applicant dated 1 and 6 September 2004;
- **Information Memorandum** for The Burbank Film and Television Fund prepared and issued by Equity Investment Management Services Pty Ltd ('Manager') and BrassRing Distribution Pty Ltd ('Distributor') dated May 2004 and received by the ATO on 30 August 2004;
- Film Investment Joint Venture Agreement ('**Investment Agreement**') between each Investor and the Manager dated 30 July 2004 and received by the ATO on 30 August 2004;
- Film Investment Joint Venture Agreement Accession Deed ('**Accession Deed**') between each Investor and the Manager received by the ATO on 7 May 2004;
- **Copyright Acquisition Agreement** between the Manager, Paragon Entertainment Ltd ('Production Producer') and each Investor dated 30 July 2004 and received by the ATO on 30 August 2004; and
- **Distribution Agreement** between the Manager, the Distributor and each Investor dated 30 July 2004 and received by the ATO on 30 August 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.

16. In accordance with the above documents, an Investor who participates in the arrangement must be a wholesale client as defined in section 761G of the *Corporations Act 2001*. A wholesale client is explained in paragraphs 60 to 64 in the Explanation area of this Product Ruling.

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

The Participants

18. The parties involved in the arrangement are:

- **Investor:** A person who invests in the Burbank Film and Television Fund ('Fund') pursuant to the Accession Deed. The Investor will acquire a Copyright interest in the Produced Films for 14 years under the terms of the Copyright Acquisition Agreement and will grant exclusive Marketing Rights to the Distributor under the terms of the Distribution Agreement.
- **Manager:** Equity Investment Management Services Pty Ltd is the Manager who, on behalf of the Investors, manages the Investors' Copyright interests in the Fund. The Manager will enter into the Investment Agreement, Copyright Acquisition Agreement and Distribution Agreement on behalf of each Investor.
- **Distributor:** BrassRing Distribution Pty Ltd is engaged to distribute the Produced Films throughout the world. The Distributor will provide a distribution guarantee to the Investors.
- **Production Producer:** Paragon Entertainment Ltd, a company incorporated under the laws of Hong Kong, will assign to each of the Investors a Copyright interest in respect of the Copyright in each of a number of Produced Films.

Defined Terms

19. Terms which have been defined within the relevant documents to the arrangement include the following:

- **Actual Amount Paid to Investors** means the total amount paid to the Manager on behalf of the Investors by the Distributor in accordance with the Distribution Agreement at or before the Guarantee Time.

- **Actual Distribution Guarantee Amount** means the difference between the Maximum Distribution Guarantee Amount and the Actual Amount Paid to Investors.
- **AFMA Collection Society Rights** means the sole and exclusive right in the Territory:
 - (i) to register the Produced Films and the Investors' interest in the screenplay for the Produced Films and the musical content of the Produced Films, with AFMA Collections in the name of the Distributor as the licensee of the Investor of the relevant rights administered by that organisation or agency including the right to:
 - a. copy the Produced Films off air from television broadcasts;
 - b. retransmit by cable either simultaneously or at different times any television broadcast, transmission or diffusion of the Produced Films; and
 - c. collect taxes or royalties payable with regard to blank audio and video tape and the sale and rental of copies of the Produced Films and video recording and playing devices and other hardware; and
 - (ii) to apply for and direct payment to the Distributor of all money received by AFMA Collections that is referable to or payable in respect of the Produced Films.
- **Ancillary Rights** means the following rights throughout the world unless otherwise agreed by the Manager and the Production Producer:
 - (a) the right to use or license the use of the words comprising the title of the Produced Films, as a trademark, servicemark, style or business name or otherwise;
 - (b) the exclusive rights in any original music and any non-exclusive right in the other music:
 - (i) to make and exploit a recording of the soundtrack of the Produced Films; and
 - (ii) to exploit any other rights acquired by the Production Producer in the original music and other music;

- (c) the exclusive right in the copyright of the script and the work:
 - (i) to publish the script in book volume form or electronically;
 - (ii) to write and publish a synopsis of the script and the contents of the Produced Films;
 - (d) the merchandising rights; and
 - (e) the new media rights,

but does not include remake sequel or spin off rights or any excluded rights.
- **Collections Account** as set out in Item 2 of Schedule 5 of the Distribution Agreement.
- **Copyright** means all existing and future copyright subsisting worldwide in the Produced Films including the copyright subsisting in them as a cinematograph film or films pursuant to section 86 of the *Copyright Act 1968*, and the right to do or authorize the doing of all or any of the acts specified in section 86 of the *Copyright Act 1968* together with all rights necessary to distribute and exploit the Produced Films throughout the Territory, in any and all media limited to the Term. This definition includes all copyright existing under the laws of the United States of America during the Term and all analogous rights under the laws of each and every other jurisdiction through the world during the Term.
- **Distributable Amount** means the funds to be distributed from the Returns Account in accordance with Clause 6 of the Investment Agreement after payment of any amounts in accordance with clause 7 of the Investment Agreement.
- **Gross Proceeds** means all moneys received by the Distributor or from its associated or related corporations or from any sub-distributor or subagent from Marketing the Produced Films in the Territory pursuant to its rights hereunder and credited to the Collections Account, including without limitation:
 - (i) all moneys whatsoever arising from the exploitation of the Marketing Rights;
 - (ii) moneys received by way of government or other rebates or subsidies or otherwise received in respect of the Marketing of the Produced Films;

- (iii) the value of any prizes or awards paid to production companies other than those paid to individuals for their contributions to making the Produced Films;
- (iv) moneys received from the AFMA Collection Society Rights; and
- (v) any net moneys received or recovered in consequence or settlement of any claim for breach or alleged breach or violation of the Copyright or any other rights in the Produced Films which shall be for the benefit of the Investors.

For the avoidance of doubt all Gross Proceeds shall be net of withholding tax deducted from moneys earned from Marketing the Produced Film.

- **Guarantee Time** means 30 June 2013.
- **Marketing and Marketing Rights** are all or any of the promoting, advertising, negotiating, selling, licensing, hiring, distributing, exhibiting, televising and screening in relation to the Produced Films in the Territory by means of:
 - (i) the exploitation of the rights specified at Item 3 of Schedule 1;
 - (ii) the enforcement of the Marketing Rights; and
 - (iii) the right to authorise, delegate and license other persons to do all and any of the foregoing, as principal or agent including Marketing of the rights as defined in this sub-clause, and authorising such persons to incur Marketing and promotion expenses in respect of the Produced Films.
- **Maximum Distribution Guarantee Amount** means a minimum of 70% of the Investment of each Investor raised as at the closing date or an amount equivalent to the level of pre-sales obtained from arm's length third parties at the time of entering into the Distribution Agreement whichever is the greater.
- **Net Proceeds** means all moneys resulting from the Marketing, use, distribution and exploitation of the Produced Films and the Ancillary Rights (including the Copyright but excluding the underlying rights and the excluded rights) received by the Manager from the Distributor of the Produced Films.

- **Returns Account** means the bank account for the receipt of the amounts set out in clause 6.2.1 of the Investment Agreement from the Produced Films to be opened in the name of the Manager as Trustee for the Investors.
- **Term** of the Distribution Agreement shall be 12 years from the date of the Distribution Agreement subject to clause 24.
- **Term** of the Copyright Acquisition Agreement means the period commencing on the date of the Copyright Acquisition Agreement and ending on 30 June 2019.
- **Territory** means the world.

The Fund

20. The Manager will make an invitation to Investors, who are wholesale clients as defined in section 761G of the *Corporations Act 2001*, to invest in the Produced Films in the Fund. The offer will close, Copyright interests will be allocated and documents will be executed on or before 30 June 2005. The Investment will involve an Investor paying to the Manager an amount ('Investment'), together with an Application Fee equal to 0.5% of the Investment amount (to cover the ancillary costs of acquiring the Copyright).

21. The Manager will apply 100% of each Investment to investment in the Produced Films, all of which are 'Australian films' for the purposes of Division 10B. A maximum of 33 Produced Films will be acquired by the Fund for a purchase price of \$22,600,000. This equates to \$684,485 per Produced Film. The minimum investment required before the arrangement can proceed is \$11,636,245, which corresponds to 17 Produced Films.

22. All 33 films have been produced. They consist of 2 films ('Films') and 3 sets of 6 episodes and 1 set of 13 episodes ('Television Series'). Depending on the level of funds raised under the offer, a minimum of 17 to a maximum of 33 Produced Films will be acquired, being a mix of Films and Television Series. The Manager has the final choice of which Produced Films are selected for acquisition.

23. Investors are expected to derive assessable income from the Produced Films from the year ending 30 June 2005 through to the end of the year ending 30 June 2019.

Investment Agreement

24. The Investment Agreement sets out the terms and conditions under which the Investors agree to invest in the Produced Films.

25. Under the Investment Agreement, each of the Investors severally agrees to pay their Investment in the Produced Films into the Investment Account. The Investors irrevocably authorise the Manager to apply that amount to the Investors' payments of purchase price under the Copyright Acquisition Agreement (clause 2.1). The Investors authorise the execution on their behalf of the Copyright Acquisition Agreement and the Distribution Agreement (clauses 2.2 and 2.4).

26. Under clause 3.1 the Manager will receive Net Proceeds on behalf of the Investors under the Distribution Agreement. The Manager will open and operate an interest bearing Returns Account until 30 June 2019. The Returns Account will be used for receiving Net Proceeds, interest paid on the Returns Account and from authorised investments, and any Actual Distribution Guarantee Amount payable under the Distribution Agreement (clause 6).

27. The Manager will be entitled to receive an initial fee ('Application Fee') of 0.5% of the Investment payable by each Investor, an annual fee of \$50,000 and reimbursement of expenses. The annual fee and reimbursement of expenses will be paid from the Returns Account before any amounts are distributed to Investors (clause 7).

28. Investors will be entitled to distributions from the Returns Account in accordance with Schedule 6 as follows:

Firstly, to the Investors pro rata and pari passu until they have progressively received an amount equal to the Actual Distribution Guarantee Amount.

Secondly, to the Investors (pro rata and pari passu) and the Distributor in the proportions of:

Investors (pro rata and pari passu)	80%
Distributor	20%

until the Investors have received 100% of their Investment.

Thirdly, to the Investors (pro rata and pari passu) and the Distributor and Manager in the proportion of:

Distributor	25%
Manager	25%
Investors (pro rata and pari passu)	50%

until 30 June 2019.

29. The Manager will pay distributions on or before 45 days from 30 June and 31 December in each year (clause 6.9). On the payment of distributions the Manager will provide the Investors with a detailed statement relating to the Marketing of the Produced Films and any reports on the Marketing activities under the Distribution Agreement (clause 6.3). The Manager need not disburse amounts to the Investors unless the amount available exceeds \$20,000 or unless the Investors call for a disbursement of Distributable Amounts (clause 6.4).

30. The Manager, Investors or Distributor are not able to assign their rights or obligations under this agreement without the written consent of the others.

Accession Deed

31. The Accession Deed will be between each Investor and the Manager. Under this Deed, the Investor agrees to invest the sum specified in the Accession Deed and be bound by the terms and conditions of the Accession Deed and Investment Agreement.

32. Under Provision 2(c) of the Accession Deed the Investor warrants that the Investor is a resident of Australia for the purposes of the ITAA 1936 and ITAA 1997. At the expiry date of the Accession Deed all rights in the Produced Films will revert to the Production Producer.

Copyright Acquisition Agreement

33. The Copyright Acquisition Agreement makes provision for the acquisition by the Investors of 100% of the Copyright in the Produced Films covered by the agreement. The agreement is between the Production Producer and the Manager as agent for each of the Investors.

34. In consideration for the payment of each Investor's respective Investment, via the Manager, the Production Producer assigns to each Investor the present and future Copyright in each of the Produced Films acquired by the Fund (clause 2.2). The Copyright will be assigned to the Investors from the date of the agreement until 30 June 2019. The Investors will have no interest in, or receive any consideration for, the Copyright at the end of the Term. Each Investor's Copyright interest will be in the proportion their Investment relates to the total Investments. In accordance with clause 2.3 the sum of the Investors' Investments must be equal to:

- (b) the Minimum Subscription; or
- (c) the total purchase price paid in respect of the Produced Films selected for acquisition by the Manager on behalf of the Investors;

whichever is the greater.

35. The arrangement will not proceed if the Minimum Subscription of \$11,636,245 is not achieved by 30 June 2005.

36. At clause 2A the Production Producer assigns all of its rights, title and interest under existing Distribution Agreements to the Manager effective upon acquisition of the Produced Films by the Manager on behalf of the Investors.

Distribution Agreement

37. The Distribution Agreement is between the Distributor and the Manager as agent for each of the Investors. The Investors will grant the Distributor the exclusive Marketing Rights for each of the Produced Films acquired by the Fund, throughout the world for a 12 year term, with an option for the Distributor to extend the term for a further 2 years (clauses 2(a) and 24).

38. Gross Proceeds received by the Distributor from the distribution of the Produced Films will be deposited into the Collections Account. The Distributor must direct sub-distributors and sub-agents to pay amounts, less applicable deductions, directly to the Collections Account (clause 12). Gross Proceeds shall be applied in accordance with clause 5(b) as follows:

- (i) Commissions to the Distributor as per Schedule 4;
- (ii) Marketing Expenses as per Schedule 2; and
- (iii) Recoupment of any part of the Actual Distribution Guarantee Amount the Distributor has paid out which has not been recovered if, and only if, the amount of Net Proceeds distributed to the Manager before or after the Guarantee Time exceeds the Maximum Distribution Guarantee Amount,

and thereafter 100% of the balance (being Net Proceeds) shall be disbursed to the Manager at not less than six monthly intervals.

Distribution Guarantee

39. The Distributor will provide a distribution guarantee which will guarantee that Investors will receive by 30 June 2013 (on a cumulative basis) from all territories under the Distribution Agreement an amount equal to the level of presales obtained with arm's length third parties at the time of entry into the Distribution Agreement or 70% of the cost of acquiring the Copyright interests in the Produced Films (whichever is the greater).

40. In addition, the Distributor may enter into a credit insurance arrangement with an arm's length financial institution for the purpose of enhancing the credit obligations of the third party broadcasters and sub-distributors and of the Distributor. It is understood that any such arrangement will be entered into with a bank in an OECD country in the ordinary course of business and at commercial rates. The credit insurance will only protect Investors and/or the Manager against an insolvency issue or contractual default of a third party broadcaster or sub-distributor or the Distributor.

41. No amount of the Investment funds will be applied to secure the distribution guarantee. All Investment funds will be paid to the Production Producer in acquisition of the Copyright in each of the Produced Films acquired by the Fund.

42. The funding of the distribution guarantee or the credit insurance arrangement is not attributable in any way or form whether directly or indirectly to any money raised or expended in relation to the acquisition of the Produced Films. This includes the fees payable to any person who receives payment out of any moneys contributed to the cost of acquiring the Copyright in the Produced Films.

Finance

43. There is no finance facility offered by the Manager 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 Manager 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 Manager on or before 30 June 2005.

44. 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

Division 11A

45. The purchase price of the Copyright in the Produced Films is not a royalty. No amount of the purchase price is required to be withheld under the royalty withholding tax provisions in Division 11A.

Division 10B

46. Provided that the Minimum Subscription of \$11,636,245 is achieved by 30 June 2005, and provided that the Accession Deed, Investment Agreement, Copyright Acquisition Agreement and Distribution Agreement are executed on or before 30 June 2005, an Investor will become an owner of the Copyright in the Produced Films for the purposes of subsection 124K(1).

47. A deduction is available to an Investor in the Fund under Division 10B as follows:

- (a) 50% of the Investment is allowable in the year ending 30 June 2005, the year of income in which the Produced Films are first used by the Investors to produce assessable income, and
- (b) the remaining 50% is allowable in the year ending 30 June 2006.

Partnership

48. For the year ending 30 June 2005 and subsequent years of income, Investors who acquire 100% of the Copyright in the Produced Films from the Production Producer will be in a tax law partnership for the purposes of Division 5 of Part III of the ITAA 1936 (see definition of 'partnership' in section 995-1 of the ITAA 1997). The partners will receive income jointly from the commercial exploitation of the Copyright in the Produced Films. Section 90 of ITAA 1936 provides that the net income of a partnership is calculated as if the partnership were a resident taxpayer, and is the assessable income

less all allowable deductions. The partnership will be required to lodge a partnership return for each year of income, as required by section 91 of the ITAA 1936.

49. Each partner will be a partner in a partnership and, in accordance with section 92 of the ITAA 1936, where the partner is a resident, will be required to include his or her individual interest in the net income of the partnership in his or her assessable income.

Section 8-1 ITAA 1997

50. Each Investor will be entitled to a deduction under section 8-1 of the ITAA 1997 for their proportionate share of:

- (a) the annual management fee payable to the Manager by Investors;
- (b) the reimbursement of expenses incurred by the Manager; and
- (c) amounts payable to the Distributor and the Manager out of Distributable Amounts in accordance with the Investment Agreement.

51. The above expenses will be incurred by the Investors for the purposes of section 8-1 when they are paid to the Manager and/or the Distributor from the Returns Account in accordance with paragraphs 27 and 28.

Part 3-1 ITAA 1997 – Capital Gains Tax

52. The Copyright interest of each Investor will constitute a CGT asset.

53. The Application Fee will be capital expenditure and not deductible to the Investor, but will form part of the cost base and reduced cost base of the Investor's Copyright interest.

54. Where an Investor claims a deduction under Division 10B in respect of the purchase price for Copyright in the Produced Films, the cost base and reduced cost base of the Investor's Copyright interest in each Produced Film will be reduced by an amount equal to the amount of the Investor's Investment in accordance with section 110-45 of the ITAA 1997.

55. Each Investor will make a capital loss in relation to the Copyright in each Produced Film equal to the amount of the Application Fee on the termination of the Fund and the expiry of the Investor's Copyright interest on 30 June 2019.

Section 79D

56. Section 79D does not apply to deny or defer the deductions otherwise allowable.

Section 82KL

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

Part IVA

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

Assumptions

59. This Ruling is made subject to the following assumptions in respect of the Produced Films acquired by the Fund:

- (a) an Investor will incur capital expenditure on the purchase of Copyright (paragraph 124L(1)(b));
- (b) the Minimum Subscription will be achieved by, and the Accession Deed, the Investment Agreement, the Copyright Acquisition Agreement and the Distribution Agreement will be executed on or before, 30 June 2005;
- (c) the Project will be completed and the Partnership will use the Copyright for the purpose of producing assessable income on or before 30 June 2005 (subsection 124L(1));
- (d) a certificate, issued by the Department of Communication, Information Technology and the Arts, will be in existence in relation to the Produced Films (subsection 124K(1) or section 124ZAC);
- (e) the Investors will not exercise the discretion contained in subsection 124UA(2);
- (f) the effective life of the Copyright in the Produced Films is deemed to be two years (subsection 124UA(1));
- (g) 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 acquiring Copyright interests in the Produced Films ('Australian films');

- (h) the dominant purpose of the Investors is to make a commercial return from their investment in the Produced Films and the arrangements will be executed in the manner described in this Ruling; and
- (i) copyright interests are acquired at an arm's length value from the Production Producer.

Explanation

Corporations Act 2001

60. For this Ruling to apply, an offer for an interest in the Fund 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*.

61. An Investor in the Fund 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)); or
- the 'professional investor test' (paragraph 761G(7)(d)).

62. 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 Fund 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 Fund on acceptance by the person to whom the offer is made and the amounts previously paid by the person for interests in the Fund of the same class that are held by the person add up to at least \$500,000.

63. 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.

64. 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.

Division 11A

65. The Production Producer is a company incorporated under the laws of Hong Kong. The total Investments paid by the Manager, on behalf of the Investors, to the Production Producer as the purchase price of the Produced Films is not a royalty, either under any of the specific statutory categories, or under the general law. No amount of the purchase price is required to be withheld under the royalty withholding tax provisions in Division 11A.

Division 10B

The Cost of a Unit of Industrial Property

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

67. In our view, based on the information provided, the Investors and the Production Producer are dealing at arm's length. The Investors will pay the Investment to the Manager under the terms of the Investment Agreement. The Manager will enter into the Copyright Acquisition Agreement with the Production Producer under which the Investors will be assigned 100% of the Copyright in the Produced Films on payment of the Investment (purchase price).

Used for the purpose of producing assessable income

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

69. The Investors, through the Manager, will licence their interest in the Copyrights to the Distributor. The Distributor will market the Produced Films worldwide. The Partnership is to receive income generated from the commercial exploitation of the Produced Films in accordance with Schedule 6 of the Investment Agreement. It is our view that the Copyright in the Produced Films will be used for the purpose of producing assessable income. A deduction will be available to the Investors in the year ending 30 June 2005 provided the Investors purchase their Copyright interest in the Produced Films and the relevant transaction documents are executed on or before 30 June 2005.

Entitlement to annual deductions

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

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

Residual value

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

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

Effective life of a unit

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

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

75. Once Minimum Subscription is obtained, on or before 30 June 2005, the Production Producer will assign 100% of the Copyright in the Produced Films purchased to the Investors. The Production Producer will also assign 100% of the Copyright in Produced Films purchased after Minimum Subscription and on or before 30 June 2005. The residual value for an Investor will be the capital expenditure incurred by that Investor to acquire their Copyright interest in the Produced Films acquired by the Fund on or before 30 June 2005.

76. On the assumption that no election in terms of subsection 124UA(2) will be made, the effective life of the Copyright in the Produced Films is two years. Consequently, the deduction available to an Investor in the year in which the Copyright is first used by the Partnership to produce assessable income is 50% of the capital expenditure incurred by that Investor to acquire his or her interest in the Copyright.

77. The deduction available in the following year will be the residual value of the Copyright in the Purchased Films at that time, being the cost of the unit to the owner less the deductions allowed in previous years (assuming that no consideration was received by the Partnership or the Investors when the Manager, on behalf of the Investors, enters into the Distribution Agreement). The deduction available is therefore the remaining 50% being, the capital expenditure incurred (cost of unit) less the 50% deduction allowed in the previous year.

Partnership for income tax purposes

78. The Investors who acquire 100% of the Copyright in the Produced Films will comprise 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). Division 5 of Part III applies so that the assessable income of a partner includes so much of the individual interest of the partner in the net income of the partnership or, in the case of a partnership loss, a partner is entitled to a deduction for so much of his or her individual interest in any loss of the partnership. It should be noted that the partnerships are not common law partnerships and consist only of the persons who receive income jointly from the exploitation of the Copyright in the Produced Films. The Manager and the Distributor are not partners in the Partnership.

79. The Partnership will receive passive income from the exploitation of the Copyright in the Produced Films.

80. As the Investors between them hold 100% of the Copyright in the Produced Films, the Investors' tax law partnership is entitled to the income received in the Returns Account. The amounts paid from the Returns Account prior to distributions to Investors are not amounts paid by the Investors' tax law partnership (refer to paragraphs 82 to 85).

81. A partnership return will be required to be furnished for each year of income as required by section 91. The Investors will be required to disclose their share of the partnership net income in their returns of income as required by section 92.

Section 8-1 ITAA 1997

82. The annual \$50,000 Management Fee incurred by the Investors under the Investment Agreement will be an allowable deduction to the Investors under section 8-1 of the ITAA 1997 as the Management Fee is incurred by the Investors in gaining or producing assessable income of the Investors tax law partnership.

83. Amounts paid into, and credited to, the Returns Account will be assessable income to the Investors' tax law partnership. Amounts deducted from the Returns Account under the Investment Agreement in respect of expenses incurred by the Manager in relation to the management of the Copyright interests will be an allowable deduction of the Investors, in the proportion that each Investor's Investment relates to the total Investments, pursuant to section 8-1 of the ITAA 1997. The liability to pay the reimbursement is incurred by the Investors in gaining or producing the assessable income of the Investors' tax law partnership.

84. Distributions of Distributable Amounts to the Manager and Distributor, respectively, in accordance with the Investment Agreement, will be an allowable deduction to the Investors, in the proportion that each Investor's Investment relates to the total Investments, pursuant to section 8-1 of the ITAA 1997, as these outgoings are also incurred in gaining or producing assessable income of the Investors' tax law partnership.

85. The deductibility of interest incurred by Investors who finance their participation in the Fund through a loan facility with a bank or other financier is outside the scope of this Ruling. Product Rulings only deal with arrangements where all details and documentation have been provided to, and examined by, the Tax Office.

Capital Gains Tax

The Copyright Interest of each Investor in each Produced Film is a CGT asset

86. Subsection 108-5(1) of the ITAA 1997 defines a CGT asset to include 'any type of property' or 'a legal or equitable right that is not property'. The Copyright Act 1968 provides that Copyright is a personal proprietary right.

87. The Investment Agreement provides that the Investors each have an aliquot share in the Copyright of each Produced Film, arising from the common ownership of the Copyright by the Investors as tenants in common. Paragraph 108-5(2)(a) of the ITAA 1997 provides that a part of, or an interest in, a CGT asset, is also a CGT asset. Accordingly, each Investor's interest in the Copyright of each Produced Film will constitute a CGT asset.

Cost base and reduced cost base of an Investor's Copyright interest

88. The cost base of each Investor's Copyright interest comprises 5 elements, as set out in section 110-25 of the ITAA 1997.

89. In the circumstances of the Arrangement, the Investment of each Investor is money paid in respect of acquiring each Investor's Copyright interest, and therefore, prima facie, forms part of the first element of the cost base under subsection 110-25(2) of the ITAA 1997.

90. However, where the Investor has deducted the amount of their proportion of the purchase price under Division 10B, section 110-45 of the ITAA 1997 will operate to preclude the Investment forming part of the cost base and reduced cost base of the Investor's Copyright interest.

91. The second element of the cost base is the incidental costs incurred by the taxpayer to acquire the CGT asset and that relate to the CGT event that happens to the asset (subsection 110-25(3) of the ITAA 1997). The 'incidental costs' which may be included in the cost base include remuneration for the services of an agent.

92. Pursuant to the Investment Agreement, the Manager acts as the agent of the Investor in entering into the Copyright Acquisition Agreement on behalf of each Investor. The Application Fee is paid by way of remuneration for the services of the Manager in this regard. It follows that the Application Fee forms part of the cost base and reduced cost base of the Investor's Copyright interest under the second element.

93. As the Application Fee is regarded as capital expenditure and non-deductible by the Investor, subsection 110-45(1B) of the ITAA 1997 does not operate to exclude the fee from forming part of the cost base of the Investor's Copyright interest.

Capital loss on termination of Copyright interest

94. When the Investor's Copyright interest in each of the Produced Films expires, CGT event C2 will happen (paragraph 104-25(1)(c) of the ITAA 1997). No capital proceeds will be received by an Investor for the expiration of the Copyright interest. Accordingly, on expiration of the Copyright interest, each Investor will

make a capital loss equal to the reduced cost base of the Copyright interest.

95. The reduced cost base of the Copyright interest will be at least equal to the amount of the Application Fee, but will not include the amount of the Investment to the extent that the Investor has deducted their purchase price for their share of the Copyright in the Produced Films under Division 10B.

Section 79D

96. Section 79D does not apply where there are no 'foreign income deductions' (as defined in subsection 160AFD(9)).

97. The transactions covered by the arrangement do not give rise to 'foreign income deductions' because the deductions under Division 10B do not relate to any 'assessable foreign income' (as defined in subsection 160AFD(9)). The income derived by the Investors under the Distribution Agreement will have an Australian source and will not be 'assessable foreign income'.

98. The Investors' have no beneficial interest in the Gross Proceeds received by the Distributor and paid into the Collections Account. The Investors have no entitlement to any withholding tax credits deducted from amounts paid into the Collections Account. The Investors are only entitled to amounts paid into, or credited to, the Returns Account.

Section 82KL – recouped expenditure

99. The operation of section 82KL depends, among other things, on the identification of a certain quantum of 'additional benefits'. Insufficient 'additional benefits' will be provided in respect of this project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 124M.

Part IVA

100. 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 Investors will obtain, for example, a 'tax benefit' from entering into the scheme, in the form of a deduction allowable under the provisions in Division 10B, that would not have been obtained but for the scheme. 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 a tax benefit.

101. 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 in the Produced Films. 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.

Detailed contents list

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Related Rulings/Determinations:

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

Subject references:

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

Legislative references:

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- ITAA 1936 82KL
- ITAA 1936 Pt III Div 5
- ITAA 1936 90
- ITAA 1936 91
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- ITAA 1936 124K(1)
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- ITAA 1997 104-25(1)(c)
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- Corporations Act 2001
- Corporations Act 2001 761G
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