



PR 2005/103 - Income tax: Film Investment - Heist

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 This document has changed over time. This is a consolidated version of the ruling which was published on *10 August 2005*



Product Ruling

Income tax: Film Investment – Heist

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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**, **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 'Heist', 'the Film' or 'the Project'.

Tax law(s)

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

- section 26AG of the *Income Tax Assessment Act 1936* (ITAA 1936);
- section 79D of the ITAA 1936;
- section 82KL of the ITAA 1936;
- Division 5 of Part III of the ITAA 1936;
- Division 10BA of Part III of the ITAA 1936;
- section 124ZAG of the ITAA 1936;
- section 124ZAO of the ITAA 1936;
- Part IVA of the ITAA 1936;
- Division 35 of the *Income Tax Assessment Act 1997* (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. In this Ruling, where applicable, all fees and expenditure referred to include Goods and Services Tax (GST) set out in the *A New Tax System (Goods and Services Tax) Act 1999* (GST ACT). An 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*.

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 of 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
Attorney General's Department
Robert Garran Offices
National Circuit
Barton ACT 2600

or posted at: <http://www.ag.gov.au/ccca>

Date of effect

11. This Ruling applies prospectively from 10 August 2005, 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 Rulings

14. This Ruling replaces Product Ruling PR 2005/82 which is withdrawn on and from the date this Ruling is made, 10 August 2005. Product Ruling PR 2005/82 does not apply to any Investors as no applications were accepted for the Film by 30 June 2005.

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 15 March 2005 as constituted by documents provided on 17 March 2005, 24 March 2005, 29 March 2005, 19 April 2005, 6 May 2005, 13 May 2005 and 16 May 2005 and

- additional correspondence dated 22 March 2005, 19 April 2005, 6 May 2005 and 16 May 2005;
- Correspondence from the Tax Office to the Applicant dated 17 March 2005, 24 March 2005, 30 March 2005, 7 April 2005, 2 May 2005;
 - Draft Information Memorandum for Heist received by the Tax Office on 16 May 2005;
 - Draft **Production and Investment Deed** between Backdaw Productions Pty Ltd ('the Production Company'), WMS Solutions Pty Ltd ('the Representative') and the Investors, received by the Tax Office on 29 July 2005;
 - Draft **Accession Deed** between Backdaw Productions Pty Ltd ('the Production Company'), WMS Solutions Pty Ltd ('the Representative') and the Investors, received by the Tax Office on 29 July 2005;
 - Assignment Deed between Ian Daw ('the 'Owner') and Backdaw Productions Pty Ltd ('the Production Company') dated 21 March 2005;
 - Draft Distribution Licence – Australasia between Backdaw Productions Pty Ltd and Intertropic Films Pty Ltd ('the Distributor') received by the Tax Office on 29 March 2005;
 - Letter from an overseas Distributor to Backdaw Productions Pty Ltd dated 26 January 2005;
 - Letter of Intent from a local Distributor to Backdaw Productions dated 22 February 2005;
 - Letter of Intent from a Completion Guarantor to Backdaw Productions Pty Ltd dated 18 February 2005; and
 - Provisional Certificate under section 124ZAB dated 16 February 2005 in relation to Heist.

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. 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.

17. In accordance with the above documents, an Investor who participates in the Project must be a wholesale client as defined in section 761G of the *Corporations Act 2001*. A wholesale client is explained in paragraphs 58 to 62 in the Explanation area of this Product Ruling.

The Participants

18. The parties involved in the arrangement are:

- **Investor:** A person who enters into an Accession Deed and a Production and Investment Deed, incurs capital expenditure in acquiring an interest in the Copyright in the Film and is accepted by the Production Company in accordance with the Production and Investment Deed.
- **Representative:** WMS Solutions Pty Ltd will be appointed as Representative to act on behalf of the Investors (clause 1.4 of the Production and Investment Deed). As stated in section 14 of the Information Memorandum, WMS Solutions Pty Ltd will be appointed as representative of each Investor and is responsible for monitoring the production and marketing of the Film on behalf of the Investors, representing their interests generally and performing various administrative tasks.
- **Production Company:** Backdaw Productions Pty Ltd will act as the Production Company and agrees to produce and complete the Film pursuant to clause 4.2 of the Production and Investment Deeds.
- **Distributor:** Intertropic Films Pty Ltd will be granted an exclusive licence by the Production Company to distribute the Film for the Territory. The Territory means the countries and/or geographical areas specified in Item 8 of the Schedule accompanying the Distribution Licence – Australasia.
- **Distributor:** An overseas Distributor, in its letter of 26 January 2005, has indicated its willingness to act as the international sales agency for worldwide distribution of the Film.
- **Distributor:** A local Distributor, in its Letter of Intent of 22 February 2005, has indicated its willingness to distribute the Film to all major home video and television markets.
- **Completion Guarantor:** A Completion Guarantor, in its Letter of Intent of 18 February 2005, has confirmed that it is, in principal, prepared to issue a Completion Bond on the Film, subject to the fulfilment of certain conditions.

Defined terms

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

- **'Accession Deed'** means a deed substantially in the form of Annexure 'A'.
- **'Ancillary Rights'** means the following rights to the extent (if any) which the Production Company shall have them at any time:
 - (a) the right to deal with the Copyright of the Script;
 - (b) the right to use the characters in the Script and the Film in any way;
 - (c) the right to make or license the making of recordings of the soundtrack of the Film; and
 - (d) merchandising rights.

For clarity, Ancillary rights do not include:

- (i) the right to publish the Script in volume form;
- (ii) the right to produce a stage play or other dramatic work based on the Script;
- (iii) the right to produce any film about the production of the Film;
- (iv) the right to any novel or book relating to, or developed from the Script or the Film; or
- (v) the right to produce or exploit any sequel, remake or series based on the Film and the Script or on the characters or events in the Script and the Film.
- **'Auditor'** means the person named as such in the Production Particulars in Schedule 1 Part B or a replacement person approved by the Representative as Auditor.
- **'Bank Accounts'** means the Production Account, the Collections Account and any other accounts established for the production and Marketing of the Film.
- **'Budget'** means the detailed budget for production of the Film approved by the Production Company appearing in Part A of the First Schedule which shall not in total exceed the amount of the Budgeted Cost.
- **'Budgeted Cost'** means the amount specified as such in Part A of Schedule 2.
- **'Collections Account'** means the bank account referred to in 2 of Part B of Schedule 2. The name of the Account is, 'Backdaw Productions Pty Ltd Heist Collection Account'.

- **‘Completion Date’** means the date of completing the Film which (subject to any extension which is agreed by the Production Company and all Investors) shall be on or before 30 June 2008.
- **‘Completion Guarantor’** means the completion guarantor of the Film.
- **‘Copyright’** means:
 - (a) the Copyright of the Film under section 86 of the Copyright Act of the Commonwealth of Australia;
 - (b) Copyright of the Film under the law of any country other than Australia; and
 - (c) rights in the Film in the nature of, or analogous to, the rights in (a) and (b) under the law of Australia or any other country.
- **‘Deductible Expenses’** means all actual and reasonable costs paid or incurred by the Distributor directly in connection with the exploitation of the Licence and, without limitation, includes:
 - (a) the P & A Expenditure;
 - (b) censorship application fees and other expenses payable in connection with the censorship classification of the Film;
 - (c) the cost of transporting the Film to and within the Territory including all insurances, shipping charges and customs and import duties and other charges and expenses incurred and paid by the Distributor in connection with delivery of all prints, accessories, trailers and publicity material;
 - (d) storage and warehousing expenses for all prints, accessories, trailers and publicity materials;
 - (e) the cost of all tape masters, dubs and all materials necessary for the manufacture of sub-masters, format conversion costs and all other charges made by laboratories or transfer houses for supplies and work which may be required in connection with the Film;
 - (f) all screening expenses;
 - (g) all charges and expenses related to the checking of percentage engagements;
 - (h) all sums actually expended by the Distributor in connection with cutting, editing, reassembling, re-editing or re-scoring in accordance with this Agreement;

- (i) insurance premiums on negatives, masters, prints and dubs;
- (j) music copyright royalties paid or incurred;
- (k) all sums required to be paid or payable to any guild, union or other party on account of or in connection with the exploitation of the Licence;
- (l) subject to the prior written approval of the Licensor, all reasonable costs and expenses incidental to the assertion or maintenance of claims for the infringement of or other interference by third persons with the Film or any part of parts thereof or, subject to the prior written approval of the Licensor, all reasonable legal fees and other costs and expenses in connection with any actions for the enforcement thereof and, subject to the prior written approval of the Licensor, all reasonable legal expenses properly incurred in connection with any of the foregoing matters, or in connection with any litigation questioning rights in the Film, as well as any and all sums spent in connection with proceedings or actions which may be taken against any third parties to pay any moneys due on account of the Film, or on account of any arrangements with said third parties in which the Film is involved;
- (m) Australian feature film industry standard fees for, as applicable, the in-house provision of the following services:
 - (i) publicist;
 - (ii) graphic art and layout design;
 - (iii) photographic processing; and
 - (iv) duplication and/or mastering,where, in accordance with Australian feature film industry practice, those services would otherwise be provided by third parties as part of the proper exploitation of the Licence and are reasonable, substantiated and directly attributable to the Film; and
- (n) reasonable travel and accommodation expenses of the Distributor's employees provided they are incurred with the prior written approval of the Licensor,

but, except as provided in (n) above, excluding salaries or wages of its employees.

- **'Distribution Fee'** means the applicable fee payable to the Distributor in accordance with this Agreement in respect of the Distributor's exploitation of the Licence, being 15% of Gross Receipts.
- **'Expiry Date'** means 30 June in the year immediately following the date of seven years after Completion of the Film which may be extended by the Production Company, and which shall include such further period to receive Gross Receipts which are due but not received by the Production Company prior to the Expiry Date.
- **'Final Certificate'** means a certificate issued pursuant to Division 10BA of Part III of the ITAA 1936 as amended or replaced.
- **'Force Majeure'** means war, invasion, acts of foreign enemies, terrorism, hostilities (whether war be declared or not) civil war, rebellion, revolution, insurrection, military or usurped power or confiscation or nationalism or requisition or destruction of or damage to property or act of interruption, natural disaster, cyclone, act of god, incapacity of director, change of legislation, subordinate legislation, local government laws, and administrative fiat or decree, or any other matter of cause which is beyond the reasonable control of the Production Company.
- **'Gross Receipts'** means all money resulting from Marketing and actually received by the Production Company by the Expiry Date.
- **'Investment'** means the amount actually contributed by the Investor to the Budgeted Cost and **'Investments'** has a corresponding meaning.
- **'Market'** means the exclusive right to assign, license and otherwise deal with the Film and all Ancillary Rights throughout the World, and all physical material created in relation thereto and Marketing has a similar meaning.
- **'Overage'** means any amount in excess of the Budgeted Cost required to complete the Film which is expended by the Production Company in accordance with this Deed.
- **'Production Account'** means the bank account referred to in Part B of Schedule 2. The name of the Account is, 'Backdaw Productions Pty Ltd Heist Production Account'.
- **'Production Particulars'** means the production particulars of the Film appearing in Part B of the First Schedule.
- **'Provisional Certificate'** means a provisional certificate issued under Division 10BA of Part III of the ITAA 1936.
- **'Purchase Price'** means one dollar (\$1.00) exclusive of GST.

- **‘Qualifying Australian Film’** means a qualifying Australian film as defined in the ITAA 1936.
- **‘Script’** means the script (including revisions) written by Greg Clayton and Phil Avalon based on the story outline written by Ian Daw and as modified by the Production Company during the production of the Film.
- **‘Territory’** means:
 - (a) The Commonwealth of Australia;
 - (b) New Zealand; and
 - (c) Papua New Guinea, Fijian Islands, Tonga, Cook Islands, Samoa, Norfolk Island, Kiribati, Phoenix Islands, Tuvalu, Nauru, New Britain, Solomon Islands, Admiralty Islands, New Caledonia, Vanuatu, the Tokelau Islands and the Christmas Islands.
- **‘Underage’** means any of the Budgeted Cost unexpended by a day 3 months after the Completion Date.
- **‘Underlying Rights’** means the rights throughout the world for the respective periods of copyright to themselves (and authorise others to) make and Market the Film by all means devised and yet to be devised using the Script (exclusively) and the music (non-exclusively) used in the Film (‘the Music’).
- **‘Warranties’** means the warranties of the Production Company set out in Schedule 3.
- **‘Work’** means the literary or dramatic work in the Script of the Film including any revisions thereof.

The Project

20. The Project involves the production of a film entitled ‘Heist’. Provisional Certificate number P06929 dated 16 February 2005 has been issued by the Department of Communications, Information Technology and the Arts in respect of the Film to be made by the 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.

21. The total budgeted cost of the Film is \$4,997,870 which comprises direct production costs of \$4,932,870 and Non-Deductible Expenses of \$65,000.

22. Investors will make capital contributions towards the direct production costs of the Film and the Non-Deductible Expenses. The Minimum Investment that will be accepted is \$110,000 and thereafter, Investments will be accepted in multiples of \$11,000. There is no minimum subscription; in the event that the Film is not fully subscribed all funds will be returned to Investors.

Accession Deed

23. To invest in the Film an Investor must enter into an Accession Deed with the Production Company and the Representative. Under the Accession Deed, the Investor agrees to invest the sum specified in the Deed as its Investment in the Film. The Investor also agrees to be bound by the terms and conditions contained in this Deed and the Production and Investment Deed.

24. The Investor irrevocably and exclusively appoints the Representative or its nominee to solely represent it in all dealings with the Production Company in relation to the Film.

25. The Investor will be entitled to the share of copyright in the Film specified in Item 3 of the Schedule or as calculated in accordance with the Production and Investment Deed.

Production and Investment Deed

26. The Investment Deed is between the Production Company, the Representative and the Investor. Recital D. states that by executing an Accession Deed the Investors have severally agreed to invest in the production of the Film under the terms of this Deed which creates ownership of a share of the Copyright and a right to a share of the Gross Receipts.

27. Each Investor agrees to contribute the Investment by payment into the Production Account immediately upon execution of an Accession Deed. If the Investments do not equal the Budgeted Cost by 29 June 2006, the Production Company shall return all Investments to the Investors within 14 days and all rights, responsibilities, powers and obligations of the parties under this Deed shall immediately be at an end.

28. The Production Company will expend any underage on meeting direct costs of producing the Film.

29. The Production Company will pay any overages not met by the Completion Guarantor.

30. The parties agree that from the Completion Date until the Expiry Date, the Investors (in respect of their Investments) and the Production Company own the Copyright of the Film as tenants in common in the following proportions:

Production Company:	50%
Investors:	50% × $\frac{\text{Investors Investment}}{\text{total of all Investors Investments}}$

31. As and from the Expiry date, all Copyright and all other rights in the Film will be owned solely by the Production Company, and subject to the rights of the Representative and the Investors to sue for antecedent breach, all rights, responsibilities, powers and obligations of the parties will terminate on the Expiry Date.

32. The Production Company must produce and complete the Film by the date one year after commencement of principal photography of the Film or 30 June 2008, whichever occurs first.

33. The Production Company must establish the Production Account prior to the date of this Deed and the Collections Account within thirty days after the Completion Date. Money in the Production Account may not be expended before 29 June 2006 except on bank charges and only be expended as provided in this Deed. The Production Company must pay Gross Receipts received by it directly into the Collections Account.

34. Each Investor grants the Production Company an exclusive licence to Market for that Investor's interest in the Underlying Rights and the Copyright. This exclusive licence to Market commences on the date of this Deed and, subject to this Deed, continues until the Expiry Date.

35. Gross Receipts must be distributed by the Production Company according to the following 'Disbursement of Gross Receipts' Schedule:

FIRST:	1% of Gross Receipts to be paid to the Representative as its fee.
SECOND:	To the Investors pro rata and pari passu until each has thereby received 100% of the amount they have invested in the Film.
THIRD:	To the Production Company for the amount of Overages paid or borrowed by the Production Company for Overages including any interest on loans.
FOURTH:	To the Completion Guarantor to repay any moneys provided by the Completion Guarantor in relation to the Film.

- FIFTH: (a) to the Production Company 50%; and
(b) to the Investors 50%, and to each Investor pari passu and pro rata that their Investment bears to the total of all Investments.
- SIXTH: After the Expiry Date, all Gross Receipts are payable to the Production Company.

Assignment Deed

36. In consideration of the payment of the Purchase Price to the Owner by the Purchaser, the Owner as beneficial and legal owner, assigns to the Purchaser all his present and future right, title and interest (including copyright) in and to the Work throughout the world for the full period of copyright of it.

37. The Purchaser agrees to pay the Purchase Price on the execution of this Deed.

Distribution Licence – Australasia

38. Under this Licence, the Licensor grants to the Distributor an exclusive license to distribute the Film on the terms and conditions set out in this Agreement. The Licensor has the sole and exclusive right to grant a distribution licence for the Territory of the Film.

39. Gross Receipts will be distributed in the following order:

First – in payment to the Distributor of the applicable Distribution Fee;

Second – in payment to the Distributor of the Deductible Expenses; and

Third – in payment of the balance to the Licensor, by deposit to the credit of the Collection Account.

Letter from the overseas Distributor

40. An overseas Distributor has indicated that it would be prepared to act as the international sales agency for worldwide distribution. In the letter to the Production Company they have stated that their standard sales commission would be in the region of 10% for the US and 15% for all other territories.

Letter of Intent from the local Distributor

41. A local Distributor has indicated that it would be prepared to distribute the Film to all major home, video and television markets.

Distribution Agreements

42. All distribution agreements will be between the Distributor and the Production Company as exclusive licensee of the Investors. All overseas Gross Receipts of the Film will be paid to the Production Company as exclusive licensee. The Production Company will pay all of those Gross Receipts into the Collections Account.

Letter of Intent from the Completion Guarantor

43. The Completion Guarantor has indicated that it is in principle, prepared to issue a completion Bond to the fulfilment of certain conditions. It needs to be satisfied:

- with matters such as the final shooting script, final budget, final shooting schedule, post-production schedule and delivery requirements;
- that the financing for the budget (including contingency) is in place, and all the agreement for the acquisition of the rights to the script written are adequately assured to the Production company; and
- in respect to contracts of employment of the key cast and crew and in respect to a number of other matters such as insurance, music rights, filming locations, studio, laboratory deal and post-production generally.

Finance

44. There is no finance facility offered by the Production Company or any other party to the arrangement. Investors can fund their investment in the Film themselves, or borrow from an independent lender. Regardless of the source of loan funds, this Ruling will not apply to Investors if the Production Company 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 Production Company on or before the execution of the Accession Deed and the Production and Investment Deed.

45. This Ruling does not apply if a finance arrangement entered into by an Investor to fund the Investor's Investment in the Film 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;
- 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 10BA

46. A deduction is available to an Investor in the Film under Division 10BA for 98.7% of the amount contributed toward the production costs of the Film.

47. A deduction is not available until the production budget of \$4,997,870 has been achieved, each Investor's Accession Deed has been executed, and the Production and Investment Deed has been executed.

48. Upon Completion of the Film, after the audit has been carried out by an independent auditor, Division 10BA deductions will be withdrawn from Investors to the extent that their investment moneys were spent on Non-Deductible Expenses (section 124ZAG).

Partnership and section 26AG

49. For the year ending 30 June 2006 and subsequent years of income, Investors who initially acquire 50% of the Copyright in the Film 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). The partners will receive income jointly from the commercial exploitation of their Copyright interest in the Film.

50. All amounts received by the Partnership, in respect of the Film are assessable income of the Partnership under section 26AG in the income year in which they are received. This includes amounts received on the disposal of a Copyright interest. 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.

Section 124ZAO

51. Interest in respect of investment 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 from the Film (subsection 124ZAO(2)). Any excess interest and revenue outgoings may be carried forward indefinitely and offset against future income from the Film (subsection 124ZAO(3)).

52. The deductibility or otherwise of interest arising from loan agreements entered into with financiers is outside the scope of this Ruling. Refer to paragraphs 78 and 79 for further information.

Division 35 of the ITAA 1997

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

Section 79D

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

Section 82KL

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

Part IVA

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

Assumptions

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

- (a) the Investor was a resident of Australia for tax purposes at the time the money was expended (subparagraph 124ZAFA(1)(b)(i));
- (b) the investment moneys will be paid to the Production Company by way of contribution to the cost of producing the Film under a contract entered into on or before the end of the financial year in which the capital

moneys are to be expended by the Division 10BA Investor, being 30 June 2006. The production contract will specify that the investment moneys contributed represent the estimated cost of production of the Film (paragraph 124ZAFA(1)(a) and subparagraph 124ZAFA(1)(d)(iv));

- (c) at the relevant time, a provisional certificate (section 124ZAB) or a final certificate (section 124ZAC) is in force in relation to the Film;
- (d) each Investor, at the relevant time, expects to become one of the first owners of the Copyright in the Film when the Copyright comes into force (subparagraph 124ZAFA(1)(c)(i));
- (e) each Investor, at the relevant time, intends to use the interest in the Copyright for the purpose of producing assessable income from the exhibition of the Film as mentioned in subparagraph 124ZAFA(1)(c)(ii);
- (f) there will be in force a declaration lodged in respect of the Film in accordance with subsection 124ZADA(1) by a person accepted by the Commissioner under subsection 124ZADA(2) as an appropriate person to make such a declaration (subparagraph 124ZAFA(1)(d)(iii));
- (g) before the expiration of six months after the time when the Film is completed, an application will be made for a final certificate in accordance with section 124ZAC, otherwise the provisional certificate shall be deemed never to have been in force (subsection 124ZAB(10));
- (h) all requirements of the Department of Communications, Information Technology and the Arts will be met and a final certificate will be issued;
- (i) the Film will be completed and the Investors' interest in the Copyright in the Film will be used for income producing purposes within two years after the close of the financial year in which the contributions are made (subsection 124ZAFA(2));
- (j) by reason of the said capital moneys being expended, the Investor will become one of the first owners of the Copyright in the Film before 1 July 2008;
- (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 Production Company will expend the Underage in a manner that will preserve the status of the Film as a 'qualifying Australian Film'; and
- (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.

Explanation

Corporations Act 2001

58. For this Ruling to apply, an offer for an interest in the Project 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*. Offers to wholesale clients do not require a prospectus or product disclosure statement.

59. An investor in the Project 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)).

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

61. 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.

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 '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 10BA

The 'directly expended' requirement

63. 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.

64. Paragraph 8 of Taxation Ruling IT 2111 discusses this requirement. It states: 'Direct expenses on a film production which qualify for a deduction under section 124ZAA can generally be described as **those relating to the production process** as distinct from those associated with financing or marketing of the Film. Such expenses would **typically include amounts paid for the acquisition of story rights and the surveying of locations, payments to the producers, directors and cast, and the costs of insurance of production associated risks, drawing up performers' contracts and the building of sets and scenery**' (emphasis added).

65. The investors will pay the Investments to the Production Company which will use 98.7% of total Investments, being \$4,932,870, for application towards the production costs. In doing this, the Production Company is to ensure that this proportion of funds contributed by investors is only expended on items within the Film's production Budget.

66. The Tax Office view is that the 'directly expended' requirement is not met at the point in time when the Investors make payments to the Production Company in respect of the Budget for the Film. Rather, the extent of the application of the money by the 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.

67. 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 Production Company as Underage. In this regard, the parties have agreed that any Underage will be retained by the Production Company as an additional production fee in a manner that will preserve the status of the Film as a 'qualifying Australian film'.

68. 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.

69. 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

70. 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).

71. 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.

72. The 'at risk' rule applies to an Investor's risk of loss before and after completion and distribution of the Film. Any arrangement which limits an Investor's risk of loss can breach the 'at risk' rule. Certain types of common industry arrangements affecting risk during production of the Film are accepted as not offending the 'at risk' rule. This acceptance does not extend to arrangements which put funds into the hands of Investors to enable them to make their contributions to the costs of film production. This cannot be taken to mean that post-completion arrangements are also acceptable if they do not put funds into the hands of Investors to enable them to make their contributions. The position in paragraph 13 of IT 2111 is limited to the situations expressly mentioned.

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

Non-arm's length transactions

74. 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.

75. 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 fund would normally be required.

76. 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 2006, 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.

Partnership and assessable income

77. 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). All amounts received by a Partnership of Investors in a Film, including amounts received on disposal of the Copyright in the Film, will be assessable income of the Investors under section 26AG in the income year in which they are received. 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.

Interest on borrowed funds

78. Investors should note that the deductibility of interest is outside the scope of this Ruling (refer to paragraph 52). However, interest incurred on borrowed funds should be deductible provided the finance arrangement does not contain any of the features identified in paragraphs 44 and 45.

79. 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 from the Film (subsection 124ZAO(2)). Any excess interest may be carried forward to succeeding years of income for offset against future film income from the Film (subsection 124ZAO(3)).

Division 35 of the ITAA 1997

80. Subsection 35-5(2) of the ITAA 1997 specifically provides that Division 35 of the ITAA1997, which regulates the deduction of losses from non-commercial business activities, is not intended to apply to 'activities that do not constitute carrying on a business, for example, the receipt of income from passive investment'.

81. The transactions covered by the Project amount to an acquisition of passive investments and the deriving of income from those investments. Hence, Division 35 of the ITAA 1997 does not apply to the Project.

Section 79D

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

83. The transactions covered by the Project do not give rise to 'foreign income deductions' because the deductions under Division 10BA do not relate to any 'assessable foreign income' (as defined in subsection 160AFD(9)). The income derived by the Investors under the Draft Distribution Licence – Australasia, and any other Distribution Agreements entered into by the Production Company, will have an Australian source and will not be 'assessable foreign income'.

84. The Investors have no beneficial interest in the Gross Receipts received from any Distributors. The Investors have no entitlement to any withholding tax credits deducted from amounts paid under the Draft Distribution Licence – Australasia, or any other Distribution Agreements entered into by the Production Company. The Investors are only entitled to amounts paid into, or credited to, the Collections Account held by the Production Company.

Section 82KL – recouped expenditure

85. Section 82KL has no application to Division 10BA arrangements and is therefore not relevant to any deductions properly allowable to the Investors under Division 10BA.

Part IVA

86. 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.

87. An Investor to whom this Ruling applies intends to stay in the scheme for its full term and derive assessable income from the exploitation of the Copyrights of the Film. Further, there are no features of the Project, as described in the said arrangement, that suggest that the Project is so 'tax driven' and 'so designed to produce a tax deduction of a certain magnitude', that the operation of Part IVA is attracted.

Payment of interest by an Investor where an assessment is amended

88. 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.

89. 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* under which the Commissioner can remit, in appropriate circumstances, the whole or part of the charge.

Detailed contents list

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Related Rulings/Determinations:

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

Previous Rulings/Determinations:

PR 2005/82

Subject references:

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

Legislative references:

- ITAA 1936 26AG
- ITAA 1936 26AG(9)
- ITAA 1936 79D
- ITAA 1936 82KL
- ITAA 1936 Pt III Div 5
- ITAA 1936 Pt III Div 10BA
- ITAA 1936 124ZAA(6)
- ITAA 1936 124ZAB
- ITAA 1936 124ZAB(10)
- ITAA 1936 124ZAC
- ITAA 1936 124ZADA(1)
- ITAA 1936 124ZADA(2)
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- ITAA 1936 124ZAFA(1)(d)(iii)
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- ITAA 1936 177A
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- Corporations Act 2001
- Corporations Act 2001 761G
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- Corporations Act 2001 761G(7)(c)
- Corporations Act 2001 761G(7)(d)

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