

PRODUCER OFFSET RULES 2007: EXPLANATORY STATEMENT

Legislative Context

The Producer Offset Rules 2007 (the Rules) are made by the film authority pursuant to section 376-265 of the *Income Tax Assessment Act 1997* (ITAA). The film authority is defined as the Film Finance Corporation Australia Ltd (FFC) by subsection 376-55(3) of the ITAA.

The Rules are a Legislative Instrument within the meaning of the *Legislative Instruments Act 2003*.

The FFC is responsible for issuing certificates of eligibility for the Producer Offset pursuant to section 376-65 of the ITAA. The Producer Offset is a tax offset to encourage production of Australian films and television programs.

A certificate for the Producer Offset entitles the applicant company to a 40% (for a feature film) or 20% (for other media) refundable tax offset on the company's qualifying Australian production expenditure (QAPE), as determined by the FFC pursuant to section 376-75.

For the purposes of this Explanatory Statement (ES), such certificates are referred to as 'final certificates' to distinguish them from provisional certificates.

Provisional certificates provide guidance to applicants as to whether their production will qualify for the Producer Offset once it is completed. A provisional certificate does not entitle an applicant to a tax offset, nor does it bind the FFC in considering an application for a final certificate.

Purpose of the Rules

The Rules provide for the way in which the FFC will issue provisional certificates for the Producer Offset and specify how applications for provisional certificates and final certificates are made, including the form of applications, the information to be provided, how such information is to be verified and procedures for seeking further information.

The Rules also provide for reports to be sought from independent line producers and auditors in relation to applications for certificates as a way of verifying information contained in the applications under paragraph 376-265(2)(c) of the ITAA.

In effect, the Rules implement the intention of Division 376 of the ITAA by requiring sufficient information to be provided to the FFC to enable it to undertake its statutory duty in issuing certificates for the Producer Offset and determining films' QAPE. In addition, it provides for applicants to seek provisional certificates before production to enable them to pursue financing and investment with guidance from the FFC that the film, on the basis of the information provided, would be likely to be certified for the Producer Offset.

Impact

The Rules are unlikely to have any substantive impact on applicants, as in order for the FFC to make decisions under Division 376, the FFC needs to have access to the information required of applicants by the Rules. The impact on the FFC will be that it will have certainty about the information to be requested of applicants and for procedures that will need to be implemented in order for the Producer Offset to be administered efficiently.

The Rules are largely based on the *Refundable Film Tax Offset Rules 2002*, which provide similar authority to the Arts Minister in relation to the Refundable Film Tax Offset (RFTO) as is provided to the FFC in relation to the Producer Offset. The RFTO is provided under Division 376 of the ITAA as it was before the passage of the *Tax Laws Amendment (2007 Measures No. 5) Act 2007* (the Act), but under subitem 92(1) of Part 2 of Schedule 10 to the Act the RFTO is not available in respect of films which began principal photography or production of the animated image on or after 8 May 2007.

Consultation

The Producer Offset was developed in response to the 2006 Review of Australian Government Screen Support Measures (the Review). The Review included release of a public discussion paper, which attracted 82 submissions. The Producer Offset was announced in the context of the 2007-08 Budget and the Department of Communications, Information Technology and the Arts (DCITA) and the Department of the Treasury commenced further informal consultation to assist in the drafting of the Act.

Over 150 people were provided with confidential access to a draft Bill in relation to the Producer Offset in August 2007, which resulted in finalisation of the Act.

Finally, the Senate Economics Committee held an inquiry into the Act in late August 2007, attracting submissions and holding public hearings.

Throughout the development of the Producer Offset, industry has been continually consulted on a formal and informal basis. This consultation informed the development of the Rules. The FFC and DCITA collaborated on the drafting of the Rules.

Notes on Clauses

Part 1 of the Rules outlines procedural requirements and definitions. Part-specific Definitions are also provided by Rule 5, 16 and 21.

Part 2 of the Rules provide for the FFC to issue provisional certificates for the Producer Offset. To the maximum extent possible, provisional certificates and the process for applying for them mirror that for final certificates provided under Division 376 of the ITAA.

Rule 6 sets the limitations on the company that can apply for a provisional certificate. Consistent with the requirements for final certificates in the ITAA, an applicant must

be an Australian resident company or a foreign resident company with a permanent establishment and an ABN, and must either be the company through which production expenditure is to be channelled or be a company that is developing the production prior to the production company being established. By restricting access to such companies, this requirement is aimed at limiting the number of applications that are unlikely to go ahead with production.

Rules 7 and 8 set the broad requirements for applications for provisional certificates, including requiring applications to be in writing, signed and delivered to the FFC. Rule 7 also requires information listed in Schedule 1 to the Rules to be attached to the application, but requires certain information only if the film in question is a series or a season of a series (generally this means a television series, but it is intended to be technology neutral). Applications made in respect of co-productions (that is, films made under an arrangement entered into between the Commonwealth or an authority of the Commonwealth and a foreign country or an authority of the foreign country) must attach relevant co-production agreements to prove their status as co-productions.

Also, Rule 7 provides that applicants for provisional certificates can opt to exclude QAPE from the application and the assessment. This may occur, for example, where a film is clearly going to expend the minimum QAPE to meet the relevant expenditure thresholds, so the applicant only wishes to know whether the film is likely to meet the significant Australian content test. This option saves both the applicant and the FFC time and resources. Where an application deals with expenditure, the applicant must attach an expenditure statement outlining what the anticipated QAPE and total film expenditure of the film will be.

The expenditure statement requirements for a provisional certificate are outlined in Rule 22. Such a statement must say where expenditure is likely to be made (Australia or overseas), give a breakdown of likely expenditure against each budget item, and describe the location in which each good or service will be provided, including the location of any land used in production (specifically, whether the land was in Australia). A statement must also specify expenditure incurred by a previous company from whom the applicant has taken over production that is intended to be claimed as QAPE. Projected expenditure on travel must be specified in expenditure statements. Also, all expenditure must be expressed in Australian dollars, using an estimated exchange rate.

The requirements in Rule 22 allow the FFC to decide whether each proposed item of expenditure is likely to be QAPE and therefore whether the total QAPE of the film is likely to meet the minimum expenditure requirements in subsection 376-65(6) of the ITAA.

Rule 9 outlines the FFC's responsibilities and powers upon receipt of an application, to enable the FFC to administer the provisional certification scheme. The FFC must consider the application and decide whether it will issue a provisional certificate. In doing so, it may use its own expertise, contract independent line producers to consider whether the film meets the statutory criteria for the Producer Offset, and seek information from any third party. Where information is sought from a third party, including from an independent line producer, the FFC are required to give applicants

an opportunity to comment on such information. These requirements are consistent with those for final certificates.

Where an application asks the FFC to consider eligibility under the QAPE thresholds in subsection 376-65(6), an independent line producer's report may consider whether individual charges are commercially reasonable, whether they are actually QAPE and whether there is evidence that a relationship between entities that are related may not be at arm's length. These allow the FFC to ensure that charges are not being inflated to increase a film's QAPE.

The FFC may seek further information from an applicant under Rule 10 and place time limits on response. The FFC may refuse a certificate if time limits are not met.

Rule 11 provides that where the FFC does not believe, on the basis of the information provided, that the film will or is likely to meet the statutory conditions for the Producer Offset, it may refuse to issue a provisional certificate. However, where the FFC considers that the film will or is likely to meet the statutory conditions it must issue such a certificate, by virtue of Rule 13. These rules are consistent with those for final certificates in Subdivision 376-D.

Rule 12 requires that written notice be provided to applicants within 28 days of the FFC refusing to issue a provisional certificate. Such notice must outline the specific statutory condition or conditions that the FFC was not satisfied that the application met.

Rule 14 outlines the required content for provisional certificates, including any conditions attached to the certificate. All provisional certificates must note that the decision is based on the information provided. This is because a provisional certificate is a guide to eligibility only, and does not bind the FFC in considering final certificates for the Producer Offset. Rule 15 makes it clear that a provisional certificate has no effect either way on the eligibility of a film for a final certificate.

Requirements for certificates

Part 3 makes rules about the form of applications for 'final' certificates issued by the FFC under section 376-65 of the ITAA.

Rule 17 requires the application to include certain information listed in Schedule 2 to the Rules, requires an application to be in writing and includes special requirements for series, seasons of series and co-productions. Rule 18 requires an application to be delivered to the FFC. These requirements are consistent with those for provisional certificates noted above.

Rule 17 also requires an expenditure statement to be attached to an application. An expenditure statement is the key part of an application for assessing whether a film meets the QAPE thresholds in subsection 376-65(6) of the ITAA and for determining the amount of the Producer Offset. Expenditure statements must be independently and properly audited. Applications must also include a budget spreadsheet in an FFC-approved form. Both the expenditure statement and budget spreadsheet will be relied upon by the FFC in determining the QAPE of the film under section 376-75 of the

ITAA. Applicants must ensure that all audits are conducted in accordance with all applicable standards (Rule 25).

Where QAPE is being claimed in relation to acquiring copyright or producing copyrighted promotional material, an application must also include agreements verifying the transfer of copyright ownership.

Expenditure statement requirements are outlined in Rule 23. Such a statement must say where expenditure is likely to be made (Australia or overseas), give a breakdown of likely expenditure against each budget item, and describe the location each good or service will be provided, including the location of any land used in production (specifically, whether the land was in Australia). A statement must also specify expenditure incurred by a previous company from whom the applicant has taken over production that is intended to be claimed as QAPE. Projected expenditure on travel must be specified in expenditure statements, as must each of the special items of QAPE in the tables in sections 376-150 and 376-170 of the ITAA.

The expenditure statement must also separately identify QAPE claimed that relate to development or remuneration of key cast and crew under paragraph 376-170(4)(b), which is capped at 20% of total film expenditure. Any expenditure paid for using development funding provided by an Australian Government film agency must also be separately identified. Such expenditure cannot be QAPE by virtue of subsection 376-170(4). Other particular items of QAPE must also be separately identified.

The rules about expenditure statements ensure that the FFC has sufficient information to assess compliance with Subdivision 376-C and therefore to determine the film's level of QAPE.

Finally, Rule 17 requires a foreign expenditure statement to be attached where QAPE has been made in a foreign currency.

Expenditure statements are governed by Rule 24, which requires all foreign expenditure to be converted to Australian expenditure within the meaning of items 9 and 9B of the table in subsection 960-50(6) of the ITAA. The itemised reporting of this will enable the FFC to check that calculations were made accurately.

Rule 19 outlines what the FFC may do in considering an application for a final certificate. Consistent with a provisional certificate the FFC may use its own expertise, contract independent line producers to consider whether the film meets the statutory criteria for the Producer Offset, or seek information from any third party. Where information is sought from a third party, including from an independent line producer, the FFC must give applicants an opportunity to comment on such information.

Where the FFC contracts an independent line producer to report on the application, the report may consider whether individual charges are commercially reasonable, whether they are actually QAPE and whether there is evidence that a relationship between entities that are related may not be at arm's length. These allow the FFC to ensure that charges are not being inflated to increase a film's QAPE. The report may

also consider whether the applicant is in fact the production company and meets the requirement in subsection 376-65(1).

The FFC may also seek further information from an applicant under Rule 20 and place time limits on response. The FFC may refuse to issue a certificate if time limits are not met.

Schedule 1 – provisional certificates

Part A of Schedule 1 to the Rules outlines what should be provided in an application for a provisional certificate. It provides the FFC with the authority to request sufficient information of an applicant in order for it to decide whether the film is likely to qualify for the Producer Offset:

- Items 1.1 to 2.5 are general information about the applicant and the film. The running time may also be relevant in relation to the average QAPE per hour threshold some types of films must meet.
- Items 2.6-2.18 seek information about the nationality of production and allow the FFC to consider if the film has significant Australian content within the meaning of section 376-70 of the ITAA.
- Items 2.19 to 2.28 require the applicant to disclose existing assistance from certain Australian Government agencies, including tax incentives and direct investment, which in particular cases act as bars to certification for the Producer Offset (subsection 376-55(4)). The provision also seeks information on assistance provided from state government agencies to allow tracking of total Government support for film. Development assistance within the meaning of items 2.23-2.24 may reduce QAPE.
- Items 2.29-2.30 require information about expenditure incurred on the film as a foreign resident.
- Items 2.31-2.33 require particular information where the film is a series or a season of a series relating to the overall cap on Producer Offset support for up to 65 episodes of a series (paragraph 376-170(4)(c)) and the need for a series to have a new creative concept different from that of any existing series (see ITAA subsection 376-70(2)).
- Item 3.1 and 3.3 require additional information that will be relevant for tracking a film if it changes production companies during its making. This will enable tracking of production from provisional to final certification.
- Item 3.2 allows the FFC to check that services provided by related entities are at market rates.

Part B of Schedule 1 to the Rules requires certain documents to be attached to the application to certify the veracity of information, including a statutory declaration that the application is true and correct, evidence that the applicant meets the requirement in subrule 6(a), and evidence of a film being a co-production, where relevant.

Schedule 2 – Certificates

Part A of Schedule 2 to the Rules outlines what should be provided in an application for a provisional certificate. It provides the FFC with the authority to request sufficient information of an applicant in order for it to decide whether the film is likely to qualify for the Producer Offset:

- Items 1.1 to 2.5 are general information about the applicant and the film. The running time may also be relevant in relation to the average QAPE per hour threshold some types of films must meet.
- Items 2.6-2.18 seek information about the nationality of production and allow the FFC to consider whether the film has significant Australian content within the meaning of section 376-70 of the ITAA.
- Item 2.19 requires dates for the commencement and completion of QAPE. It allows the FFC to check the average exchange rate for QAPE incurred in a foreign currency.
- Item 2.20 checks whether the film satisfies the expenditure thresholds in subsection 376-65(6) of the ITAA.
- Items 2.21 to 2.30 require the applicant to disclose existing assistance from certain Australian Government agencies, including tax incentives and direct investment, which in particular cases act as bars to certification for the Producer Offset (subsection 376-55(4)). The provision also seeks information on assistance provided from state government agencies to allow tracking of total Government support for film. Development assistance within the meaning of items 2.25-2.26 may reduce QAPE.
- Items 2.31 to 2.32 require information about expenditure incurred on the film as a foreign resident.
- Items 2.33-2.35 require particular information where the film is a series or a season of a series relating to the overall cap on Producer Offset support of up to 65 episodes of a series (paragraph 376-170(4)(c)) and the need for a series to have a new creative concept different from that of any existing series (see ITAA subsection 376-70(2)).
- Item 3.1 and 3.3 require additional information that will be relevant for tracking a film if it changes production companies during its making. This will enable tracking of production from provisional to final certification.
- Item 3.2 allows the FFC to check that services provided by related entities are at market rates.

Part B of Schedule 2 to the Rules requires certain documents to be attached to the application to certify the veracity of information.

- Item 1.1 requires a statutory declaration certifying the application.
- Item 1.2 requires evidence in relation to expenditure which would not normally be QAPE but may be in some circumstances (see items 6-9 in the table in section 376-135 of the ITAA).
- Item 1.3 requires evidence that the company meets the statutory requirement of residency (paragraph 376-55(1)(d) of the ITAA).
- Item 1.4 will establish whether the company has the requisite level of responsibility for the film (subsection 376-55(1) of the ITAA).
- Item 1.5 requires evidence of a film being a co-production, where relevant.

Schedule 3 provides the form of the auditor's statement required by paragraph 17(3)(d).