

SUBMISSION BY
MEDIA, ENTERTAINMENT & ARTS ALLIANCE
TO
SENATE ECONOMICS COMMITTEE
REGARDING
INQUIRY INTO THE PROVISIONS OF THE TAX LAWS AMENDMENT
(2007 MEASURES NO.5) BILL 2007

AUGUST 2007



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.

The Media, Entertainment & Arts Alliance appreciates the opportunity to make a submission to the Inquiry into the Provisions of the Tax Laws Amendment (2007 Measures No.5) Bill 2007. This submission confines itself to commenting on those provisions relating to the film production offsets.

The Alliance welcomes this new package of assistance mechanisms, originally announced in the May Federal Budget.

The package extends the current Film Tax Offset Rebate available for large budget productions to Australian productions that are typically produced with smaller budgets. In accordance with the Government's policy objectives, the new Producer Offset for qualifying Australian productions offers more generous assistance than the offset for larger, predominantly foreign productions. The existing offset, now to be known as the Location Offset, has been made more attractive by increasing the offset from 12.5% to 15% in response to the raft of incentives that have been put in place internationally following its introduction in Australia in 2002. In recognition of the increasing value of postproduction, digital and visual and effects, particularly in large budget productions, a new offset, to be known as the PDV offset has been introduced.

Like the Government, the Alliance is hopeful that these new assistance mechanisms will result in a growth of employment opportunities enabling the industry to achieve and maintain the critical mass necessary to underpin a viable industry.

The Producer Offset will hopefully assist Australian producers to build strong companies, enabling them to compete more effectively in the international market and produce quality productions that will find audiences here and abroad.

The Alliance welcomes the changes made to the film productions offsets since they were announced in May and appreciates that the Government has consulted widely and listened closely to industry concerns.

The Alliance does however have a concern that broadcasters will be able to access the Producer Offset.

Historically, the Government has intervened in the film and television industry in areas subject to market failure.

For that reason, Division 10BA was available only to those program types subject to market failure – specifically, feature films, mini-series, telemovies and documentaries. Similarly, finance from the Film Finance Corporation Australia (FFC) is available only for these program types. The same was true of the establishment of the Film Licensed Investment Companies.

However, the Producer Offset extends the concept of eligible programs to series comprising up to 65 episodes.

Free-to-air commercial broadcasters already have an obligation to broadcast a certain number of hours of adult drama, children's drama and documentaries annually. An overall transmission quota for Australian programming more broadly also applies. Predominantly drama subscription television broadcasters also have a mandated expenditure requirement.

These requirements have been imposed by Government in recognition of the fact that the licensees have access to valuable and scarce public assets.

To allow the broadcasters to access the Producer Offset will effectively offer them subsidy to undertake activity they are already required to undertake as part of the price of accessing spectrum.

When the Commercial Television Production Fund was in place, it offered substantial levels of funding for the production of television series but the series so funded were not able to be counted as eligible content for the purposes of the Content Standard. In this way, the funding drove up levels of Australian television drama.

Clearly, the Government's intention in extending the Producer Offset to cover series is in part the result of its desire to see greater levels of Australian drama on television – a policy objective the Alliance supports.

However, the Alliance considers that this policy objective would most effectively be served by allowing access to the Producer Offset in respect of series production only where the programs so assisted are additional to drama hours mandated by the Australian Content Standard.

The Australian Content Standard and the subquotas for adult drama, children's drama, children's programming and documentaries were introduced and remain in place as an effective and cost efficient way for the Government to ensure its policy objectives – as set out in the Broadcasting Services Act – are achieved. They also put a price on the licensees' access to spectrum. There should be no need for the Government to then subsidise the broadcasters in order that the quotas be satisfied.

The Alliance recommends the Bill be amended to ensure that the Producer Offset is used to drive greater levels of Australian television drama series than that mandated by the Content Standard by specifying that series made with the support of the Offset cannot be counted as eligible programs for the purpose of satisfying the Content Standard.

One other matter of concern remains the fact that insurances and completion guarantees are not considered eligible expenditure for the purposes of the offsets.

When the original offset was put in place, the Department of Communications, Information Technology and the Arts was of the view that insurances and completion guarantees were eligible expenditure. However, the Australian Taxation Office (ATO) took a different view and these costs were determined to be non-qualifying expenditure.

The Alliance accepts the principle that expenditure relating to the financing of a production is not eligible production expenditure. Indeed, this was the case with funds raised under Division 10BA. However, unlike the offsets, expenditure on insurances and completion guarantees was considered eligible expenditure for the purposes of Division 10BA.

The Alliance believes that both should be eligible expenditure for the purposes of the offsets. This is particularly important for the Producer Offset. Australian productions are reliant on completion guarantees to ensure a production is completed as, unlike American studios, they are not in a position to self-fund completion in the event of an insurable occurrence. The Alliance made a submission to the ATO in this regard and believes it is a matter that needs attention. That submission is attached.

The Alliance also accepts that the Government might concur with the ATO that completion guarantees and insurance costs are a financing cost rather than a production cost. In that event, the Alliance argues that as the Government has historically treated both as production costs, a policy decision could be taken to continue that practice in the context of the film offsets.

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

Media, Entertainment & Arts Alliance

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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 damage 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 a good country to locate offshore production.