Australian Government

Screen Australia

FACT SHEET: Timing of the Producer Offset Acquittal

NOVEMBER 2009

Please note: Screen Australia cannot provide legal or accounting advice and strongly recommends that all potential applicants for the Producer Offset seek competent independent professional assistance. The information below is in the nature of general information only, not tailored to any project in any way, and not intended to be relied on in place of professional advice.

CONTEXT

The Producer Offset is credited to a company with a final certificate issued by Screen Australia in the company's income tax return for the same financial year in which the film is completed. The offset is credited firstly against any pre-existing tax liabilities, with the remainder paid out as a refund.

Because the offset is credited through the income tax system, it cannot be paid until submission of the eligible entity's income tax return following the end of the financial year. This may mean that the entity incurs substantial interest costs on any financing of the offset if the film is completed early in the financial year.

The timing of payment of the Producer Offset is an issue which is likely to be addressed in submissions made to Government in connection with the 2010 review of Division 376 of the *Income Tax Assessment Act 1997*. Pending that review and its outcomes, in an effort to assist the production industry, a working group comprising representatives of the Department of the Environment, Water, Heritage and the Arts (DEWHA), Treasury, the Australian Taxation Office (ATO) and Screen Australia has identified possible interim solutions for delivery of the Producer Offset which are outlined below. Producers and their advisers are strongly encouraged to seek advice in relation to these proposed solutions, as their availability to particular producers and particular projects will need to be carefully assessed.

INTERIM SOLUTIONS

1 Liquidation of a Special Purpose Vehicle (SPV)

How does it work?

The ATO has advised that it will generally only process a tax return for a taxpayer before the end of a financial year where it has certainty that the taxpayer will not earn any further taxable income in that financial year. The ATO has indicated that that certainty can be achieved by a voluntary liquidation of a film production company before the June 30 year end. The ATO wrote to the Screen Producers Association of Australia on 15 October 2009 outlining its views. The letter is available at:
http://www.ato.gov.au/businesses/content.asp?doc=/content/00221060.htm&pc=001/003/076/001/001&mnu=43076&mfp=001&st=&cy=1

It is assumed that such a liquidation would be a members' voluntary winding up: that is, a solvent liquidation. In order to proceed with a members' voluntary winding up, a majority of the directors of the company need to sign a declaration (usually referred to as a 'solvency declaration') that they have inquired into the affairs of the company and they are satisfied that the company will be able to meet all of its liabilities in full within 12 months. There are significant penalties under the Corporations Act for directors who make a declaration without having reasonable grounds for doing so.

If the directors are not able to sign that declaration, the winding up would need to proceed as a creditors' winding up, which has materially different characteristics, procedures and legal consequences for the company and its directors. This is a matter for competent legal advice, and it is particularly important for the directors of the entity that they obtain such advice at the outset.

The intent of the members' voluntary winding up mechanism in this context is that if the company is in a position to commence a members' voluntary winding up, the liquidator of the company can lodge its tax return, including the claim for the Producer Offset, once the winding up has commenced rather than waiting until the end of the financial year (it is anticipated that the final certificate would be obtained and the tax return prepared prior to the appointment of the liquidator). It is assumed that the eligible entity would be a special purpose vehicle (SPV), with no ongoing obligations other than the offset loan, and no entitlements beyond the expectation of receipt of the offset. Again producers need to seek their own legal and other advice in relation to these arrangements.

It is our understanding that the ATO would then process the return in accordance with its usual practice (a process which we understand currently takes four to eight weeks) and (subject to any existing tax liabilities of the entity) pay the offset to the liquidator. The liquidator (in accordance with the requirements of the Corporations Act) would then repay the offset lender, and deal with any balance of the offset amount remaining (essentially, in payment of any costs of the liquidation and other liabilities and any balance to the members). Following completion of the winding up the SPV would be deregistered.

How do I implement this?

A critical aspect on which producers need to seek advice is the quarantining of the SPV from any ongoing rights and liabilities. Ordinarily this will be facilitated by the various agreement(s) with the producer – in Screen Australia's case, the Production Investment Agreement (PIA) – which should vest all ongoing rights and obligations following completion of the project in the parent company rather than in the SPV. Examples of ongoing rights and liabilities which might need to be considered could include:

- copyright and recoupment entitlements under the PIA
- residuals for cast
- rights and liabilities under distribution agreements
- ongoing insurance contracts
- obligations around delivery
- any outstanding invoices and claims relating to production

It is Screen Australia's view that the possibility of the SPV initiating a members' voluntary winding up (subject to the directors being in a position to sign the solvency declaration) would need to be reflected in the contracting from the outset, but this is certainly an aspect which legal advice would need to address.

In addition to seeking legal and financial advice, Screen Australia strongly recommends that producers also discuss the issues with (in no particular order) the offset cashflow provider, the investors in the project, the insurance broker, completion guarantor, any Screen Australia investment manager on the project and the MEAA.

Finally Screen Australia emphasises that, apart from the significant legal issues, it is fundamentally a cost/benefit question. Producers will need to decide whether, given the timing and the costs (i.e. both interest costs and costs associated with a winding up, including the liquidator's fee), a winding up is warranted.

When can it happen?

This process can only be implemented after the final offset certificate is issued, which must occur following completion of the film and the final audit. Because of this timeframe, producers may consider that liquidation is unlikely to be worthwhile for any film completed later than January (as the final certificate is unlikely to be received much before the end of the financial year in any event).

What should producers do?

- Seek competent legal and financial accounting advice, particularly regarding the treatment under the relevant agreements of rights, interests and responsibilities after completion of the film
- Speak to your investors, including – where it is an investor in the project – your Screen Australia investment manager.

- Subject to your legal and financial/accounting advice, consult with your cashflow lender, the bond and other relevant third parties including those mentioned above.

2 Variation of ongoing PAYG instalments

How does it work?

If the film is not made under an SPV structure and/or is part of a ‘consolidated group’, and the eligible entity must pay ongoing income tax instalments, the ATO may be able to assist companies with final certificates for the Producer Offset to vary their ‘Pay as You Go’ (PAYG) income tax instalments in anticipation of receiving the offset at the end of the financial year. However, this can only be done once a final certificate has been issued to the entity (so that the availability and amount of the offset is known) and there are PAYG instalments that subsequently fall due.

What should producers do?

Producers should consult with their accountant and/or tax adviser and the ATO for further information. Please note that this interim solution will only be an option if there is income earned and income tax payable during the course of the tax year. It is therefore unsuited to the SPV structure (in which no income accrues to the SPV) and in practice may only be available for companies with multiple productions and ongoing income streams.

BACKGROUND

In April 2009, the Minister for the Environment, Heritage and the Arts, the Hon Peter Garrett MP, and the then Assistant Treasurer, the Hon Chris Bowen MP, released the results of the statutory review of the impact of the three offsets provided by Division 376 of the *Income Tax Assessment Act 1997* (the Producer Offset, the Location Offset and the PDV Offset) on the balance of production between in-house broadcasters' production and production by the independent sector. One of the issues raised in the review that was outside the review's scope was the issue of the timing of the acquittal of the Producer Offset.

In announcing the results of the review, the Minister noted that the issue was significant and requested that Screen Australia, DEWHA, the Treasury and the ATO form a working group to find solutions to the issue. The Ministers' press release can be found at http://www.environment.gov.au/minister/garrett/2009/mr20090408.html .

The working group analysed potential solutions from a legislative, regulatory and administrative perspective and briefed the Minister in late May.

The Minister wrote to industry in June outlining the two available solutions, which are outlined above. Since then, Screen Australia has been consulting with industry members including offset cashflow providers.

Screen Australia and the ATO discussed the possible interim solutions with industry at the July 2009 meeting of the ATO's Film Industry Partnership.