

SUBMISSION BY
MEDIA, ENTERTAINMENT & ARTS ALLIANCE
TO
DEPARTMENT OF COMMUNICATIONS, INFORMATION TECHNOLOGY
AND THE ARTS
REGARDING
REFUNDABLE FILM TAX OFFSET SCHEME

JULY 2006



The Media, Entertainment & Arts Alliance

The Media, Entertainment & Arts Alliance (Alliance) is the industrial and professional organisation representing the people who work in Australia's media and entertainment industries. Its membership includes journalists, artists, photographers, performers, symphony orchestra musicians and film, television and performing arts technicians.

Executive Summary

The Media, Entertainment & Arts Alliance appreciates the opportunity to make a submission to the review of the Refundable Film Tax Offset Scheme.

The Refundable Film Tax Offset Scheme was announced on 4 September 2001 as part of the Government's Integrated Film Package with films in production on that date being eligible. It recognised that Australia has a sophisticated production industry suitably skilled and resourced to work on large budget productions of a size not normally undertaken by the Australian industry. It also recognised that attracting "run-away" productions from offshore could assist in smoothing out the peaks and troughs of employment cycles for Australian actors and technicians, enable skills upgrading for technicians and showcase what the Australian industry is able to achieve to wider international audiences.

The Offset Scheme was designed as a simple and certain scheme, factors that are attractive to overseas producers when determining where to locate a production. Australia had already demonstrated that the skills base and infrastructure existed and needed only to introduce an attractive financial incentive.

The Offset Scheme has delivered considerable benefits to the industry but since its introduction the international film producing climate has changed. This review offers the opportunity for the Scheme to be adjusted to the conditions that prevail today.

The Alliance is of the view that the Offset Scheme has been a successful mechanism and will continue to be the most effective incentive to attract large offshore productions to Australia. However, the Alliance recommends that the following adjustments could usefully be considered by Government to ensure Australia stays a competitive destination:

- Acceptance of insurances as Qualifying Australian Production Expenditure (QAPE) and, where relevant, completion guarantee costs.
- Adjust the requirement for QAPE to represent at least 70% of the film's total production expenditure if QAPE is between \$15 million and \$50 million.
- Increase the percentage rebate to 15%.
- Fix the exchange rate on the first day of principal photography for eligibility purposes (but not for rebate purposes).
- Allow interim claims prior to the completion of the production.
- Allow piggy-backing subsequent to the completion of principal photography for a two-year period for further productions from the same entity that would not otherwise be eligible in their own right.
- Introduce an additional incentive for productions that film overseas but wish to undertake postproduction in Australia.

Finally, the Alliance considers that mechanisms to attract offshore productions to Australia are only valuable if the Australian industry is healthy. The most attractive features for overseas producers continue to be the fact that Australia has a well developed film and television industry with a highly skilled workforce, combined with the fact that Australia is a developed English-language country enjoying a stable democracy with a generally conducive climate, clean water and sophisticated infrastructure. To that end, the Offset Scheme needs to continue to be viewed as one part of the range of mechanisms that are required to underpin the Australian production industry.

Changes in the international market

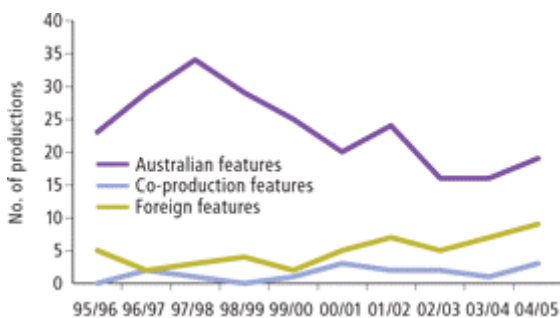
Since the early 1990s Australia has developed an international reputation as a destination for “runaway” productions. During the 1990s, the principal competition was from the United Kingdom and Canada, the latter consistently capturing the lion’s share.

As can be seen from data compiled by the Australian Film Commission, the number of foreign feature films has trended upwards for a decade but since the introduction of the Offset Scheme, the amount spent in Australia by foreign films has risen rapidly. Clearly, the Offset Scheme is delivering results in respect of feature films.

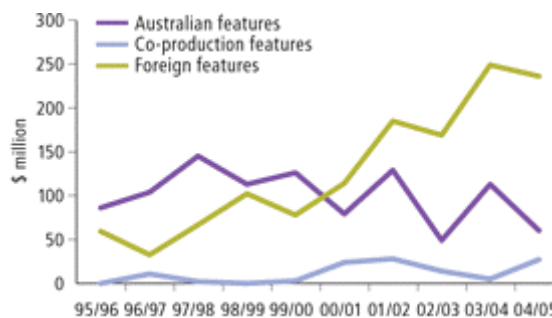
However, the same is not true for television drama production where the trendline is down for both the number of hours produced in Australia and the amount spent in Australia.

Canada continues to capture the majority of American runaway television production. However, as other countries looked at Canada’s success, incentive schemes have been progressively introduced around the world. That trend has been followed by the introduction of incentives in a number of American states.

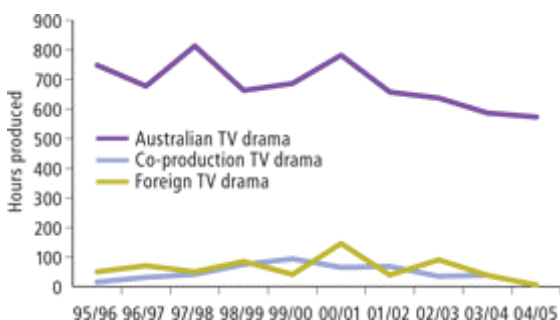
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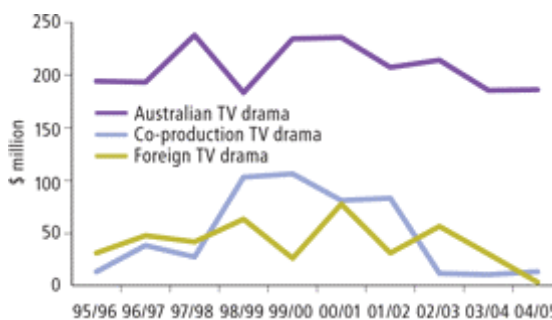
Spend in Australia by features



Hours of TV drama



Spend in Australia by TV drama



Source: *National Survey of Feature Film and TV Drama Production 2004/2005*, Australian Film Commission, available online at <http://www.afc.gov.au/nps/npsover.html>.

Whilst the trendline for features looks promising enough, the results are not as good as had been anticipated – the principal reason being the proliferation of incentives in other territories, notably in Eastern Europe which has captured a number of large budget American feature films in recent years.

When the Taxation Laws Amendment (Film Incentives) Bill 2002 was introduced in Parliament, the Explanatory Memorandum set out the Government’s expectations as follows:

The expected growth of foreign production in Australia is up to \$850 million in 2005-2006. This represents around 5 large scale films a year (with total average budget of \$120 million and average expenditure in Australia of around \$60 million), and a similar number of medium scale films (with a total average budget of \$50 million and average expenditure in Australia of around \$37.5 million). Beyond this time frame, this figure is likely to continue to grow, due to growth in average film production costs and some capacity increase in the Australian industry.

...

In determining the cost and benefits of this measure an assumption in relation to the expected uptake of this measure has been made as follows. Over the first 5 years of the offset's operation, it is expected to apply to 6 big budget films in Australia each year, and 4 medium budget level productions.¹

It was anticipated that cost to revenue over the five years 2001-02 to 2005-06 would be \$168.1 million.² It has, in fact, turned out to be in the order of \$111 million.

It appears that what was not anticipated was the manner in which other territories might implement similar schemes. Additionally, other factors such as movements in the exchange rate have had a bearing on the extent to which Australia has been a more or less attractive destination than other countries.

Attachment A presents a 2005 snapshot of some of the incentives available internationally. Not noted is the Fijian tax offset scheme, which mirrors Australia's but with a dramatically lower threshold designed to attract television commercials in addition to television series and feature films.

Further, the options on offer continue to change. Attachment A refers to the sale and leaseback arrangements that were available in the United Kingdom. That scheme has now been replaced with a tax benefit based on 20% of the qualifying expenditure applicable to up to 80% of a production's total budget.

The Alliance recognises that simply making the Australian scheme more attractive than all others could result in a race to the bottom as other territories emulate changes here. However, it should nonetheless be possible to make adjustments to the current scheme that incorporate five year's experience with its operation and make it even more attractive than is the case at present.

It also needs to be recognised that there will always be factors that will influence where a production chooses to locate that cannot be influenced by incentives. Health scares such as an outbreak of SARS, terrorism and currency fluctuations all affect the behaviour of "runaway" production. In the wake of the terrorist attack on New York and Washington, a significant number of American actors and directors refused to fly, causing production that may otherwise have used Australia as a location to remain in North America.

Whilst incentives are important in attracting large budget productions to Australia, just as, if not more important, is the health of the Australian local industry itself. It is the existence of a developed, sophisticated local industry with a highly skilled world-class workforce and infrastructure that has been the key to Australia being considered a viable destination for "run-away" productions. The health of the local industry itself is therefore central to the efficacy of any incentive to attract large budget productions. The Alliance is consequently pleased to see that the outcome of this review will be taken into account in the forthcoming Review of Australian Government Film Funding Support.³

¹ *Taxation Laws Amendment (Film Incentives) Bill 2002*: Explanatory Memorandum, page 30.

² *Ibid*, page 3.

³ *Review of Australian Government Film Funding Support*, Discussion Paper, DCITA, July 2006, page 4.

Eligibility of insurance as Qualifying Australian Production Expenditure

The Offset Scheme is administered by the Department of Communications, Information Technology and the Arts (DCITA). The Alliance understands that the manner in which DCITA has managed the Offset Scheme has been well received by producers. However, two matters have come to light wherein the Australian Tax Office (ATO) reached different conclusions regarding Qualifying Australian Production Expenditure (QAPE) – specifically, the treatment of insurances and freight – which DCITA had treated as eligible for the purposes of QAPE.

The Alliance considers that the ATO's treatment of insurances and, where relevant, completion guarantees, does not reflect the intention of the legislation. A copy of the Alliance's submission to the ATO is attached at Attachment B.

The cost of insurance is significant and can represent 1% of the production budget and sometimes more. For medium size productions, the inability to count insurances for the purposes of QAPE could render the production ineligible for the Offset.

In any event, it is clear that DCITA has always considered insurances as eligible expenditure. If legislative amendment is required to enable this to be the case, the Alliance supports such a move.

Adjust the requirement for QAPE to represent at least 70% of total production expenditure if QAPE is between \$15 million and \$50 million

When the Offset Scheme was designed, it was anticipated that the 70% threshold would encourage medium sized production to undertake postproduction and visual special effects in Australia. It has been only marginally successful in that regard.

Rather, it has unfortunately acted as a disincentive to medium range budget films – those with budgets between \$20 million and \$50 million. This is particularly unfortunate given the range of incentives now on offer internationally and the overall decline in the production of extremely large budget productions such as *Superman Returns*.

The Alliance recommends consideration be given to adjusting the 70% requirement either by lowering it if not by removing it.

Increase the percentage rebate to 15%

The Alliance is aware of a range of recommendations that the rebate be increased. Certainly, at 12.5% it is not as internationally competitive as it once was. Further, as indicated above, it has not generated the number of productions nor the spend originally anticipated.

The Alliance considers the rebate could be increased to around 15% without increasing the cost to revenue beyond that originally anticipated by the Government.

Fix the exchange rate on the first day of principal photography

The exchange rate has moved considerably since the introduction of the Offset Scheme. Since 2001, the Australian dollar has risen 34% against the American dollar. This has had a negative impact, particularly in respect of television drama which is far more price sensitive than larger budget feature films. Additionally, the Australian dollar has also strengthened against the New Zealand dollar.

To make the Scheme more certain, the Alliance recommends that productions be able to fix the exchange rate for purposes of eligibility (but not for the purposes of the rebate) at a particular point in time. This would allow producers to know that, having made the decision to film in Australia, their production would not become ineligible at a later point in time because of currency fluctuations.

The Alliance suggests that the date the exchange rate for an individual production be fixed by the point at which the budget is locked off and the decision to film in Australia becomes irreversible. The Alliance understands that producers consider the first day of principal photography could be a useful date on which to set the exchange rate.

The Alliance is not, however, proposing any change to the manner in which the rebate itself is calculated, just seeking to ensure productions are not disadvantaged having made the decision to locate production in Australia.

Interim claims prior to the completion of the production

The Alliance considers there is merit in allowing interim claims to be made prior to completion and delivery of the production. Interim payments are available in other jurisdictions. As the Scheme is a tax offset, interim payments could be made annually and adjusted at the completion of the production.

Piggy-backing

To encourage return business and to attract television production, the Alliance believes there is merit in considering allowing an entity that has produced an eligible production to piggy-back further productions that would not otherwise individually be eligible for the Offset Scheme. Allowing piggy-backing from one eligible production for a two year period could assist in capturing work that would not otherwise come to Australia and, in particular, might foster the return of movies of the week.

Australia was once attractive to movies of the week but that program format has dried up, given more attractive incentives elsewhere – for instance, both Canada and Ireland offer incentives that do not have threshold requirements.

The Alliance is not proposing that Australia duplicate the incentives available elsewhere, but considers that piggy-backing might be an effective way of encouraging a greater throughput of work than is currently the case.

Postproduction incentives

The Alliance is aware of a number of proposals to attract more postproduction and visual special effects work to Australia.

With many large budgets productions relying increasingly on visual effects, it is not uncommon for postproduction to take a year or even longer. With changes in technology, it is now possible for postproduction and visual effects to be undertaken in more than one country and sometimes in three or more countries as the work is sub-contracted to major postproduction and visual effects companies globally.

The Alliance considers there is merit in examining how the application of an Offset Scheme might be developed for productions that seek to use Australia as a location for postproduction alone.

ATTACHMENT A

UNITED STATES OF AMERICA		
State	Type	Amount
Florida	P.R. ⁵	5%
Hawaii	P.T.C. ^{**}	4%
	I.T.C. ^{**2}	100% film investment credit
Illinois	L.T.C. ^{**4}	25% on 1 st \$25,000 wages Hotel tax exemption
Louisiana	L.T.C. ^{**4}	10-20%
	I.T.C. ^{**2}	10-15% investment
Missouri	P.T.C. ^{**6}	50%
New Jersey	Loan Gty	30% of private loans
New Mexico	P.T.C. ^{**6}	15%
	Loans	100% finance loan
New York	P.T.C. ⁶	10% 5% New York City
Rhode Island	P.T.C. ^{**6}	25%
Oklahoma	P.R. ⁵	15%
Oregon	P.R. ⁵	10%
Pennsylvania	P.T.C. ^{**6}	20%
South Carolina	L.R. ³	5%
	T.C. ^{**8}	20% of investment in Procco
Utah	P.R. ⁵	10%
Federal	T.D. ⁹	100% deduction

Unless otherwise specified, the incentives are calculated or based on expenditures made in the applicable jurisdiction. Not all details concerning the incentives are included for summary purposes.

- * Refundable
 ** Non-Refundable
 † Announced but regulation pending
 †† To come into force in June 2005. Current regime is a 100% tax deduction
 1 CCA: Capital Cost Allowance

CANADA		
Province	Type	Amount
Alberta	Production Grant	20% of Prod. Costs
British Columbia	L.T.C.*(Content) ⁴	30%†
	L.T.C.*(Prod Services) ⁴	18%†
Manitoba	L.T.C. ^{**4}	35%
New Brunswick	L.T.C. ^{**4}	40%
	Equity Investment	\$400,000.
Newfoundland & Lab	L.T.C. ^{**8}	40%
	Equity Investment	Max 25% budget
Nova Scotia	L.T.C. ^{**4}	30%
Ontario	L.T.C.*(Content) ⁴	30%†
	L.T.C.*(Prod Services) ⁴	18%†
Prince Edward Island	Equity Investment	Max 20% Budget
	L.R. ³	30%
Quebec	L.T.C.*(Content) ⁴	29.17%†
	L.T.C.*(Prod Services) ⁴	20%†
Saskatchewan	L.T.C. ^{**4}	35%
Yukon	L.R. ³	35%
	Tr. Rebate ¹¹	50%
Federal	L.T.C*(Content) ⁴	25%
	L.T.C*(Prod Services) ⁴	16%

The information contained herein was obtained from third party sources as of January 2005. However BLG does not guarantee the completeness or accuracy of the information provided and all readers are advised to consult professional advisors in respect of their particular circumstances.

- 2 I.T.C.: Investment Tax Credit
 3 L.R.: Rebate on eligible labor or employment costs
 4 L.T.C.: Tax credit calculated on Labor Costs
 5 P.R.: Rebate of a portion of qualified production expenses
 6 P.T.C.: Tax Credit calculated on production expenditures

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INTERNATIONAL		
Country	Type	Amount
Australia	P.T.C. ^{**8}	12.5%
	CCA ¹	100% deduction
Belgium	T.S. ¹⁰	150% deduction of investment
France	P.T.C. ^{**8}	20%
Germany	T.D. ⁹	100% deduction of investment
Hungary	Tax Write-off	20% of costs
Iceland	P.R. ⁵	12%
Ireland	CCA ¹	80% deduction
Isle of Man	Equity Investment	25% of budget
Luxembourg	T.D. ⁹	30%
Netherlands	T.S. ¹⁰	100% deduction
New Zealand	Grant	12.5% of Budget
Puerto Rico	I.T.C. ^{**2}	40% of resident costs
	T.C. ^{**8} Infrastructure	40% equity cash
South Africa	Tr. Rebate ¹¹	15% for Foreign Prod. 25% for S.A. Prod.
	CCA ¹	100% deduction
United Kingdom	T.C. ⁸ S & L ⁷	20%††

Most incentives mentioned are subject to maximum amounts, conditions and eligibility requirements. Further, some jurisdictions may include additional regional or other bonuses not mentioned here for summary or presentation purposes.

- 7 S & L: Sale and Leaseback
 8 T.C.: Tax Credit
 9 T.D.: Tax Deduction
 10 T.S.: Tax Shelter
 11 Tr. Rebate: Travel Rebate

ATTACHMENT B

SUBMISSION
BY
MEDIA, ENTERTAINMENT & ARTS ALLIANCE
TO THE
AUSTRALIAN TAXATION OFFICE
DRAFT TAXATION DETERMINATION
TD 2005/D52

DECEMBER 2005

Media, Entertainment & Arts Alliance

The Media, Entertainment & Arts Alliance (Alliance) is the industrial and professional organisation representing the people who work in Australia's media and entertainment industries. Its membership includes journalists, artists, photographers, performers, symphony orchestra musicians and film, television and performing arts technicians.

Executive Summary

The Alliance appreciates the opportunity to comment on the Draft Tax Determination TD 2005/D52 addressing whether, for the purposes of Division 376 of the *Income Tax Assessment Act 1997* (ITTA), extra expense insurance premiums are eligible film production expenditure.

The Alliance welcomed the introduction of the refundable tax offset. It promised a simple, transparent mechanism to replace the uncertainties encountered by investors when raising Division 10B film investment. The tax offset was attractive to large offshore productions and looked set to boost both offshore financed film production in Australia and large budget productions financed as official co-productions.

However, a number of uncertainties have now emerged that threaten the attractiveness of Australia as a location for filming. Those uncertainties include the manner in which permanent establishment might now be defined the Australian Taxation Office (ATO) and two recent draft tax determinations, one of which is the subject of this submission.

This particular draft tax determination highlights a problem of communication between the ATO and the Department of Communications, Information Technology and the Arts (DCITA).

The Alliance understands that DCITA had been of the view that extra expense insurance was an eligible production expenditure whereas the ATO, as set out in the draft determination, is of a contrary view. This unfortunate communication breakdown does not assist in marketing the tax offset as an industry friendly, transparent and clear mechanism of support.

This difference of opinion is particularly unfortunate as the *DCITA Refundable tax offset for a film production in Australia Guidelines* were released in July 2002 and have been publicly available since that time. The DCITA Guidelines address those matters that are not considered qualifying Australian production expenditure (QAPE) and notably no mention is made of insurances. It goes without saying that producers overseas are relying on these guidelines as they make decisions about whether or not to locate production in Australia.

If the draft determination stands, some productions may find their eligibility to the offset blocked, having calculated expenditure against a set of parameters understood to be accurate and subsequently found not to be. This is more likely to be the case with lower budget productions, those that undertake a substantial proportion of film production outside Australia and official co-productions. Official co-productions and Australian productions rarely have total budgets in excess of \$25 million and are particularly susceptible. It would be unfortunate if the ruling resulted in films that would have otherwise had access to the offset being excluded.

In any event, the Alliance is of the view that extra expense insurance should rightfully be considered QAPE to the extent that it relates to production activities undertaken in Australia. The draft determination argues that extra expense insurance is a financing expenditure whereas in fact it is an expenditure incurred in order to ensure that a production is completed.

Extra expense insurance

The draft tax determination defines extra expense insurance as being insurance policies that include:

- film producer's indemnity insurance
- extra expense insurance
- negative film risk insurance
- weather insurance
- faulty stock, camera and processing insurance, and
- cost blow-out insurance

With the exception of weather insurance, all the above insurances are standard insurances effected on Australian and overseas productions.

So called cost blow-out insurance is more commonly known as a completion bond or completion guarantee and the only productions that film in Australia that do not pay for a completion guarantee are self-financed productions made by major American studios. In those instances, the decision to not take out a completion guarantee is a risk assessment that others who produce films with investment from third parties cannot afford.

Other insurance policies taken out on productions include:

- workers compensation insurance
- public liability insurance
- props, sets and wardrobe insurance
- cash in transit
- equipment insurance, and
- motor vehicle insurance.

As far as the Alliance is aware, this is the first time that the ATO has considered differentiating between classes of insurance.

Whilst being different incentives for film production, the insurances deemed ineligible in this draft tax determination have been considered eligible expenditure for the purposes of Divisions 10B and 10BA of the ITAA by the ATO. Whilst recognising that the tax offset is a different form of assistance with different guidelines, it is nonetheless difficult to see how such insurances can be characterised as financing expenditure when claiming an incentive under the tax offset but not when an investor is claiming a deduction under Divisions 10B or 10BA.

The determination states that “Expenditure incurred in relation to raising the finance for a film would include the establishment costs of obtaining a loan, such as fees paid to intermediaries. This would also include expenditure incurred in relation to obtaining insurance cover that is a financing cost (such as brokers’ fees)”. The determination goes on to say “Premiums for insurance that relates to finance that has been obtained, or that is obtained at the insistence of a financier in the course of obtaining finance and in order to obtain it, is clearly expenditure which ‘relates’ to obtaining finance. Where the financier intends to rely on the proceeds of the insurance policy to ensure repayment of its money, and requires the insurance to be taken out for that reason, the relationship between the premium and obtaining finance is even clearer. ‘Completion guarantee’ insurance is of this kind. The completion guarantor effectively uses its money to complete the film as originally agreed upon and generally pays the necessary production expenses directly. Often ‘completion guarantee’ cover will be obligatory to assure distributors, foreign talent, and financiers that the film will be completed and delivered.”

The Alliance considers that the draft determination, in relying on things done at the insistence of the financier in the course of obtaining or in order to obtain finance is misplaced. There are many matters that will be required in order to finance a production, including for instance commitments for certain persons to work on the production, such as the director, key cast and heads of department. Further, taking out reasonable insurance policies is done not to ensure repayment of money to the investor (other than to ensure a completed production that can then be marketed and distributed). Rather the insurance policies exist to replace finance already expended on the production in order to rectify the occurrence the subject of the policy.

In the same way that, when insured, equipment can be repaired or replaced when stolen or damaged, a sequence that has been filmed and the resulting footage damaged, when insured (faulty stock and processing insurance), the scene can be filmed again. It is difficult to see how the former insurance is a legitimate production cost and that latter is financing expenditure.

The determination, in commenting on why insurance policies such as “props, sets and wardrobes [sic]; miscellaneous equipment; money; and public liability have no particular connection with funding the film’s completion or obtaining or servicing finance to do so.” It goes on to argue why this is the case: “Hired wardrobe need not be accidentally destroyed and so paid for; other people’s equipment need not suffer unintended damaged needing compensation; money need not be lost or stolen so as to need replacement ...” Equally, film stock need not be damaged necessitating the reshooting of scenes.

The determination argues that “Extra expense policies cover the additional cost of production where an insured event leads to that extra cost.” Exactly the same can be argued in respect of an incident giving rise to a public liability claim.

In short, the Alliance considers that determinations about QAPE should have been settled at the time the tax offset was designed and prior to guidelines defining QAPE being published.

The draft determination contradicts the manner in which financing costs and insurances have been defined in respect of Divisions 10B and 10BA.

Finally, the determination flags to overseas productions that the certainty that had thought to have been constructed in the tax offset scheme is illusory. It contradicts the message the government wishes to send that Australia is good country to locate offshore production.