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**Taxation Laws Amendment (Film Incentives) Bill
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I N F O R M A T I O N A N D R E S E A R C H S E R V I C E S

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No. 93 2001-02

Taxation Laws Amendment (Film Incentives) Bill 2002

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Taxation Laws Amendment (Film Incentives) Bill 2002

Date Introduced: 14 February 2002

House: House of Representatives

Portfolio: Treasury

Commencement: Royal Assent. However, the refundable tax offset will be available for films completed on or after 4 September 2001.

Purpose

To introduce a refundable tax offset (rebate) at the rate of 12.5% which will be available to a company which satisfies certain minimum film production expenditure in Australia.

Background

The Australian film industry comprises a number of components, local productions for both TV and feature films, overseas financed productions principally based on feature films, co-productions of both TV and feature films and post production services provided to films produced both locally and overseas.

While there has been substantial publicity given to the role Australian studios play in the production of 'foreign'¹ feature films, this category has rarely exceeded the amount spent on Australian features during the period from 1994-95 to 2000-01. According to the Australian Film Commission (AFC), in the period 1994-5 and 2000-01 Australian production exceeded 50 % of the value of feature productions in all but two years and reached a maximum of 71 % in 1996-97. The following Table provides further information:

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	Australian features ¹		Co-productions ²		Foreign features ³		All feature production \$m
	\$m	%	\$m	%	\$m	%	
1994/95	39	41%	2	2%	54	57%	94
1995/96	86	59%	0	0%	60	41%	146
1996/97	104	71%	11	7%	32	22%	147
1997/98	145	68%	2	1%	67	31%	214
1998/99	113	53%	0	0%	102	47%	215
1999/00	126	61%	3	1%	78	38%	207
2000/01	79	36%	24	11%	114	53%	217

Source: Australian Film Commission²

Notes:

- 1 Productions under Australian creative control.
- 2 Official co-productions and other productions involving shared creative control, i.e. with a mix of Australians in key creative positions.
- 3 Productions under foreign creative control with a substantial amount shot in Australia.

It is difficult to calculate the number of people employed in the making of feature films which would be covered by the Bill as only aggregate industry figures are available. Using Australian Bureau of Statistics (ABS) figures, the AFC has concluded that 15 195 people were employed in the film and video production industry in 1999-2000. This industry comprises television, advertising and training videos in addition to feature films. Of those employed, 7 234 were employed as permanent full-time employees, 772 were permanent part-time employees and 7 103 were casual or temporary employees.³ In relation to the value of production activity (this includes TV, feature films and other productions) the AFC, again relying on ABS statistics, reports that out of a total production activity during 1999-2000, feature films contributed \$149 million of a total value of \$1 792 million.⁴

The taxation treatment of the financing of investments in the film industry is dealt with in Divisions 10B and 10BA of the *Income Tax Assessment Act 1936* (ITAA36). Division 10BA deals specifically with deductions available for Australian films while Division 10B deals with deductions available for the acquisition of industrial property, including

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intellectual property of which films form a part (principally the copyright in a film). The main difference between the Divisions is that 10BA will provide a deduction from the start of production if the film has been issued with a certificate that it complies with the conditions specified in the Division. Division 10B concessions are only available once the intellectual property in the film has come into existence, ie after the film has been completed. A further difference between the Divisions is that the degree of Australian participation and control for a film to be eligible for a deduction may be lower under Division 10B when compared to Division 10BA. According to a Australian Taxation Office ruling:

It is considered that if a film satisfies the requirements of a 'qualifying Australian film' under Division 10BA it will usually, if not always, qualify as an 'Australian film' for the purposes of Division 10B. A certificate issued under Division 10BA is considered sufficient to allow deductions for investment under Division 10B. However, the converse does not apply.⁵

The significant part of the ATO ruling is that while a film may qualify for a Division 10B deduction, a certificate issued under that Division does not mean that it qualifies for a deduction under Division 10BA, therefore making the potential range of films covered by Division 10B greater than those covered by Division 10BA.

Both Divisions now allow a 100% deduction for the amount invested in an eligible project (previously Division 10BA allowed deductions of 150% and 120% depending on the period in which the film was produced). The full deduction under Division 10BA is available in the first year that expenditure was incurred while under Division 10B the deduction is spread over two years.

The availability of the deductions in Division 10B has been questioned following the use of 'mass marketed tax effective schemes' which sought to provide deductions while minimising the risks to investors. Such schemes were marketed more for their tax advantages than the financial success of the film in which the investment was made. The matter came to notice following the ATO's refusal of deduction for the film Red Planet, reported in July 2001⁶, and received further attention following the denial of deductions for the film Moulin Rouge.⁷ The reasons for the disallowance of specific investments was not disclosed as it involved private taxation information, but on the same date as the disallowance of the deductions for Moulin Rouge was reported (3 August 2001) the ATO issued a media release regarding the availability of Division 10B deductions. The main reason for the denial of a deduction was that under the investment arrangements taxpayers had a guaranteed return on their investment regardless of the success or otherwise of the project and did not bear a risk if the deductions were denied. Another reason for the disallowance was that the principal return to the investor was the tax benefit rather than a direct monetary return.⁸

Without specifically endorsing the schemes used, the film industry was generally disapproving of the reduction in the possible use of the Division 10B deductions,

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principally on the grounds that the removal of any incentive to the industry would reduce the chances for the local production industry. However, the view has also been expressed that offshore productions should not be subsidised to be produced in Australia without equivalent assistance being available to the local industry.⁹

In an interview on 12 August 2001 the Prime Minister indicated that the government was reviewing the ATO decisions and possible changes to assist the industry.¹⁰ The tax measures to be implemented by this Bill were announced as part of a general Film Industry Package by the Minister for Communications, IT and the Arts on 4 September 2001 (the tax measures were also announced by the Treasurer on the same date). The main elements of the Package are:

- A refundable tax offset at the rate of 12.5% of qualifying Australian expenditure where:
 - the film's [qualifying] Australian expenditure is between \$15 million and \$50 million and at least 70% of the total production budget is spent in Australia, or
 - if the film's [qualifying] Australian expenditure is more than \$50 million, the proportion of the total budget spent in Australia is disregarded.
- The Division 10B concession will continue to apply but a film will not be eligible for the tax offset and the Division 10B concession.
- An additional \$92.7 million would be made available to the local industry up to 2005-06, involving:
 - an additional \$7.5 million for the AFC in 2002-03 increasing to \$10.5 million for 2003-04 for television drama
 - SBS Independent, which invests in independent drama, will continue to be funded until 2005-06 with current funding levels of approximately \$5 million being increased by \$2 million in 2002-03 and \$3.5 million in 2003-04
 - Film Australia will receive an additional \$2.7 million a year from 2002-03 to fund its community service obligations
 - the AFC will receive an additional \$3 million in 2002-03 rising to \$5 million from 2003-04 to go towards script, project and practitioner development
 - the Film, Television and Radio School will receive an increase of \$500 000 in 2001-02 and an additional \$1 million from 2002-03 for equipment used in training for digital media
 - a grants program of \$2.1 million over 3 years will be available to encourage innovative broadband content, and

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- AusFILM will receive \$1 million per year from 2002-03 to establish a ‘one stop shop’ for foreign producers seeking to meet the legal requirements of Australian governments.

According to the Statement, the package, excluding the tax offset, will increase spending on the industry by 18% in 2002-03, rising to 25% in 2004-05.

The package was welcomed by the Australian industry, with the executive director of the Australian Screen Directors Association reported as stating that the package had ‘something for everyone’, while the chief executive of AusFILM is reported as saying that the tax offset would attract more foreign productions to Australia.¹¹

According to the 2001 Tax Expenditure Statement, the current Division 10B and 10BA concessions cost an estimated \$20 million in each of the years from 1997-98 to 1999-2000, \$17 million in 2000-01 and is projected to cost \$16 million for each year between 2001-02 and 2004-05. This compares with projected costs for the tax offset of \$5 million in 2002-03, \$35 million in 2003-04 and \$32 million in 2004-05.¹² As the tax offset is aimed principally at high value overseas productions, the later figures give an indication of the cost of attracting such activities to Australia compared with the Division 10B cost.

Main Provisions

Item 2 of Schedule 1 will insert a **new Subdivision 376** into the *Income Tax Assessment Act 1997* (ITAA97), dealing with the tax offset.

A company will be entitled to the offset in a year if the film was completed in that income year, the Arts Minister has issued a certificate for the film (see below), the claim for the offset is made during that year and the company is resident in Australia or has a permanent establishment in Australia and an ABN. The company will not be entitled to the offset if it or someone else makes a claim for a deduction under Division 10B or a certificate has been issued under Division 10BA (**proposed section 376-5**).

The amount of rebate will be 12.5% of qualifying Australian expenditure (see below) (**proposed section 376-10**).

The Minister may issue a certificate for a film if the company satisfies the residency requirements referred to above, the film was completed on or after 4 September 2001 and it was produced for:

- exhibition to the public in cinemas, by broadcasting on television or through distribution as a video recording (including tapes and disks)
- is a feature film or a mini-series of television drama
- is not to a substantial extent:

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- a documentary, an advertising program or a commercial
- a discussion quiz, panel, variety or similar program
- a film of a public event
- part of a drama series that is of a continuing nature, or a training film
- the qualifying Australian production expenditure is at least \$15 million, and if between \$15 and \$50 million the company carried out all of the activities of the production of the film and 70% of the production expenditure on the film was spent in Australia (70% test), or
- if the qualifying Australian production expenditure is at least \$50 million, the company either carried out or made the arrangements for carrying out all the production activities in Australia (**proposed section 376-15**).

In determining whether a film satisfies the 70% test it may disregard the remuneration paid to one person, including travel and other costs associated with the film (eg the sum paid in regard to a highly paid actor overseas could be disregarded) (**proposed section 376-20**).

Production expenditure and qualifying Australian production expenditure are defined in **proposed Subdivision 376-C**.

Production expenditure is generally defined to be expenditure incurred in making the film (including pre and post production activities but not developing the proposal for the making of the film, obtaining finance, distribution or promotion) and other expenditure reasonably incurred in the use of facilities or equipment (**proposed section 376-25**). However, some of these items may be included to the extent that they are qualifying Australian production expenditure (**proposed section 376-35**).

Qualifying Australian production expenditure is generally defined as a company's expenditure on goods and services in Australia, the use of land in Australia, the use of goods that are located in Australia at the time they were used in making the film, or expenditure reasonably attributed to such activities (**proposed section 376-40**).

Proposed section 376-45 deals with a number of specific types of expenditure included in the definition, including:

- development expenditure incurred in Australia for purposes contained in proposed section 376-40 (development expenditure includes location surveys and assessment, scriptwriting, casting and budget development – **item 4 of schedule 1**). Legal expenses may only be included to the extent to which they relate to writers' contracts or copyright issues
- expenditure incurred in obtaining Australian copyright

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- Australian business overheads to the extent that they are not incurred for the making of the film but are reasonably necessary for the making of the film to a maximum of the lesser of 2% of the production expenditure on the film or \$500 000
- expenditure incurred in Australia on promotional material where the copyright is held by an Australian citizen or resident, and
- expenses for travel to Australia for a person in the making of the film, unless the remuneration paid to the person does not fall within the definition of qualifying Australian production expenditure.

Specifically excluded from the definition is remuneration and travel costs in relation to a person who is not a member of the cast and enters Australia to work for less than 2 consecutive weeks on the project, or expenditure excluded by the regulations (**proposed section 376-50**).

Proposed section 376-65 provides that if expenditure has not been incurred on an 'arm's length basis' its value for the above provisions will be the 'arm's length' value of the activity (this is basically an anti-avoidance provision).

Where a company making a film in Australia is taken-over by another company, the expenditure incurred by the first company will be deemed to have been incurred by the take-over company, so that while the first company will no longer be eligible for the rebate (as the film has not been completed) the second company will be able to claim for the expenditure so long as it satisfies the residency requirements at the time the claim is made (**proposed section 376-70**).

The issue of certificates by the Minister for Arts is dealt with in **proposed Subdivision 376-D** and contains largely administrative rules. A company may apply for a certificate for a film after it has been completed, the Minister may issue or refuse to issue the certificate and may revoke a certificate if satisfied that it was issued due to fraud or serious misrepresentation. Decisions to refuse to issue or revoke a certificate may be reviewed by the Administrative Appeals Tribunal. **Proposed section 376-105** will establish a Film Certificate Advisory Board to advise the Minister on applications for certificates or such other functions relating to the offset as specified by the Minister.

Endnotes

- 1 The definition used is that provided by the Australian Film Corporation. A foreign feature is defined as one where it is under foreign creative control with a substantial amount shot in Australia.
- 2 Australian Film Commission, Feature Film production: Activity summary:
<http://afc.gov.au/GTP/mpfeaturesummary.html>

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- 3 Australian Film Commission, Production Industry, Overview: Employment:
<http://afc.gov.au/GTP/mpemployment.html>
- 4 Australian Film Commission, Production Industry, Fast facts:
<http://www.afc.gov.au/GTP/mpfast.html> - Rbn57091
- 5 Australian Taxation Office, Income Tax: Taxation Incentives for the Australian Film Industry: [Taxation Ruling No. IT 2629](#)
- 6 *The Australian*, 6 July 2001.
- 7 *The Age*, 3 August 2001.
- 8 Australian Taxation Office, *Media Release*, 3 August 2001. A description of the various arrangements used and an expansion of the reasons for disallowance are contained in draft ruling [TR2001/D7](#).
- 9 *The Age*, 3 August 2001.
- 10 *Prime Minister*, Doorstop Interview, Sydney, 12 August 2001.
- 11 *The Sydney Morning Herald*, 5 September 2001.
- 12 *Treasury*, Tax Expenditure Statements 2001, December 2001.

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