



Australian Government
Australian Taxation Office

Australian film industry incentives 2008

To help you complete your tax return for 1 July 2007 – 30 June 2008
To be used by taxpayers claiming a tax deduction or a tax offset in
relation to Australian film production

WHAT DEDUCTIONS CAN I CLAIM FOR INVESTING IN AUSTRALIAN FILMS?

If you invest in the Australian film industry, you may be eligible for a special tax deduction for capital expenditure incurred in acquiring an interest in the copyright of an Australian film.

As a taxpayer, you may be able to claim a deduction under either:

- 1 **Division 10B** of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936), which gives investors a deduction, normally spread over two years, for capital contributions used to acquire rights in or under copyrights relating to an 'Australian film', or
- 2 **Division 10BA** of Part III of the ITAA 1936, which gives investors a 100% deduction for capital expenditure used to produce a 'qualifying Australian film' where, as a consequence, they acquire an interest in the initial copyright of the film.

Division 10B applies to both residents and non-residents, while Division 10BA applies to residents only. A resident taxpayer can make an election that Division 10BA is not to apply to their project and can therefore choose to apply Division 10B instead.

DIVISION 10B

Division 10B is available to both residents and non-residents and has potentially broader application than Division 10BA. Division 10B applies in relation to a film certified in writing by the Minister for the Environment, Heritage and the Arts as an 'Australian film' being one that:

- (a) has been, or is to be, made wholly or substantially in Australia or an external territory, and which will have a significant Australian content or

- (b) has been, or is to be, made under an agreement or arrangement entered into between the Australian Government and the government of another country.

Under Division 10B you may be entitled to a deduction for the capital cost of producing an 'Australian film' or the capital cost of acquiring the copyright in an 'Australian film'. If you invest in a 'qualifying Australian film' under Division 10BA you may make an election that Division 10B apply to you rather than Division 10BA.

You have two methods of claiming a deduction in relation to a film certified as an 'Australian film' for the purposes of Division 10B:

- you can deduct the costs incurred over two years under Division 10B, or
- you can elect that Division 10B does not apply to you and deduct the costs of the unit over the effective life of the copyright in accordance with Division 40 of the ITAA 1997.

If Division 10B applies and you deduct the costs over two years, half the cost of acquiring the interest in the copyright is deductible in the year of income during which the film was first used to produce assessable income. The other half is deductible in the following year.

If you elect that Division 10B does not apply to you and you acquire the copyright for a specified period, you can claim deductions over the shorter of that specified period or the period ending when the effective life of the copyright ends.

DIVISION 10BA

A deduction under Division 10BA is available only where the following circumstances are met:

1 You must be a resident of Australia who

- has expended capital monies in producing the film or as a contribution to its production
- is expected to become the first owner, or one of the first owners, of the copyright of the film, and
- intends to use the copyright to produce assessable income from public exhibition in cinemas or by television broadcasting.

AND

2 The film must be certified by a provisional certificate or a final certificate as a 'qualifying Australian film'.

The Minister for the Environment, Heritage and the Arts must certify the film as a qualifying Australian film. It must be:

- an eligible film – a film produced wholly or principally for the cinema or television which is a feature film (including an animated feature film), a documentary or a television mini-series, and
- an Australian film – a film with a significant Australian content made wholly or substantially in Australia or an external territory, or a film made as a result of an agreement between the Australian Government and the government of another country.

Ultimately, eligibility for a deduction depends on a final certificate being issued when the film is completed. However, you may claim a deduction on the basis of a provisional certificate.

Deductions for expenditure or contributions

A Division 10BA deduction is available to an investor who contributes capital monies that are spent directly in producing the film or contributed to the cost of producing a film. Your deduction is limited to the amount of your contribution that is spent directly on the production of the film.

In any given year, other deductions for expenses relating to the film investment, such as interest payable on the money used to make the capital contributions, are limited to the amount of film income from that film for that year.

Subject to this limitation, any unused deduction can be carried forward and applied against income from the film in future income years.

Investors and potential investors should be aware that, while an up-front deduction on the basis of a provisional certificate can be claimed, this deduction will be later disallowed if the following conditions set out in Division 10BA arise:

- the film does not receive a final certificate from the Minister for the Environment, Heritage and the Arts certifying that the film is a qualifying Australian film
- the film is not exhibited commercially within two years of the end of the income year in which capital monies were first spent to produce the film or were contributed to the cost of producing the film, or

- the copyright of the film did not come into existence within the relevant two-year period and you have not derived assessable income under an agreement granting another person the rights to exhibit the film.

For deductions to be available for capital monies contributed to the cost of producing a film, both of the following must occur:

- There must be in place a production contract, or a production contract and an underwriting contract or contracts, and the production contract must specify how the capital monies contributed will be expended in producing the film, or by way of contribution to the cost of producing the film.
- An appropriate person – usually the producer – must lodge a declaration stating that a contract for the production of the film has been entered into and that a person has or persons have agreed to expend an amount specified in the contract as the estimated cost of producing the film, and detailing how the qualifying contributions have been or will be dealt with. You must lodge the declaration before one month after the end of the income year in which funds are first contributed towards the production of the film. An extension of time to lodge the declaration may be granted.

If your film investment does not meet the requirements of Division 10BA, any deductions you claimed for it will be withdrawn. You will receive a notice of amended assessment for the relevant years disallowing the deductions. The Commissioner of Taxation can amend assessments disallowing claims made under Division 10BA at any time. In the event of an amended assessment, false or misleading statement penalties and an interest charge may also apply.

Deductions for an investor who takes the place of other investors

An investor in a qualifying Australian film who takes the place of another investor before the film is completed may be eligible for a deduction. The replacement investor's contribution may still be treated as being for the costs of producing the film. As long as the requirements outlined in the **Deductions for expenditure or contributions** section of this fact sheet are satisfied, the replacement investor will be allowed a deduction in the year in which they contribute to the cost of production.

Proceeds from film investment

Under Division 10BA, receipts from the film – whether from Australia or overseas – are assessable income. Amounts received on the disposal of the whole or part of a copyright are also required to be returned as assessable income. You may be entitled to a partial exemption if you were allowed a deduction under a contract entered into before 25 May 1988.

Partnerships

Division 10BA does not apply in working out the net income or loss of a partnership. Any capital expenditure is treated as having been expended in accordance with any agreement between the partners or according to each partner's interest. Film income is apportioned to each partner in a similar manner.

Losses

You can offset film losses carried forward from prior years against film income only. A film loss arises when you have a tax loss in an income year and when your film deductions (that is, your Division 10BA deductions and your other deductions for expenses relating to your Division 10BA investment) exceed the sum of your assessable film income and your net exempt film income. The film loss is either the tax loss or the difference between your film deductions and the sum of your assessable film income and your net exempt film income, whichever is less. A film loss cannot be deducted from income other than film income but can be carried forward and deducted from future film income. You can carry forward film losses you incurred in 1989–90 and subsequent income years for an unrestricted period.

WHAT INFORMATION MUST I KEEP?

You must be able to provide the following information if we request it:

- the title or proposed title of the film
- the date of issue of the provisional certificate or, if the film has been completed, of the final certificate
- the certificate number
- the completion date or proposed completion date of the film
- details of your contribution or expenditure, including
 - the date of any contract under which you made the expenditure
 - the date and the amount you paid
 - the name and address of the person you paid
 - whether you paid the amount in place of an underwriter
- details of your interest or expected interest in the copyright arising out of your expenditure on the film
- details of all income derived from the film, including any amounts you received or will receive from the disposal of all or part of your interest in the film's copyright
- details of arrangements or proposals under which you may expect to derive income from the film
- the name and address of the entity producing the film
- the name and address of the person who lodged or will lodge the necessary declaration in relation to the film
- the tax office at which the declaration was or will be lodged.

Additionally, if a claim for a deduction is for any amount paid by a partnership of which you are a partner, you need to be able to provide the following information:

- the name and tax file number of the partnership
- the tax office where the tax return of the partnership was or will be lodged.

WHAT ELSE SHOULD I KNOW?

Foreign source income – limitation of Division 10B and Division 10BA deductions

Receipts from the exploitation of a film overseas are foreign income. Any intention to receive foreign income could make a Division 10B or a Division 10BA deduction that would otherwise be allowable a 'foreign income deduction' and subject to quarantining measures. *Taxation Determination TD 2004/29 – Income tax: can section 79D of the Income Tax Assessment Act 1936 operate to limit deductions available under Division 10B or Division 10BA of Part III of the Income Tax Assessment Act 1936?* outlines the Tax Office's position on the limitation of Division 10B or Division 10BA deductions in these cases.

Deduction safeguards

There are safeguard provisions to ensure that Australian film industry incentives are not exploited. Two examples are:

- Expenditure qualifying for the Division 10BA deduction is limited to amounts that the investor may lose if the film venture fails.
- The Tax Office must be satisfied that the deductions claimed under Division 10B or Division 10BA have not been inflated as part of a non-arm's length transaction.

Repeal of Division 10B and Division 10BA

As a consequence of the introduction of the new film production offsets (see page 6), Division 10B and Division 10BA have been repealed. Applications for certificates under Division 10B and Division 10BA will not be accepted after 25 September 2007. A first deduction under Division 10B will only be available up until 30 June 2009, and a deduction under Division 10BA is not allowable in relation to the 2009–10 income year or a later income year.

Investment in a film licensed investment company (FLIC)

Under Subdivision 375-H of the ITAA 1997 taxpayers were able to claim deductions for amounts paid by them for shares in a company which has been granted a license to raise concessional capital under the *Film Licensed Investment Company Act 2005*. Deductions are not available for shares issued after 30 June 2007.

The FLIC tax concession allows certain returns of concessional capital (that is, capital invested in a FLIC during its licence period) to be treated as franked dividends. If you are an investor in a FLIC, you may have received a notice from the company advising that it is returning to you an amount of concessional capital that is, for tax purposes, a franked dividend. The FLIC will advise you of the amount of your dividend and the franking credit.

WHERE DO I CLAIM A DEDUCTION ON MY TAX RETURN UNDER DIVISIONS 10B AND 10BA?

- Individual taxpayers claiming a deduction for an investment in an Australian film or a qualifying Australian film can show the deduction at item **D10** on their *Tax return for individuals (supplementary section) 2008* (NAT 2679).
- Trustees must show the amount at item **18** on their *Trust tax return 2008* (NAT 0660), clearly identifying it as a film industry incentive deduction.
- Companies must use the *Company tax return 2008* (NAT 0656). Information about which label to use on the tax return is in the *Company tax return instructions 2008* (NAT 0669).

REFUNDABLE FILM TAX OFFSET (RFTO) FOR FILMS THAT COMMENCED PRINCIPAL PHOTOGRAPHY BEFORE 8 MAY 2007

Under repealed (but saved) Division 376 of the ITAA 1997 a company can claim a refundable tax offset in its income tax return for an income year for qualifying Australian production expenditure (QAPE) on certified films completed during that year. The amount of the tax offset is 12.5% of the total of the company's QAPE on the film.

Commencement

The tax offset provisions apply to eligible films completed on or after 4 September 2001. From 1 July 2004 a qualifying television series is an eligible film and the tax offset provisions apply to eligible production expenditure incurred on or after 1 July 2004 on a qualifying television series.

Eligible films

The eligible films are:

- feature films
- telemovies
- mini-series
- television series

which have been produced for:

- exhibition to the public in cinemas
- exhibition to the public by way of television broadcasting, or
- distribution to the public as a video recording (on tapes, DVDs etc)

and in respect of which the Minister for the Environment, Heritage and the Arts has issued a certificate.

NOTE

A pilot to a television series is taken to be an episode of the television series. However, if the pilot is produced overseas, then all the expenditure reasonably attributable to the production of the pilot episode is ignored in the calculation of total production expenditure.

What is qualifying Australian production expenditure?

A company's QAPE on a film is the company's production expenditure on the film that is incurred on, or is reasonably attributable to:

- goods and services provided in Australia
- the use of land located in Australia
- the use of goods that are located in Australia at the time they are used in the making of the film.

There are a number of specific inclusions and exclusions to this broad test of QAPE.

The specific inclusions:

- Australian development expenditure
- Australian copyright acquisition
- Australian business overheads (there are limits on the amount claimable, see the next page)
- Australian copyrighted promotional material, and
- travel to Australia where that travel relates to incoming journeys for film personnel whose remuneration qualifies as QAPE, and if other than a cast member, whose stay in Australia is for a period of more than two consecutive calendar weeks.

The specific exclusions:

- the remuneration and the cost of other benefits in relation to short-term visits, by non cast members, of less than two consecutive calendar weeks
- the cost of services that are predominantly performed outside Australia but are embodied in the cost of goods that are delivered to and used by the production company in making the film in Australia – for example the cost of animation or special effects work undertaken outside of Australia is not QAPE, and
- legal expenses except those which relate to writers' contracts or copyright issues including chain of title.

Key expenditure threshold levels

The tax offset is not available where the company's QAPE on an eligible film does not exceed A\$15 million.

Where the company's QAPE on an eligible film is at least A\$15 million but less than A\$50 million, the tax offset is available where the QAPE is at least 70% of the film's total production expenditure.

Where the company's QAPE on an eligible film is A\$50 million or more, the tax offset is available regardless of the film's total production percentage ratio.

In relation to an eligible film that is a television series, the tax offset is not available unless the average QAPE per hour of the series' duration is at least A\$1 million.

Eligible applicants

The tax offset can only be claimed by the film production company:

- where the value of QAPE is at least A\$15 million but less than A\$50 million, is responsible for carrying out, or making arrangements to carry out, all the activities worldwide that are necessary for the making of the film
- where the value of QAPE is A\$50 million or more, is responsible for all the activities involved in making the film in Australia.

The production company must be an Australian resident company or a non-Australian resident company operating in Australia through a permanent establishment which has an Australian business number (ABN), both when the company lodges its income tax return and when the tax offset is due to be credited to the company.

Where several companies are involved in the making of a film, only one company can be eligible for the tax offset. Accordingly, it will be necessary to adopt structures whereby one company is responsible for all the film production activities or the Australian activities, depending on the value of QAPE to be incurred.

Where a production company has taken over the making of the film from another company (which may itself have taken over the making of the film from another company, and so on), each company making the film is taken to have incurred the production expenditure of the previous company. However, any expenditure incurred to enable the takeover is not production expenditure.

Total film production expenditure

A film's total production expenditure is defined as so much of a company's expenditure as is incurred in, or is reasonably attributable to, the making of the film from pre-production up to the point when the film is ready to be distributed, broadcast or exhibited to the general public.

The following expenditure is not production expenditure:

- financing expenditure (includes completion guarantees and certain types of insurance policies – refer to *Taxation Determination TD 2006/2 – Income tax: for the purposes of Division 376 of the Income Tax Assessment Act 1997, are some insurance premiums excluded from film production expenditure?*)
- development expenditure – unless QAPE
- copyright acquisition expenditure – unless QAPE
- general business overheads – unless QAPE
- publicity and promotion expenditure – unless QAPE
- acquisition of depreciating assets
- deferrals and profit participations
- residuals – unless paid out by the company to a cast member before the film is completed and is not repayable.

General Australian business overheads

Where overheads are not directly incurred or attributable to the making of the film and represent a combination of other activities undertaken by the company, a proportion of the expenditure may be claimed as QAPE but limited to the lesser of:

- two per cent of the total of the company's production expenditure on the film, or
- \$500,000.

Depreciating assets

Only the decline in value of the asset is treated as production expenditure for the purposes of the tax offset. The company can either accept the effective life determinations of the Commissioner or self-assess on the basis of their particular circumstances.

The Commissioner's determinations regarding effective life of depreciating assets used in film production can be found in *Taxation Ruling TR 2007/3 – Income tax: effective life of depreciating assets (applicable from July 1 2007)*.

Goods and service tax (GST)

For purposes of the tax offset the amount of total production expenditure and QAPE is the GST-inclusive cost, irrespective of whether the company is able to claim input tax credits under Division 11 of the *A New Tax System (Goods and Services Tax) Act 1999*.

Accruals basis of accounting

Expenditure that has been incurred but not actually paid will count as production expenditure.

Currency exchange

All production expenditure incurred in foreign currencies must be converted into Australian dollars using an average rate of exchange commencing from the start of principal photography and ending when the film is completed.

For television series the rate of exchange must be averaged across the production period commencing when QAPE began to be incurred and concluding with the completion of the television series. The time period includes pilot episodes of a television series if expenditure on the pilot is QAPE.

Arm's length principle

All transactions between any two or more parties under which a company directly or indirectly incurs film production expenditure must be worked out on the basis that each party was dealing with each other at arm's length. This includes both domestic and international arrangements.

The Commissioner has stated in *Taxation Determination TD 2002/20 – Income tax: if an Australian film production company alters its method of charging for film production services supplied to a foreign associate to account for the impact of the tax offset scheme under Division 376 of the*

Income Tax Assessment Act 1997, will the Commissioner apply Division 13 of Part III of the Income Tax Assessment Act 1936 or the Associated Enterprises article of a relevant double tax agreement to increase the charge? that he accepts that the tax offset scheme may produce a relatively reduced transfer price for production services rendered and will not seek to apply the transfer pricing rules under Division 13 of the ITAA 1936, provided the production company's profit outcomes make commercial sense and accord with what an independent party would do to protect its own economic interest.

Timeframe requirements

Only qualifying television series must be completed within a given timeframe which depends on whether the series is predominantly animation or live action. In relation to animation this is 36 months from the time production expenditure begins to be incurred. For live action or other non-animated series principal photography must be completed within 12 months of commencement. Pilot episodes are excluded from the timeframe as well as any second-unit photography.

Choice of benefits

If the tax offset is claimed, other incentives, such as funding from the Film Finance Corporation Australia (FFC) or deductions under Division 10B or Division 10BA, are not available. The tax offset is not available if deductions are claimed under Division 10B by the company or someone else, or if a provisional certificate or final certificate for the film has been issued under Division 10BA. However, eligibility for the tax offset is restored if an issued Division 10BA provisional certificate for the film has been revoked under subsection 124ZAB(6A) of the ITAA 1936. A FLIC cannot invest any of its concessional capital in a film production that will claim the tax offset.

NEW FILM PRODUCTION OFFSETS

New Division 376 of the ITAA 1997 (enacted on 25 September 2007) provides for the:

- enhancing of the existing RFTO for QAPE (the location offset)
- introduction of a refundable film tax offset for 'post, digital and visual effects production' in Australia (the PDV offset), and
- introduction of a refundable tax offset for Australian expenditure in making Australian films (the producer offset).

Commencement and application of the tax offsets

The location offset applies to films commencing principal photography or production of the animated image on or after 8 May 2007.

The PDV offset applies to post, digital and visual effects production for a film that commences on or after 1 July 2007.

The producer offset applies to QAPE incurred on or after 1 July 2007.

Availability

The offsets are available to the production company which is responsible for a film's QAPE, provided it is:

- an Australian resident company, or
- a non-resident company with a permanent establishment in Australia and an ABN.

In order to claim the location or PDV offsets, the production company must first obtain a certificate of eligibility from the Minister of the Environment, Heritage and the Arts.

In order to claim the producer offset, the production company must first obtain a certificate of eligibility from the FFC.

Key eligibility criteria

The location offset is a refundable tax offset of 15 per cent of a film's QAPE incurred on films. Where the QAPE is more than \$15M but less than \$50M, the offset is to be claimed in the income tax return for the income year in which the production expenditure on the film ceased to be incurred. Where the QAPE is at least \$50M, the offset is to be claimed in the income tax return for the income year in which the QAPE ceased being incurred.

The PDV offset is a refundable tax offset of 15 per cent of a film's qualifying Australian production expenditure that relates to the post, digital and visual effects production of a film. The offset is to be claimed in the income tax return for the income year in which the PDV expenditure has ceased being incurred.

The producer offset is a refundable tax offset of 40 per cent of a film's QAPE for Australian feature films and 20 per cent where the Australian film is not a feature film. The offset is to be claimed in the income tax return for the income year in which the film is completed.

Certification and how to access the film tax offsets

For the location and PDV offsets, eligible film production companies will need to apply for a certificate of eligibility from the Minister for the Environment, Heritage and the Arts. Applications are considered by the Film Certification Advisory Board, comprising industry representatives and a senior official from the Department of the Environment, Water, Heritage and the Arts, which advises the minister on whether to issue certificates of eligibility.

For the producer offset, eligible film production companies will need to apply to the FFC for a certificate of eligibility.

The minister and the FFC have the power to revoke a certificate in cases of fraud or serious misrepresentation. In such a case a revocation by the Minister for the Environment, Heritage and the Arts would require a full repayment of any tax offset given. Decisions not to issue or to revoke a certificate previously issued are reviewable in the Administrative Appeals Tribunal.

➤ Further information regarding location and PDV tax offsets, including certification, can be obtained from the Department of the Environment, Water, Heritage and the Arts – see below.

Further information regarding producer offset certification can be obtained from the Film Finance Corporation Australia.

In the absence of fraud or serious misrepresentation, a final certificate of eligibility guarantees the film's entitlement to the film tax offsets.

How the tax offsets affect other concessions

Only one of the film tax offsets can be claimed for a film.

Where a film tax offset is claimed, other incentives – such as deductions under Division 10B or Division 10BA – become unavailable. Conversely, a film tax offset is not available if a deduction is claimed under Division 10B or Division 10BA.

A FLIC is not able to invest any of its concessional capital in a film production that will claim the offset.

Further information

In relation to the RFTO the Commissioner has issued taxation determinations on the treatment of certain insurance costs (Taxation Determination TD 2006/2) and freight costs (*Taxation Determination TD 2006/3 – Income tax: to what extent are freight costs included in 'qualifying Australian production expenditure' within the meaning of section 376-40 of the Income Tax Assessment Act 1997?*). For further information on these and other public rulings mentioned, see our website.

Application details, guidelines and eligibility criteria are also available on the Department of the Environment, Water, Heritage and the Arts website at www.arts.gov.au/film/australian_screen_production_incentive

! NOTE

To provide greater certainty for investors, the Tax Office has introduced a product rulings system. Promoters of an investment can apply to us for a ruling on the availability of the tax benefits claimed by the investment. Potential investors may wish to approach their film promoter for details of any applicable product ruling.

More information about the product rulings system is in *Product Ruling PR 2007/71 – Income tax and fringe benefits tax: Product Rulings system*.

! MORE INFORMATION

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