

2004-2005-2006-2007

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

TAX LAWS AMENDMENT (2007 MEASURES No. 5) BILL 2007

EXPLANATORY MEMORANDUM

(Circulated by authority of the
Treasurer, the Hon Peter Costello MP)

Table of contents

Glossary	1
General outline and financial impact.....	3
Chapter 10 Film production offsets	5

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
AAT	Administrative Appeals Tribunal
ABN	Australian Business Number
ADI	authorised deposit-taking institution
APRA	Australian Prudential Regulation Authority
ATO	Australian Taxation Office
CGT	capital gains tax
Commissioner	Commissioner of Taxation
DGR	deductible gift recipient
IR&D Act	<i>Industry Research and Development Act 1986</i>
IR&D Board	Industry Research and Development Board
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
MEC group	multiple entry consolidated group
PDF Act	<i>Pooled Development Funds Act 1992</i>
R&D	research and development
TAA 1953	<i>Taxation Administration Act 1953</i>
US	United States of America
VC Act	<i>Venture Capital Act 2002</i>
VCR Board	Venture Capital Registration Board

General outline and financial impact

Film production offsets

Schedule 10 to this Bill reforms the taxation arrangements for the Australian screen media industry by:

- introducing a refundable tax offset for Australian expenditure in making Australian films (the producer offset);
- enhancing the existing refundable film tax offset for Australian production expenditure (the location offset);
- introducing a refundable film tax offset for post, digital and visual effects production in Australia (the PDV offset); and
- phasing-out the existing tax incentives provided to investors in Australian films.

Date of effect: The location offset will apply to films commencing principal photography or production of the animated image on or after 8 May 2007.

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

The producer offset applies to qualifying Australian production expenditure incurred:

- on or after 1 July 2007; and
- before 1 July 2007, to the extent that such expenditure is attributable to goods or services provided on or after 1 July 2007.

Proposal announced: This measure was announced in the 2007-08 Budget and in joint press releases from the Minister for Communications, Information Technology and the Arts and the Minister for the Arts and Sport, on 9 May 2007.

Financial impact: This measure will have these financial implications:

<i>2007-08</i>	<i>2008-09</i>	<i>2009-10</i>	<i>2010-11</i>
-\$67m	-\$71m	-\$69m	-\$69m

Compliance cost impact: Nil.

Chapter 10

Film production offsets

Outline of chapter

10.1 Schedule 10 to this Bill reforms the taxation treatment of the Australian screen media industry by:

- introducing a refundable tax offset for Australian expenditure in making Australian films (the producer offset);
- enhancing the existing refundable film tax offset for Australian production expenditure (the location offset);
- introducing a refundable film tax offset for ‘post, digital and visual effects production’ in Australia (the PDV offset); and
- phasing out the existing tax incentives provided to investors in Australian films.

Context of amendments

10.2 In the 2007-08 Budget, the Government announced a package of measures to reform and strengthen the Australian screen media industry. The package is designed to support the industry at a time when it is striving to meet the challenges of a changing global environment. The package seeks to encourage greater private sector investment in the industry and improve the market responsiveness of the industry.

10.3 Taxation incentives for the film industry are currently provided to both investors in, and producers of, films in Australia. Investors may claim deductions for capital expenditure on Australian films under either Division 10B or Division 10BA of the *Income Tax Assessment Act 1936* (ITAA 1936). Film production companies incurring expenditure on larger budget productions in Australia may be eligible for a refundable film tax offset under Division 376 of the *Income Tax Assessment Act 1997* (ITAA 1997).

10.4 The current investor tax incentives in Divisions 10B and 10BA of the ITAA 1936 have had limited effectiveness in recent years and will be phased out in favour of shifting towards incentives for producers of films.

10.5 The introduction of the producer offset represents a major new support mechanism for film producers and it will assist the industry to be more competitive and responsive to audiences. It provides a real opportunity for producers to retain substantial equity in their productions and build stable and sustainable production companies, and aims to increase private investor interest in the industry.

10.6 Division 376 of the ITAA 1997 provides a tax offset for certain Australian production expenditure incurred by a production company in making a film where a minimum level of expenditure has been incurred. The offset can be claimed in the income tax return for the income year in which the film is completed.

Summary of new law

10.7 The taxation treatment of the Australian screen media industry is reformed by:

- introducing a refundable tax offset for producers of Australian films (the producer offset) where:
 - the offset is 40 per cent of qualifying Australian production expenditure incurred on a feature film;
 - the offset is 20 per cent of qualifying Australian production expenditure incurred on films that are not feature films; and
 - the offset is available in relation to qualifying Australian production expenditure incurred on or after 1 July 2007;
- enhancing the existing refundable film tax offset for Australian production expenditure (the location offset) where:
 - the offset is increased from 12.5 per cent to 15 per cent of qualifying Australian production expenditure; and

- the increased offset is available to films commencing principal photography or production of the animated image on or after 8 May 2007;
- introducing a refundable tax offset for post, digital and visual effects production in Australia (the PDV offset) where:
 - the offset is 15 per cent of certain Australian expenditure that is incurred in relation to post, digital and visual effects production for a film; and
 - the offset is available to a film that commences post, digital or visual effects production on or after 1 July 2007; and
- phasing out the existing tax incentives provided to investors in Australian films in the following ways:
 - applications for certificates under Divisions 10B and 10BA of the ITAA 1936 will not be accepted after the date of Royal Assent of this Bill; and
 - the first deduction available 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 year of income or a later year of income.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Producer offset</i>	
Providing a refundable tax offset of 40 per cent for feature films and 20 per cent for films that are not feature films.	No equivalent.
<i>Location offset</i>	
Providing a refundable tax offset of 15 per cent.	The offset is currently 12.5 per cent.
<i>PDV offset</i>	
Providing a refundable tax offset of 15 per cent.	No equivalent.

<i>New law</i>	<i>Current law</i>
<i>Phasing out existing tax incentives for investors</i>	
<p>Not accepting applications for certificates under Divisions 10B and 10BA of the ITAA 1936 after the date of Royal Assent of this Bill.</p> <p>The first deduction available under Division 10B will only be available up until 30 June 2009. A deduction under Division 10BA is not allowable in relation to the 2009-10 year of income or a later year of income.</p>	<p>Division 10B of the ITAA 1936 provides a deduction over two years to Australian residents. The deduction is for foreign residents for capital expenditure incurred in acquiring the copyright of an Australian film which is used to produce assessable income.</p> <p>Division 10BA of the ITAA 1936 provides a deduction to Australian residents when capital expenditure is incurred in the production of an Australian film that results in the acquisition of an interest in the initial copyright of that film.</p>

Detailed explanation of new law

10.8 Division 376 of the ITAA 1997 is being repealed and replaced by a new Division 376, incorporating the new producer offset, the PDV offset and the enhancements to the existing offset. It should be noted that, unless otherwise indicated in this chapter, the concepts that are used in the existing Division 376 continue to have the same meaning and intent in the new Division 376 of the ITAA 1997.

10.9 Companies may be entitled to one of three refundable tax offsets in relation to Australian expenditure incurred in making films. The offsets are designed to support and develop the Australian screen media industry by providing concessional tax treatment for Australian expenditure.

10.10 Subdivision 376-A provides a guide to Division 376 by outlining the key features of the tax offsets and the structure of the Division. *[Schedule 10, item 1, Subdivision 376-A]*

Part 1 — The producer offset

10.11 The producer offset is a new financial incentive offered to producers of Australian films and is designed to encourage support for the Australian screen media industry. The structure of the producer offset is similar to that of the refundable film tax offset available under the existing Division 376 of the ITAA 1997, with some variations.

Eligibility for the producer offset

10.12 The producer offset is available to a company for the making of an Australian film when the following conditions are met:

- the film was completed in the income year;
- a certificate has been issued for the film by the film authority;
- the offset is claimed in the income tax return for the year by the company; and
- the company is either an Australian resident or a foreign resident that has a permanent establishment in Australia and has an Australian Business Number (ABN).

[Schedule 10, item 1, subsection 376-55(1) of the ITAA 1997]

10.13 A film is ***completed***:

- for a film that is not a series — when it is first in a state where it could reasonably be regarded as ready to be distributed or exhibited to the general public; and
- for a series (whether or not comprised of seasons) — at the earlier of:
 - the time when the 65th episode is first in a state where it could reasonably be regarded as ready to be distributed, broadcast or exhibited to the general public; and
 - the time when the series is in such a state.

[Schedule 10, item 1, subsection 376-55(2), definition of ‘completed’ in subsection 995-1(1) of the ITAA 1997]

10.14 The point of completion is generally accepted to be at a stage that includes post-production and editing as well as the shooting of the film. It does not have to be distributed or exhibited, just be in a state where either could reasonably happen if desired.

10.15 The administering authority for the producer offset is the ***film authority***, which is defined as the Film Finance Corporation Australia Limited. *[Schedule 10, item 1, subsection 376-55(3), definition of ‘film authority’ in subsection 995-1(1) of the ITAA 1997]*

- 10.16 A company is not entitled to the offset if:
- a company or someone else claims a deduction in relation to a unit of industrial property that relates to copyright in the film under Division 10B of Part III of the ITAA 1936;
 - a final certificate for the film has been issued at any time under Division 10BA of Part III of the ITAA 1936;
 - a certificate has been issued at any time under the location offset for the film;
 - a certificate for the film has been issued at any time under the PDV offset;
 - the company or someone else has deducted money paid for shares in a film licensed investment company under Subdivision 375-H and the company has invested in the film; or
 - production assistance (other than development assistance) for the film has been received by the company or anyone else before 1 July 2007 from any of the following bodies:
 - the Film Finance Corporation Australia Limited;
 - Film Australia Limited;
 - the Australian Film Commission; or
 - the Australian Film, Television and Radio School.

[Schedule 10, item 1, subsection 376-55(4) of the ITAA 1997]

10.17 Production assistance is intended to mean money paid by the above Australian Government bodies to assist in the production of the film itself. It is not intended to include, for example, grants paid to assist with a film's marketing or for a film's producer to attend film markets or festivals, or production investment of other government agencies.

10.18 The receipt of development assistance in relation to a film, prior to 1 July 2007, does not preclude the company from eligibility for the offset. **Development assistance** for a film means financial assistance provided to assist with meeting the development costs for the film and includes assistance to the extent to which it is provided in relation to any of the following:

- expenditure on location surveys or otherwise identifying or assessing possible locations;
- storyboarding and scriptwriting;
- research for the film;
- casting actors;
- developing a budget; and
- developing a shooting schedule for the film.

[Schedule 10, item 1, subsection 376-55(5), definition of ‘development assistance’ in subsection 995-1(1) of the ITAA 1997]

Details of the offset

10.19 A company is entitled to the offset for an income year only if it claims the offset in its income tax return for the year, and is an Australian resident company, or an Australian permanent establishment of a non-resident company and where it has an ABN, both when it lodges the income tax return and when the tax offset is due to be credited.

[Schedule 10, item 1, subsection 376-55(1) of the ITAA 1997]

10.20 The requirement that the company be either an Australian resident or a permanent establishment is consistent both with the non-binding obligation in the Australia-United States of America double tax treaty to avoid discrimination, and with the more general model non-discrimination clause in the Organisation for Economic Co-operation and Development model treaty. There is no discrimination between production companies that have the same tax presence in Australia, wherever resident or wherever incorporated.

10.21 Further, it simplifies the administration of these amendments and ensures that the offset is given to producers with a uniform income tax rate and treatment.

10.22 Subsection 960-100(4) of the ITAA 1997 provides that a reference to a particular kind of entity (in this case a company) in a provision, refers only to the entity in that particular capacity and not in

any other capacity. The example in the subsection illustrates that a reference to a company does not include the company acting in the capacity as trustee.

10.23 The amount of the offset is:

- if the film is a feature film — 40 per cent; or
- if the film is not a feature film — 20 per cent,

of the total of the company's qualifying Australian production expenditure on the film. [*Schedule 10, item 1, section 376-60*]

10.24 The total of the company's qualifying Australian production expenditure on the film is determined by the film authority under section 376-75 (see paragraph 10.136).

10.25 The offset must be claimed by the company in its income tax return for the income year in which the film is completed. Once lodged, there is no opportunity for that claimant to change the claim from one tax offset to another. The claim made at the time of lodging the return is irrevocable. [*Schedule 10, item 1, reference at the end of subsection 376-55(1) to paragraph (c)*]

10.26 A refund of tax offsets will occur where the total of those offsets exceeds the amount of income tax and other tax liabilities that the company would have had to pay if it had not received those tax offsets (but had received all its other tax offsets), by operation of section 67-30 of the ITAA 1997. Any amount of offset applied against tax liabilities or refunded to a company would not be assessable income for income tax purposes. However, given its untaxed nature at the company level, where a refunded offset amount is distributed to shareholders, those distributions will be unfranked dividends.

Eligible genres

10.27 A film will be eligible for the producer offset if it is one of the following:

- a feature film;
- a single episode programme;
- a series;
- a season of a series; or
- a short-form animation.

[*Schedule 10, item 1, paragraph 376-65(2)(c)*]

10.28 A documentary may qualify as a feature film, series or a season of a series, or a single episode programme.

10.29 A film is not:

- a film for exhibition as an advertising programme or a commercial;
- a film for exhibition as a discussion programme, a quiz programme, a panel programme, a variety programme or a programme of a like nature;
- a film of a public event (other than a documentary);
- a training film;
- a computer game (within the meaning of the *Classification (Publication, Films and Computer Games) Act 1995*);
- a news or current affairs programme; or
- a reality programme (other than a documentary).

[Schedule 10, item 1, paragraph 376-65(2)(d)]

Feature film

10.30 A feature film is the only format which receives a 40 per cent offset. The term feature film is intended to mean a film of at least one hour in length that is screened as the main attraction in commercial cinemas. Where a feature film is designed for release in a large-format cinema, such as IMAX, it is intended that the film be at least 45 minutes in length. For the purposes of the producer offset, it is expected that a feature film would need to show evidence of its release or proposed release in an Australian cinema (see paragraph 10.130). A feature film may be an animated feature film and may be a documentary.

Single episode programme

10.31 If a film does not receive a cinema release, but is a stand-alone programme of at least one commercial hour in length that is exhibited on another medium, it may qualify as a 'single episode programme'. This category of film includes telemovies or movies-of-the-week, films released direct to DVD or films released on the Internet, video on demand or a mobile phone delivery platform. *[Schedule 10, item 1, subsection 376-65(3)]*

10.32 The concept of *commercial hour* recognises that programmes are made of varying length and they may be transmitted to the public in different ways. For instance, a programme of 52 minutes duration may be shown without interruption by one broadcaster, but be shown in a 60 minute programming slot by a commercial broadcaster. Such a programme would be regarded as being of one 'commercial hour' in length.

10.33 A project may commence as a feature film, seeking an offset of 40 per cent, but not be picked up for Australian cinema distribution. In such a case, providing the film can achieve distribution on another platform, it may be considered to be a single episode programme.

10.34 A single episode programme may be an animated film and may be a documentary. If the programme is a documentary, it must be at least one half of a commercial hour in duration. [*Schedule 10, item 1, paragraph 376-65(3)(d)*]

Short-form animation

10.35 A short-form animation is a programme of one episode or a collection of episodes, predominantly utilising cell, stop motion, digital and/or other animation, of not less than one quarter commercial television hour in total duration. This means, for example, that a collection of six five-minute animated episodes (30 commercial minutes) would be regarded as a short-form animation, as the film will be at least one quarter of a commercial hour. [*Schedule 10, item 1, subsection 376-65(4)*]

10.36 The provision requires an animation to be a drama, which may include a comedy and/or children's animation. [*Schedule 10, item 1, subsection 376-65(4)*]

10.37 Where it is a collection of episodes, a short-form animation must have a common theme or themes and be produced wholly or principally for exhibition together, for a national market or national markets under a single title. This requirement does not mean that the animation must be broadcast in Australia, just that the collection is a bona fide collection (eg, a series or an anthology). [*Schedule 10, item 1, paragraph 376-65(4)(a)*]

Series

10.38 A series or season of a series is a multiple-episode film that does not receive a cinema release, but is exhibited on another medium. A series or season of a series must be at least two episodes and no more than 65 episodes. Each episode must be at least one commercial half-hour in length. [*Schedule 10, item 1, paragraph 376-65(5)(a), subparagraph 376-55(2)(b)(i)*]

10.39 The 65-episode limit is a cumulative cap on the support the producer offset will provide to a series. It recognises that once a series has been in production for such a number of episodes, it should be capable of being made without Australian Government support and effectively become self-sufficient.

10.40 When the 65-episode limit has been reached, that season will be deemed completed and only qualifying Australian production expenditure on the episodes up to and including the 65th episode are eligible for the producer offset. Further episodes or seasons of the series would be ineligible for the producer offset. [*Schedule 10, item 1, paragraph 376-170(4)(c)*]

10.41 Where an applicant series has episodes that were made prior to 1 July 2007, those episodes are counted towards the 65-episode limit. [*Schedule 10, item 1, subsection 376-170(5)*]

10.42 There may be cases where a new series emerges from an existing series, such as where a series is a ‘spin-off’ or where a series is a remake of a series made a long time in the past. Where there is doubt as to whether an applicant season of a series is in actuality a season of a existing series, the film authority will be expected to satisfy itself that the applicant season involves a new creative concept in order for it to be considered a season of a new series. In such cases, the episodes of the previous series will not be counted towards the 65-episode limit. The film authority must have regard to the title of the series, as well as whether the series has substantially different characters, settings, production locations and individuals involved in the making of the series compared to any other series. The film authority must also have regard to any other matters that it considers to be relevant. It is expected that such matters could include whether there had been a significant lapse in time since the completion of any other series which could be considered to have a similar creative concept to the applicant series. It is also intended that the film authority consider the creative concept of the applicant series compared only to other series, not, for example, to feature films, books or plays with a similar creative concept. [*Schedule 10, item 1, subsection 376-70(2)*]

10.43 A series or season of a series may be an animated film and may be a documentary.

Seasons of series

10.44 A season of a series is a multiple-episode film that does not receive a cinema release, but is exhibited on another medium. A season of a series is intended to represent a group of episodes that continue a series, but are made separately to previous seasons of the series. Each season of a series must be at least two episodes and the total number of

episodes of all seasons of the series can be no more than 65 episodes. Each episode must be at least one commercial half-hour in length. *[Schedule 1, item 1, paragraph 376-65(5)(b), subparagraph 376-55(2)(c)(i)]*

10.45 Where an application is made for a season of a series, the film authority will take the total number of episodes of all previously certified seasons of that series into account when calculating whether the maximum 65 episodes has been reached.

10.46 Where an applicant season of a series is part of a series that has included seasons made prior to the commencement of the producer offset or without producer offset support, the episodes of the previous seasons made before 1 July 2007 count towards the 65-episode cap. *[Schedule 10, item 1, subsection 376-170(5)]*

10.47 When the 65-episode limit has been reached, even if the 65th episode falls before completion of a season of the series, only qualifying Australian production expenditure on the episodes up to and including the 65th are eligible for the producer offset. Further episodes or seasons of the series will be ineligible for the producer offset. *[Schedule 10, item 1, paragraph 376-170(4)(c)]*

10.48 A series of which the season is a part must contain a new creative concept. In assessing the new creative concept, the same rules apply as for series (see paragraph 10.42). *[Schedule 10, item 1, subsection 376-70(2)]*

10.49 A season of a series may be an animated film and may be a documentary.

What are the qualifying expenditure thresholds?

10.50 One of the aims of the producer offset is to encourage growth of the Australian screen production industry. As a result, tax offsets are only available to projects that spend above a minimum amount on production. The minimum expenditure thresholds differ depending on the format of the project.

10.51 The expenditure thresholds are based on the qualifying Australian production expenditure of the project (see Subdivision 376-C for an explanation of how to calculate qualifying Australian production expenditure) and have two forms:

- most formats require an overall minimum expenditure threshold to be met in order to qualify for the producer offset; and

- some formats require a minimum average qualifying Australian production expenditure to be spent per hour of the film.

10.52 The average qualifying Australian production expenditure to be spent per hour is worked out by using the formula in subsection 376-65(7). This formula requires that the total qualifying Australian production expenditure for the film be divided by the total length of the series measured in hours. Parts of hours may be considered in applying this formula, so that, for instance, a 90 minute film would be regarded as 1.5 hours for the purposes of calculating qualifying Australian production expenditure per hour. [*Schedule 10, item 1, subsection 376-65(7)*]

10.53 The length of the film in this context does not refer to commercial hours, it refers to the actual length in hours of the finished film. For example, a series of eight, 30 commercial minute episodes, where each episode is of 22 minutes in actual duration, would equate to a film of 2.93 hours in length.

10.54 As this is an average requirement, there is no need for each episode of a series or documentary to meet the average qualifying Australian production expenditure threshold.

10.55 Where an application is for a season of a series, it is assessed as a production on its own and the season must meet the relevant expenditure thresholds itself.

10.56 A documentary may be a feature film, a series or a season of a series, or a single episode programme. If a documentary is a feature film, it must meet the expenditure thresholds for a feature film in order to qualify for the 40 per cent offset. However, documentaries that are single episode programmes, or series or seasons of a series need only meet expenditure thresholds for documentaries, rather than the expenditure thresholds for other projects of those formats.

10.57 A documentary will take its ordinary meaning. It is intended that it will mean a creative interpretation of actuality, other than a news, current affairs, sports coverage, magazine, infotainment or light entertainment programme.

10.58 A reality television programme is not a documentary. It is intended that the term 'reality programme' be applied to programmes in which contestants or participants are usually placed in contrived situations, where the primary purpose is to provide a vehicle within which their characters can be observed and assessed by the viewer. The primary purpose of such a reality programme would not be to explore and interpret an idea. Where there is a competitive element in the programme between

participants it is intended the programme would generally be considered a reality programme.

10.59 By contrast, a programme is more likely to be classed as a documentary when, even though it may be based around a contrived situation, the contrivance will serve to explore a creative idea, concept or theme. Observations about the character of a participant will tend to illustrate the idea, rather than serve as the primary purpose. Such programmes may contain a strong information component within which the idea is explored. There will often be critical commentary which interprets or provides context for the activity depicted.

10.60 The expenditure thresholds for each format are outlined in Table 10.1. [*Schedule 10, item 1, subsection 376-65(6)*]

Table 10.1

<i>Type of film...</i>	<i>Total of the company's qualifying Australian production expenditure on the film (as determined by the film authority under section 376-75) is at least...</i>	<i>Amount for the film worked out under subsection (7) is at least...</i>
A feature film	\$1m	not applicable
A single episode programme other than a documentary	\$1m	\$800,000
A single episode programme that is a documentary	not applicable	\$250,000
A short form animation that is not a feature film, a single episode programme or a series	\$250,000	\$1m
A film where the application for the certificate is for a series and not for a season of that series, and the series is not a documentary	\$1m	\$500,000

<i>Type of film...</i>	<i>Total of the company's qualifying Australian production expenditure on the film (as determined by the film authority under section 376-75) is at least...</i>	<i>Amount for the film worked out under subsection (7) is at least...</i>
A film where the application for the certificate is for a series and not for a season of that series, and the series is a documentary	not applicable	\$250,000
A film where the application for the certificate is for a season of a series, and the series is not a documentary	\$1m	\$500,000
A film where the application for the certificate is for a season of a series, and the series is a documentary	not applicable	\$250,000

10.61 For the purposes of the expenditure thresholds, official co-productions (ie, films made under a co-production treaty or a Memorandum of Understanding between the Australian Government and the Government of another country) may count expenditure that is in the other co-producing country or countries and that would have been qualifying Australian production expenditure if it had been incurred in Australia as qualifying Australian production expenditure. This is intended to include expenditure incurred by co-producing partners that are approved by the competent authorities in accordance with the relevant treaty or Memorandum of Understanding. *[Schedule 10, item 1, subsection 376-170(1)]*

10.62 This only applies to the expenditure thresholds and only applies to official co-productions made under a co-production treaty or Memorandum of Understanding between the Australian Government and the Government of another country. For the purposes of calculating a co-production's offset amount, only qualifying Australian production expenditure that meets the tests in Subdivision 376-C will be counted.

Production expenditure

General test

10.63 There is a general test for what constitutes production expenditure. ***Production expenditure*** of a film is so much of a company's expenditure as it incurs in, or in relation to, the making of the film; or as is reasonably attributable to the use of equipment or other facilities for the making of the film or to activities undertaken in making the film. [*Schedule 10, item 1, subsection 376-125(1), definition of 'production expenditure' in subsection 995-1(1) of the ITAA 1997*]

10.64 The making of a film means the doing of the things necessary for the production of the first copy of the film. [*Schedule 10, item 1, subsection 376-125(2), definition of 'make' in relation to film in subsection 995-1(1) of the ITAA 1997*]

10.65 A company makes a film by completing the various activities that bring the film to the point where it could reasonably be regarded as ready for exhibition or distribution (by broadcast, satellite or cable, or by video distribution on tapes or DVDs or otherwise), for which it is being produced. This is the time when the film is completed (see paragraph 10.13). Those activities include pre-production activities in relation to the film, and post-production activities in relation to the film. These take their ordinary meanings within the film industry in Australia. [*Schedule 10, item 1, subsection 376-125(3)*]

10.66 For the purposes of the offset, developing the proposal for the making of the film is not part of making the film, nor is arranging or obtaining finance for the film, which includes 'pitching' the film. Similarly, the distribution of the film and its promotion are not part of actually making the film for the purposes of the offset. Some costs of promotional material are included in both qualifying Australian production expenditure, and production expenditure; so some promotional activities can be occurring while a film is being carried out (see paragraph 10.93). However, these activities are nevertheless not part of making the film for the purposes of the offset. [*Schedule 10, item 1, subsection 376-125(4); item 7, definition of 'make' in relation to film in subsection 995-1(1) of the ITAA 1997*]

10.67 The definition of production expenditure is designed to allow expenditure to be apportioned between the film production project and any other purpose for which it has been incurred. For example, this allows the costs of facilities used in the making of a number of films to be apportioned between films. Expenditure will count as long as it has been incurred. The company does not have to actually discharge its liability to pay. This will allow expenditure to count on an accruals basis. This is

consistent with commercial practice in the film industry. Some of these expenditures, and some part of the payments by the commissioning studio, could be unpaid at the time of completion of the film and at the time the offset is claimed.

10.68 Production expenditure may have been incurred in the income year for which the offset is claimed — that is, the year in which the film is completed. It may have also been incurred in earlier years. Films are not presumed to necessarily be made within a single year. Production expenditure will generally be of a revenue nature, but may also be of a capital nature, and this is expressly acknowledged in the law. Production expenditure may be expenditure that gives rise to an income tax deduction. [*Schedule 10, item 1, subsection 376-125(5)*]

Specific inclusions

10.69 Production expenditure for a film will also include some specific expenditure incurred by the company which may not meet the general test of what is production expenditure.

10.70 All qualifying Australian production expenditure is included in production expenditure, even if it would not otherwise come within the scope of production expenditure (see paragraph 10.88). [*Schedule 10, item 1, section 376-130*]

10.71 Where a company holds a depreciating asset and uses it in making a film, the company's production expenditure on the film includes an amount equal to the decline in the value of the asset to the extent to which that decline is reasonably attributable to the use of the asset in the making of the film. 'Depreciating asset' and 'decline in value' are terms from the capital allowances regime. The capital allowances regime in Division 40 of the ITAA 1997, is designed to allow deductions for the cost of depreciating assets based on their effective life. This is their decline in value for tax purposes. [*Schedule 1, item 1, subsection 376-125(6)*]

10.72 The capital allowances regime also reconciles this assumed loss of value to the actual change in value worked out when a balancing adjustment event occurs. When a balancing adjustment event occurs for the asset before the film is completed:

- if the asset's termination value is more than its adjustable value just before the event occurred — the production expenditure of the company on the film is reduced by the film proportion of the difference; or
- if the asset's termination value is less than its adjustable value just before the event occurred — the production

expenditure of the company on the film includes the film proportion of the difference.

This will ensure that the real economic cost of using the asset in the production of the film is taken into account in working out the offset. 'Balancing adjustment event', 'termination value' and 'adjustable value' are terms used in the capital allowances regime. [*Schedule 1, item 1, subsection 376-125(7)*]

10.73 The cost of the depreciating asset is excluded from production expenditure. This provision gives a company the benefit of an appropriate allowance for the cost of depreciating assets it uses on a production, even if those assets were acquired originally for another project or before any particular film project began. A company may well have assets of this kind, and the cost of making a film should take proper account of their cost, whether they are acquired for the particular film, at the time of the particular film, or otherwise. [*Schedule 1, item 1, subsection 376-135; item 10*]

Specific exclusions

10.74 There are a number of specific exclusions that will not be eligible to be included as production expenditure.

10.75 Expenditure incurred by way of, or in relation to, the financing of a film is not production expenditure. This will specifically include interest, or other returns, on amounts invested in the film and costs connected with raising and servicing finance for the film. [*Schedule 10, item 1, section 376-135, item 1 in the table*]

10.76 Insurance policies are incurred by way of, or in relation to, the financing of a film when the risk they insure is a risk to the financing of the film production. Insurance policies such as: film producer's indemnity; negative film; faulty stock, camera and processing; and weather are mainly entered into for the purpose of ensuring that money or capital in excess of the film's budget (or to replace wasted production expenditure) will be available to complete the film if the budget is exceeded (or past production expenditure wasted) as the result of an occurrence of an insurable event. Completion bonds or guarantee policies cover the additional cost of production at least where an insured event leads to that extra cost. The primary purpose for entering into any insurance policy of this kind is to ensure that sufficient capital will be available to complete the film (or repeat a wasted step in the production of the film) if an insurable event occurs, or to pay out the financier if the film is not completed. These insurances demonstrate the relationship between the loss insured against the film's budget and finance. Expenditure for such insurance cover is either incurred by way of, or in relation to, financing the film.

10.77 Insurance premiums for comprehensive insurance policies will need to be apportioned to the extent that they relate to non-qualifying events such as the financing of a film.

10.78 Development expenditure for the film is not production expenditure, except so far as it is qualifying Australian production expenditure. *[Schedule 10, item 1, section 376-135, item 2 in the table]*

10.79 **Development expenditure** is a defined term in subsection 995-1(1) of the ITAA 1997. It is expenditure incurred in meeting the development costs for a film and includes expenditure:

- on location surveys or otherwise identifying or assessing possible locations;
- storyboarding and scriptwriting;
- research for the film;
- casting actors;
- developing a budget; and
- developing a shooting schedule for the film.

10.80 Another exclusion to production expenditure is expenditure that is incurred in acquiring copyright, or a licence in relation to copyright, in a pre-existing work for use in the film, except so far as this is qualifying Australian production expenditure, essentially because the pre-existing work is Australian. The cost of copyright, or of a copyright licence, to allow the film to use an existing work is generally not an expenditure in making the film so much as it is a cost of being in a position to make the film, and so is preliminary to production expenditure. However, the cost for pre-existing Australian copyright is included, essentially to increase the share of qualifying Australian production expenditure. This measure reflects and supports broader Australian cultural policy. *[Schedule 10, item 1, section 376-135, item 3 in the table]*

10.81 Another exclusion is general business overheads of the company that are not incurred in, or in relation to, the making of the film and are not reasonably attributable to activities, or the use of equipment or facilities, in making the film. In effect, no part of general business overheads can be attributed to making the film. However, if a part of those overheads is qualifying Australian production expenditure under the specific inclusion criteria, then that part of general overheads is not excluded from production expenditure. *[Schedule 10, item 1, section 376-135, item 4 in the table]*

10.82 Expenditure that relates to publicising or otherwise promoting the film (press expenses, still photography, promotion, videotapes, public relations and other similar expenses) is excluded from production expenditure, even if it is incurred during production, unless it is qualifying Australian production expenditure. *[Schedule 10, item 1, section 376-135, item 5 in the table]*

10.83 Another specific exclusion will be expenditure incurred by way of:

- amounts that are payable out of the receipts, earnings or profits from a film;
- amounts that depend on the receipts, earnings or profits from a film; and
- amounts that are otherwise dependent on the commercial performance of the film.

In practice, some work in making the film is done not for a set cost but for an interest in the film's performance. The production expenditure for a film, on which the offset is paid, is meant to be limited to those expenditures which are independent of the film's commercial performance and its earnings. *[Schedule 10, item 1, section 376-135, items 6 and 7 in the table]*

10.84 An amount payable in satisfaction of a residual payment right to a member of the cast cannot count as production expenditure except to the extent to which the amount is actually paid before the film is completed. *[Schedule 10, item 1, section 376-135, item 8 in the table]*

10.85 The exclusion of expenditure by way of profit share, or for residual payments, would be ineffective if production expenditure included amounts liable to be repaid because of the economic performance of the film or because residual payments proved not to be required. Therefore, all advances against profit share, against economic performance of the film or its receipts, or against residual payments, are excluded from production expenditure unless the advances are non-recoverable from the payee. *[Schedule 10, item 1, section 376-135, item 9 in the table]*

10.86 Any expenditure that goes into the cost of a depreciating asset, whether one for which deductions are calculated under Division 40 of the ITAA 1997 or one for which deductions are calculated under Division 43 of the ITAA 1997, is not production expenditure. This includes both original cost and further depreciable costs of such items. However, the decline in value of a depreciating asset (other than those buildings,

structures and improvements to which Division 43 of the ITAA 1997 applies) is itself expressly included in production expenditure. The exclusions ensure that the total production expenditure on a film, and its qualifying Australian production expenditure, are not skewed by the inclusion of substantial capital costs for depreciating assets that actually relate to many films, and not only the particular film. [*Schedule 10, item 1, section 376-135, item 10 in the table*]

10.87 Regulations may specify other costs to be excluded from production expenditure. Such regulations would be subject to the procedural rules applicable to Australian regulations and so would require registration, and would be required to be tabled in both Houses of Parliament where they would be subject to disallowance in the Parliamentary process. [*Schedule 10, item 1, section 376-135, item 11 in the table*]

Qualifying Australian production expenditure

General test

10.88 ***Qualifying Australian production expenditure*** for a film is the production expenditure for the film to the extent to which it is incurred for, or is reasonably attributable to:

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

This broad test connects particular items of production expenditure to Australia. It is meant to ensure opportunities for Australian taxpayers and for the Australian film industry, which is a major purpose of the offset. However, there are exclusions from that general connection (see paragraphs 10.97 to 10.100), which further support this intention. [*Schedule 10, item 1, section 376-145, definition of ‘qualifying Australian production expenditure’ in subsection 995-1(1) of the ITAA 1997*]

Specific inclusions

10.89 There are a number of specific inclusions provided for in the legislation [*Schedule 10, item 1, subsection 376-150(1)*]. All of these are therefore also production expenditure. A number of them are items which are not otherwise production expenditure which increase not only the total production expenditure but also the share of production expenditure which will be qualifying Australian production expenditure. This means that these inclusions can operate to bring films within the eligibility for the

offset if certain expenditures happen in Australia, not only by connecting production expenditure to Australia, but also by connecting to Australia some kinds of expenditure which would fall outside the definition of 'production expenditure' but which support Australian cultural objectives.

10.90 Development expenditure is generally not production expenditure, as discussed in paragraphs 10.78 and 10.79. However, so far as development expenditure is for goods and services provided in Australia, the use of Australian land, or the use of goods located in Australia when they are used in making the film (eg, hiring equipment or props for use in Australia on a shoot), development expenditure is production expenditure. The benefit of counting this as production expenditure and as qualifying Australian production expenditure is that it encourages development expenditure to be carried out in Australia and adds support for Australian film projects, which are likely to have lower budgets and so have more difficulty with both the expenditure and the percentage thresholds for eligibility. *[Schedule 10, item 1, subsection 376-150(1), item 1 in the table]*

10.91 However, qualifying Australian production expenditure will not include legal expenses except those which relate to writers' contracts or to copyright issues, including chain of title. This is to ensure that substantial expenditures likely to be connected more to the financing and structuring of the project than to film development are not considered to be production expenditure. *[Schedule 10, item 1, subsection 376-150(2)]*

10.92 Expenditure incurred to acquire copyright, or a licence in relation to copyright, in a pre-existing work for use in the film will be qualifying Australian production expenditure. Therefore it is production expenditure if the copyright is held by an Australian resident, whether that be an Australian resident company or person. This encourages the use of copyrights held in Australia, and so, indirectly, the use in film projects of material that is under Australian creative control. *[Schedule 1, item 1, subsection 376-150(1), item 2 in the table]*

10.93 Publicity for a film is not part of making it. However, where publicity material, for use in publicising or otherwise promoting the film, is copyright held by an Australian citizen, an Australian protected person or a person resident in Australia, and the expenditure on the material was incurred by the company before completion of the film, that expenditure is part of qualifying Australian production expenditure. This encourages the use of Australians in publicity undertaken during production. *[Schedule 10, item 1, subsection 376-150(1), item 3 in the table]*

10.94 Expenditure which is not incurred during the 'making of the film', as it is not directly attributable to the production of the first copy of the film, is not normally qualifying Australian production expenditure.

However, under this provision, it is intended that such expenditure may be included as qualifying Australian production expenditure where it is incurred in producing additional content for a subsequent release of the film and is incurred in Australia prior to the completion of the film. This means that, for example, footage for special features for a DVD release if shot in Australia during a film's production could be counted as qualifying Australian production expenditure of the film. Such expenditure would also be considered part of the film's production expenditure and, for the producer offset, total film expenditure.

Schedule 10, item 1, subsection 376-150(1), item 4 in the table]

10.95 This provision also acts as an exception to the general exclusion on publicity and promotion expenditure from production expenditure (item 5 in the table in section 376-135). For example, if a trailer to promote the film during production is shot in Australia and is intended to be released with the film in some form, this may be considered qualifying Australian production expenditure.

10.96 Regulations may prescribe additional items of expenditure as qualifying Australian production expenditure. *[Schedule 10, item 1, subsection 376-150(1), item 5 in the table]*

Specific exclusions

10.97 If expenditure has been incurred when the company is neither an Australian resident nor has both a permanent establishment in Australia and an ABN, that expenditure is not eligible as qualifying Australian production expenditure. Therefore, if a company starts a production as a non-resident without a permanent establishment in Australia this will reduce both its qualifying Australian production expenditure and the share of total production expenditure that it represents. *[Schedule 10, item 1, section 376-155]*

10.98 Where a person is not a member of the cast and enters Australia to work on the film for less than two consecutive calendar weeks, expenditure in relation to the remuneration and other benefits for this person for services regarding the film, and expenditure on the person's travel and other costs, are not qualifying Australian production expenditure. This applies to each trip made individually. The objective of this provision is to encourage opportunities for the Australian film industry without creating special labour rules restricting the benefit of the offset. *[Schedule 10, item 1, section 376-155]*

10.99 Regulations may prescribe other exclusions from what would otherwise be qualifying Australian production expenditure. *[Schedule 10, item 1, section 376-155]*

10.100 If a company enters into what is essentially a service contract, the test of whether expenditure under the contract is qualifying Australian production expenditure does not depend only on where goods embodying the result are delivered. If services will be embodied in goods that are delivered to the company and those services were predominantly performed outside Australia, for the purposes of determining qualifying Australian production expenditure this service is not provided in Australia. This rule is intended to have the effect that, what would not be qualifying Australian production expenditure if it were incurred on activities the company carries out for itself, does not become qualifying Australian production expenditure by engaging someone else. For example, the cost of animation or special effects work carried out outside Australia is not qualifying Australian production expenditure. If a company is contracted for the animation or effects work to be delivered as stock or computer media in Australia, the animation or special effects work would have to be carried out in Australia for the expenditure on contracting out this work to be qualifying Australian production expenditure. *[Schedule 10, item 1, section 376-160]*

Special rules — producer offset

10.101 It is intended that all business overheads that meet the general test for qualifying Australian production expenditure are considered qualifying Australian production expenditure. The legislation recognises that while some expenditure on a production company's general business overheads will not be directly related to a film's production, it is reasonable for a proportion of these costs to be attributed to the production. Therefore, where general business overheads are not incurred in relation to the making of the film, but are still expended in Australia, a reasonable apportionment of these overheads can be claimed as qualifying Australian production expenditure. *[Schedule 10, item 1, subsection 376-170(2), item 1 in the table]*

10.102 This apportionment is capped at either 5 per cent of the production's total film expenditure (which is outlined in paragraph 10.110) or \$500,000, whichever is the lesser. This encourages production companies to be located in Australia even if they make projects that do not qualify for the offset as well as projects that do, because a share of general overheads will only qualify for the offset if they are located in Australia. *[Schedule 10, item 1, subsection 376-170(3)]*

10.103 For the producer offset, a person's travel to and within Australia may be qualifying Australian production expenditure where they are travelling to Australia to undertake activities for the making of the film. This provision is subject to the rule that non-cast members must work on the film in Australia for at least two weeks before expenditure on those non-cast members can be considered qualifying Australian production expenditure (this is explained in paragraph 10.88). *[Schedule 10, item 1, subsection 376-170(2), item 2 in the table]*

10.104 The producer offset also allows travel from or outside Australia to count as qualifying Australian production expenditure in certain situations. Where a person's travel is to, or within, any other country other than Australia and the travel is to undertake activities in relation to the making of the film during principal photography, expenditure on that travel may be qualifying Australian production expenditure where an Australian resident's remuneration is qualifying Australian production expenditure because of the extra-territorial expenditure provision in item 4 in the table in subsection 376-170(2). For example, if an Australian-resident cinematographer travels to France to undertake location shooting for a documentary about Australian military involvement in World War I, that person's travel costs may be qualifying Australian production expenditure. *[Schedule 10, item 1, subsection 376-170(2), item 2 in the table]*

10.105 For the producer offset, expenditure made on the freighting of any goods to be used in the making of the film is qualifying Australian production expenditure. This is regardless of whether the freight is within or between Australia and other countries. *[Schedule 10, item 1, subsection 376-170(2), item 3 in the table]*

10.106 Some documentaries, iconic films on Australian events overseas and co-productions may need to shoot outside Australia. For example, a film on Gallipoli may want to film on location in Turkey or an Australian documentary on the bird of paradise may need to shoot in Papua New Guinea. Where expenditure is on goods or services provided by Australian residents for the making of the film during principal photography in a location outside of Australia, and the subject matter of the film reasonably requires the location to be used, the expenditure will be qualifying Australian production expenditure. This also means that, for example, if a film involves an overseas location, but the use of that location is not possible and achieving the impression of that location reasonably necessitates the use of another overseas location, expenditure at that other location may also be qualifying Australian production expenditure. *[Schedule 10, item 1, subsection 376-170(2), item 4 in the table]*

10.107 While receiving assistance in developing a film from an Australian Government agency does not preclude eligibility for the producer offset, it would provide unjustifiable additional assistance if the offset was then received on expenditure made with that assistance. Therefore, where development assistance (explained in paragraph 10.18) received from the Film Finance Corporation Australia Limited, Film Australia Limited, the Australian Film Commission or the Australian Film Television and Radio School is not repaid, any expenditure made with that funding is to be deducted from the qualifying Australian production expenditure. Where such assistance is repaid, the qualifying Australian production expenditure is not affected. [*Schedule 10, item 1, paragraph 376-170(4)(a)*]

10.108 The amount of expenditure that can be claimed as qualifying Australian production expenditure by a company in regard to development, remuneration for the principal director, the producers and producers' unit and principal cast, is limited. These expenditures are intended to represent the stated 'above the line' costs of a company. The qualifying Australian production expenditure that can be claimed on these costs is only up to a maximum of 20 per cent of a film's production budget — represented by the concept of 'total film expenditure' which is outlined in paragraph 10.110. This does not mean that further expenditure on 'above the line' costs cannot be made, nor does it mean that expenditure that exceeds the cap will mean that the production cannot qualify for the producer offset. Rather, it means that any expenditure on 'above the line' costs that is greater than 20 per cent of the film's total film expenditure will not be considered as qualifying Australian production expenditure and will therefore not be counted towards the expenditure threshold or the rebate amount for the production. [*Schedule 10, item 1, paragraph 376-170(4)(b)*]

10.109 The cap on 'above the line' costs and the allowance for general business overheads, are based on a concept of total film expenditure, which is intended to equate to the concept of a film's budget as understood by the Australian screen production industry. [*Schedule 10, item 1, paragraph 376-170(4)(b)*]

10.110 **Total film expenditure** is defined as the sum of:

- 'production expenditure' as defined in section 376-125;
- matters specifically included as production expenditure by section 376-130 and outlined in sections 376-150 and 376-170; and

- expenditures excluded from the definition of ‘production expenditure’ by section 376-135, to the extent that these are not covered above.

[Schedule 10, item 1, subsection 376-170(6), definition of ‘total film expenditure’ in subsection 995-1(1) of the ITAA 1997]

10.111 This is not intended to mean that some types of expenditure can be counted twice, nor does it mean that expenditure that cannot be quantified (such as profit participation) can be included. This provision is intended to represent the total amount of a film’s production company’s production budget, including development and financing, but excluding a distributor’s expenditure on marketing, promotion and distribution. The relevant film authority will have the ability to outline how a company’s total film expenditure should be reported in the rules for the producer offset.

Expenditure generally

10.112 The general expenditure tests below apply to all three offsets under Division 376.

Expenditure to be worked out on an arm’s length basis

10.113 Where the company incurs expenditure under an arrangement and any parties to the arrangement did not deal with each other at arm’s length and the amount of the expenditure would be more than it would be if they dealt with each other at arm’s length, then the amount of expenditure is taken to be the amount that would have been incurred if the parties had been dealing with each other at arm’s length. This rule applies not only to the actual arrangement under which the company incurs expenditure, but also to any act or transaction directly or indirectly connected with the expenditure the company incurs. So, for instance, arrangements which require a company to obtain certain goods or services from a particular source can be tested and, if not at arm’s length, the expenditure on those goods or services will be limited to an arm’s length amount. This will be so even if the company itself was dealing at arm’s length to obtain the goods and services since a non-arm’s length deal between others could otherwise inflate the cost. *[Schedule 10, item 1, section 376-175]*

10.114 This provision does not automatically raise expenditure to arm's length rates if the expenditure is lower. However, if expenditure has been lowered to qualify for the offset (eg, by reducing production expenditure in total so as to increase the percentage of qualifying Australian production expenditure), general anti-avoidance rules may apply.

Expenditure incurred by prior production companies

10.115 Generally, a company carries out, or arranges the carrying out of, all the activities (or all the activities in Australia) necessary for making a film. Even when the production makes use of elements from a previous production, this is still usually the case. However, in some cases, a 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). In those cases, each company making the film is taken to have incurred the production expenditure of the previous companies. Its production expenditure excludes, then, any expenditure incurred to enable it to take over the making of the film (taking over is not part of actually making the film, in the same way that proposing, financing, promoting and distributing the film are not part of making the film). *[Schedule 10, item 1, subsection 376-180(1)]*

10.116 In those cases, eligibility for the offset extends to the company that completes the production (or the Australian production) of the film. That company does not actually carry out, or arrange the carrying out, of all the activities (or all Australian activities) necessary for making the film but it is taken to do so, because it has taken over the making of the film from the previous company or companies, in the same way that it is taken to have incurred the production expenditure of those companies. So the company that completes the activities is taken to have carried out, or arranged the carrying out of, those activities that were necessary for making the film, that were actually carried out, or arranged to be carried out, by the previous company or companies. *[Schedule 10, item 1, subsection 376-180(2)]*

Currency conversion

10.117 All production expenditure and qualifying Australian production expenditure must be worked out in Australian dollars. This means that expenditure made in a foreign currency must be converted to Australian dollars. For the purposes of meeting expenditure thresholds for the offsets, the rate of exchange is the rate of exchange on the date on which principal photography or the production of the animated imaging commenced. *[Schedule 10, item 16, subsection 960-50(6), items 9 and 9A in the table]*

10.118 For the purposes of calculating the amount refunded under the offsets, the exchange rate used is the average rate of exchange for the period during which qualifying Australian production expenditure is incurred. For the PDV offset, this is the period during which qualifying Australian production expenditure in relation to post, digital and visual effects production is incurred. [*Schedule 10, item 16, subsection 960-50(6), item 9B in the table*]

Transfer pricing

10.119 An Australian film production company may be providing film production services under an agreement with a foreign parent or other associate. Australia's transfer pricing rules in Division 13 of Part III of the ITAA 1936 and the Associated Enterprises article of a relevant double tax agreement permit the Commissioner of Taxation (Commissioner) to adjust the amount the Australian film production company charges for its services, to the amount that would be charged between independent parties dealing at arm's length with each other in comparable circumstances.

10.120 In performing the comparability analysis required to apply an appropriate arm's length pricing method, a tax offset under Division 376 should be taken into account. The tax offset should be treated as a condition of the market for film production services in Australia, and taken into account in evaluating a taxpayer's transfer price in that market. This is consistent with paragraph 2.104 of Taxation Ruling TR 97/20, which accords with paragraph 1.55 of the Organisation for Economic Co-operation and Development's 1995 *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

Certification

10.121 The certification process is generally the same for all three offsets under Division 376. The producer offset will be administered by the film authority, whilst the location offset and PDV offset will be administered by the Arts Minister.

10.122 The **Arts Minister** is defined in subsection 995-1(1) of the ITAA 1997 as the Minister administering the *Film Licensed Investment Company Act 2005*.

Requirements for certification

10.123 Once a film is completed, the eligible production company may apply to the film authority for a certificate of eligibility for the producer offset. A certificate of eligibility guarantees that the applicant will receive

the producer offset on the film's qualifying Australian production expenditure. *[Schedule 10, item 1, subsection 376-230(3)]*

10.124 Certification requires that the film authority is satisfied of a number of requirements. The film authority must be satisfied that the film has been completed, and that the film has a significant Australian content or has been made under an agreement between the Australian government or an authority of the Australian government and a foreign country or an authority of the foreign country (ie, is an official co-production). *[Schedule 10, item 1, subsection 376-65(1)]*

10.125 In determining whether a film has significant Australian content, the film authority must have regard to the following:

- the subject matter of the film;
- the place where the film was made;
- the nationalities and places of residence of the persons who took part in the making of the film (including authors, composers, actors, scriptwriters, editors, producers, directors and technicians);
- the details of the production expenditure incurred in respect of the film; and
- any other matters that the film authority considers to be relevant.

[Schedule 10, item 1, subsection 376-70(1)]

10.126 This test is the same as the test previously applied to applicants for certification under Division 10BA of the ITAA 1936, with the exception that the film does not have to be wholly or substantially made in Australia and the following two matters are no longer specified as matters to which regard must automatically be had:

- the holder of intellectual copyright in the film; and
- the source of finance for the film.

10.127 While these two matters are not specific factors requiring consideration, it is intended that they may still be able to be considered as particular factors in the certification test, especially where consideration of other matters does not result in strong grounds for or against certification.

10.128 Subject to these changes, the matters detailed in the test are intended to be interpreted in the same way as the Division 10BA test, which was previously under the authority of the Arts Minister, and delegated to the Department of Communications, Information Technology and the Arts.

10.129 The film authority must also be satisfied that the film was produced for cinema release (in the case of a feature film), for public broadcast, including by satellite or by cable, or for public video release on tapes, DVDs or otherwise (in the case of other formats). In essence, therefore, the film must be produced for public release or distribution in some form. *[Schedule 10, item 1, paragraph 376-65(2)(b)]*

10.130 To be satisfied that a film is a feature film, the film authority will require evidence of an Australian commercial agreement that provides a feature film with a theatrical release in a commercial cinema. Such an agreement would be expected to be a bona fide arrangement for the theatrical release of the film, and would not be justified by a contrived arrangement, for instance for release on one, or a very small number of screens.

10.131 For formats other than a feature film, evidence of Australian distribution will be required. Examples include television broadcast agreements, or the commercial delivery of a production via a new media platform (such as online or mobile content) where access to the content is available to Australians. This may be through bona fide self-distribution or arm's length distribution.

10.132 Arm's length distribution may include:

- distribution advances or guarantees from a distributor or sales agent for Australian territory in terms of direct to DVD/VHS release, television broadcast, mobile phone or online;
- an agreement guaranteeing commercial delivery of a production via a mobile content platform or online or through retail sales for direct to DVD/VHS release in Australia; or
- development of an online service that would provide a commercial delivery of the production to Australians.

10.133 The key concept is that distribution must be on a commercial basis. Distribution guarantees or similar must be provided to the film authority in order for a film to be certified for the producer offset.

10.134 The film authority must be satisfied that:

- the film is a feature film, a single-episode programme, a series, a season of a series, or a short-form animation;
- the film is not a film of a public event, a training film, an advertisement or commercial, a discussion, quiz, panel, variety or like programme, a news or current affairs programme, a computer game or a reality TV programme;
- the applicant company carried out, or made the arrangements for, all the activities that are necessary for the making of a film, and that the applicant company is the only company that satisfied this requirement; and
- the company's qualifying Australian production expenditure on the film meets the expenditure thresholds outlined above at paragraph 10.60.

[Schedule 10, item 1, paragraphs 376-65(1)(a), (2)(c) and (2)(d), subsection 376-65(6)]

10.135 As certification requires the film authority to be satisfied of these things, the claim for the producer offset in the tax return is based only on the existence of the certificate and on the level of qualifying Australian production expenditure specified in the certificate. If the certificate is revoked because of fraud or serious misrepresentation in obtaining the film authority's satisfaction of those issues, then the certificate will be taken never to have been issued, and the offset can not be claimed or, if claimed, will be the subject of amendment of the assessment to deny the offset. *[Schedule 10, item 1, section 376-270, subsections 376-245(3) to (5)]*

Issuing of a certificate

10.136 For a company to be entitled to the producer offset for a film, the film authority must have issued a certificate for the film *[Schedule 10, item 1, subsection 376-65(1)]*. Further, the film authority will determine the level of qualifying Australian production expenditure of a certified production *[Schedule 10, item 1, section 376-75]*. Allowing the film authority to determine qualifying Australian production expenditure will provide certainty to applicants as to the amount that a certified production will receive. A determination of qualifying Australian production expenditure is not a Legislative Instrument within the meaning of the *Legislative Instruments Act 2003*.

Requirements of the certificate

10.137 Any certificate that the film authority issues is expected to be in writing, to state the company's ABN and the date of issue of the certificate, that the film is eligible for the offset, and the qualifying Australian production expenditure for the film as determined by the film authority. The film authority must notify the Commissioner of the issue of the certificate within 30 days, and will give the company's name and address, the qualifying Australian production expenditure determined by the film authority, and such other information as the film authority and the Commissioner agree. *[Schedule 10, item 1, subsection 376-240(1)]*

Revocation and refusal of certificates

10.138 The film authority will have the power to revoke the certificate if the issue of the certificate was obtained by fraud or by serious misrepresentation. Revocation will have the effect of requiring full repayment of any offset given through a tax return process. *[Schedule 10, item 1, subsection 376-245(3)]*

10.139 Where a certificate is revoked, the film authority must give written notice to the company to which the certificate was issued, including reasons for the decision. *[Schedule 10, item 1, subsection 376-245(4)]*

10.140 If the film authority decides not to issue a certificate, the company seeking the certificate must receive written notice of that decision. *[Schedule 10, item 1, subsection 376-235(2)]*

10.141 The decision not to issue a certificate, and a decision to revoke a certificate, will be reviewable in the Administrative Appeals Tribunal (AAT) on application by the company the interests of which have been affected. A determination of qualifying Australian production expenditure by the film authority is also a matter which can be reviewed by the AAT. *[Schedule 10, item 1, section 376-255]*

10.142 The notice of refusing to issue a certificate or to revoke a certificate need not set out the findings on material questions of fact, refer to the evidence and other material on which the findings were based or the reasons for the decision. The notice must, however, include advice that an application can be made to the AAT and that a statement outlining the above matters (unless the reasons have already been supplied) may be requested. A failure by the film authority to comply with these obligations will not, however, affect the validity of the decision to refuse to issue a certificate or to revoke a certificate. *[Schedule 10, item 1, section 376-250]*

10.143 Where a certificate issued to a company has been revoked under section 376-245, the income tax assessment of the company will need to be amended to deny the offset. *[Schedule 10, item 1, section 376-270]*

10.144 The relevant period in which the Commissioner may amend assessments will be during a period of four years starting immediately after the revocation of the certificate. *[Schedule 10, item 1, section 376-270]*

Rule-making powers

10.145 The film authority may make rules by legislative instrument deciding on administrative requirements for applications for certificates for the producer offset, including:

- the application form;
- the type of information to be provided;
- methods of verification of that information (such as requesting reports by auditors); and
- procedures around the provision of supplementary or additional information that the film authority may request.

[Schedule 10, item 1, subsection 376-265(2)]

10.146 The film authority may also make rules that will outline the processes and requirements for applications for provisional certificates for the producer offset. Provisional certificates will provide a guide to producers who are aiming to take advantage of the scheme. They will enable a producer to receive an indication from the film authority that a proposed production will be eligible for the producer offset if it is made in accordance with the details on which the authority relied in issuing the provisional certificate. *[Schedule 10, item 1, subsection 376-265(1)]*

Part 2 — The location offset

10.147 The location offset is the existing refundable film tax offset with enhancements. It is designed to encourage large scale film productions to locate in Australia, and is aimed at providing greater economic, employment and skill development opportunities.

How much is the offset?

10.148 The offset is 15 per cent of the total of the company's qualifying Australian production expenditure on the film. Consistent with the other

offsets, the offset amount is credited to the applicant company through the company's income tax return. [Schedule 10, item 1, section 376-15]

When is the offset available?

10.149 The offset will apply to films which commence principal photography or production of the animated image on or after 8 May 2007. [Schedule 10, Part 4, subitem 91(1)]

10.150 A film which commenced principal photography prior to 8 May 2007 may apply for the 12.5 per cent refundable film tax offset under the existing terms of Division 376 prior to the amendments made by this Bill. The *Refundable Film Tax Offset Rules 2002* also continue to operate in relation to such productions. [Schedule 10, Part 4, subitem 92(1)]

10.151 An applicant company is entitled to the offset if:

- if the total of the company's qualifying Australian production expenditure on the film is less than \$50 million — the company's production expenditure on the film ceased being incurred in the income year;
- if the total of the company's qualifying Australian production expenditure on the film is at least \$50 million — the company's qualifying Australian production expenditure on the film ceased being incurred in the income year;
- the Arts Minister has granted a certificate to the applicant company;
- the offset is claimed by the company in its income tax return for the income year in which post, digital and visual effects production work ceased; and
- the company is either an Australian resident company or a foreign resident company with a permanent establishment and an ABN. This must be the case both when the tax return is lodged and the offset is paid. While it is not strictly a requirement that the company be an eligible company when it makes its application to the Minister for a certificate, it is expected that companies will meet this criterion when they make their application.

[Schedule 10, item 1, subsection 376-10(1)]

10.152 A company may apply to the Arts Minister for a certificate of eligibility for the location offset when:

- for films with qualifying Australian production expenditure of more than \$50 million — once the company's qualifying Australian production expenditure has ceased being incurred; or
- for films with qualifying Australian production expenditure of at least \$15 million and less than \$50 million — once the company's production expenditure has ceased being incurred.

[Schedule 10, item 1, subsection 376-10(1)]

10.153 This provision recognises that for large budget films, production may continue for some time after the production leaves Australia. It provides the company with the opportunity to access the offset when the film finishes work in Australia, rather than needing to wait for the film's completion.

10.154 An applicant company is not entitled to the offset where:

- a deduction has been claimed in relation to intellectual property in the film under Division 10B of the ITAA 1936;
- the film has been issued with a final certificate under Division 10BA of the ITAA 1936 (including concessional capital investment support under the Film Licensed Investment Company scheme and equity funding by the Film Finance Corporation Australia Limited); or
- the film has been granted a final certificate for either the producer offset or the location offset.

[Schedule 10, item 1, subsection 376-10(2)]

Expenditure thresholds

10.155 As is the case for the producer offset, a film must meet certain expenditure thresholds to be eligible for the location offset. These are unchanged from the refundable film tax offset. The total of the company's qualifying Australian production expenditure, as determined by the Arts Minister, must be either:

- at least \$50 million of qualifying Australian production expenditure; or

- at least \$15 million and less than \$50 million where qualifying Australian production expenditure is at least 70 per cent of the company's production expenditure.

[Schedule 10, item 1, subsection 376-20(5)]

10.156 For each category of expenditure, there is an equivalent required level of responsibility which the company must have for the film's production. These are unchanged from the refundable film tax offset:

- for films with qualifying Australian production expenditure of more than \$50 million — the company either carried out, or made the arrangements for carrying out, all the arrangements for the making of the film in Australia; or
- for films with qualifying Australian production expenditure of at least \$15 million and less than \$50 million — the company must have either carried out, or made the arrangements for carrying out, all the arrangements for the making of the film.

[Schedule 10, item 1, subsection 376-20(5)]

Eligible genres

10.157 A film will be eligible for the location offset if it is one of the following:

- a feature film or a film of a like nature;
- a mini-series of television drama; or
- a television series not otherwise covered.

[Schedule 10, item 1, paragraph 376-20(2)(b)]

10.158 A television series will not be excluded from certification for access to the offset if it is of a documentary-like nature.

10.159 A production will be ineligible for the location offset or the PDV offset if it is a documentary (other than a television series), an advertisement or a commercial. Discussion programmes, quiz programmes, panel programmes, variety programmes, and all other programmes of that kind are ineligible. Similarly a production is not eligible if it is a film of a public event, a training film or a film forming part of a drama programme series that is, or is intended to be, of a

continuing nature and is not a television series. [*Schedule 10, item 1, paragraph 376-20(2)(c)*]

Television series

10.160 There are timeframes for the completion of a television series production. Where a television series is predominantly a digital animation or other animation it must be made within a period of 36 months. This period commences once production expenditure begins to be incurred. The commencement of the 36-month period is not triggered by either pre-production or pilot production activities. Effectively, the 36-month period excludes pre-production activities as mentioned in paragraph 376-125(3)(a), as well as activities associated with the production of a pilot (if there is one). Due to the nature of digital or other animation series, they are given a longer timeframe for completion. [*Schedule 10, item 1, subparagraph 376-20(3)(b)(i)*]

10.161 A television series other than a series which is predominantly a digital animation or other animation is subject to a different timeframe for completion. Such a series, most likely a 'live action' series, must complete all principal photography within a period of 12 months. This period again excludes activities associated with the production of a pilot episode (if there is one). Principal photography does not include second unit photography. [*Schedule 10, item 1, subparagraph 376-20(3)(b)(ii)*]

10.162 Where the film is a television series and it is applying for the location offset, it must meet an additional expenditure threshold specific to television series. A television series will be required to have a minimum average of at least \$1 million of qualifying Australian production expenditure per hour. The intent of this threshold is to ensure low-value series and series which would have been produced in Australia regardless of the extension of the offset, are excluded. The amount of qualifying Australian production expenditure per hour for a television series is worked out by using the formula in subsection 376-20(6). This formula requires that the total qualifying Australian production expenditure for the television series be divided by the total length of the series measured in hours. The calculation is the same as that explained in relation to the producer offset in paragraphs 10.52 to 10.54. [*Schedule 10, item 1, paragraph 376-20(3)(c)*]

10.163 For the location offset, a television series must be a film made up of two or more episodes that:

- are produced wholly or principally for exhibition to the public on television under a single title;
- contain a common theme or themes;

- contain dramatic elements that form a narrative structure; and
- are produced wholly or principally for exhibition together, for a national market or national markets.

[Schedule 10, item 1, paragraph 376-20(3)(a)]

10.164 The requirement that all of the episodes must be produced wholly or principally for exhibition together for a national market or national markets is designed to prevent the bundling of episodes that were not designed to be exhibited together, such as different television series produced in different languages for different markets.

10.165 Unlike the producer offset, it is intended that reality television (as referred to in paragraph 10.58) is eligible for the location and PDV offsets, but only as television series. To this end, the amendments specify that a film will be considered to contain dramatic elements that form a narrative structure (without limiting the operation of the provision) if:

- the sole or dominant purpose of the film is to depict actual events, people or situations; and
- the film depicts those events, people or situations in a dramatic or entertaining way, with a heavy emphasis on dramatic impact or entertainment value.

[Schedule 10, item 1, subsection 376-20(4)]

Production expenditure

10.166 The general test for production expenditure for the location offset is the same as that for the producer offset, including specific inclusions and exclusions and rules related to expenditure generally. There are a few special rules which apply to the location offset.

Special rules — location offset

10.167 For the location offset, a company can choose to disregard the remuneration of one person from the company's production expenditure. Remuneration includes all benefits provided for the person's services in the making of the film, and it includes the travel and other costs associated with those services, such as the costs of bringing the person to and from Australia. These costs will then be disregarded for all purposes. They will not be taken into account as part of production expenditure, or as part of qualifying Australian production expenditure. The offset will not be given for those expenditures either. *[Schedule 10, item 1, section 376-25]*

10.168 The reason for choosing to disregard one person's remuneration would generally be that the remuneration would add to production expenditure but not qualifying Australian production expenditure, and so could exclude a film from eligibility for the offset where total qualifying Australian production expenditure is below \$50 million by making that expenditure less than 70 per cent of production expenditure. The company must nominate the person whose remuneration is to be disregarded in its application for a certificate from the Arts Minister on completion of the film. *[Schedule 10, item 1, section 376-25]*

10.169 In relation to a pilot to a television series, expenditure on a pilot that is not qualifying Australian production expenditure is excluded from production expenditure. In effect, if a pilot is produced overseas and the series is subsequently produced as an eligible television series in Australia, then all expenditure reasonably attributable to the production of that pilot episode is to be excluded from the calculation of total production expenditure for the purposes of the offset. The intent of this provision is to encourage series that have already shot a pilot overseas to consider relocating to Australia. This provision enhances Australia's attractiveness as a location, as the exclusion of overseas pilot expenditure lessens the impact of the 70 per cent criterion applicable to the entire series (for series with qualifying Australian production expenditure between \$15 million and \$50 million). *[Schedule 10, item 1, section 376-140]*

10.170 In relation to a pilot to a television series produced in Australia, the provisions operate such that pilots shot in Australia will have relevant expenditure counted towards qualifying Australian production expenditure for the purposes of the offset if, and only if, the television series is an eligible series. In other words, the location offset will not be available on the pilot alone. It is intended that this will encourage the production of pilots in Australia.

Qualifying Australian production expenditure

10.171 The general test for qualifying Australian production expenditure for the location offset is the same as that for the producer offset, including specific inclusions and exclusions and rules related to expenditure generally. There are a few special rules which apply to location offset and the PDV offset.

Special rules — location offset and the PDV offset

10.172 For the location offset and the PDV offset, where a production company's general business overheads are not incurred in relation to the making of the film, but are still expended in Australia, a reasonable apportionment of these overheads can be claimed as qualifying Australian production expenditure. This apportionment is limited to either 2 per cent

of the film's production expenditure or \$500 000, whichever is the lesser. Expenditure included as qualifying Australian production expenditure by this provision is also to be included as production expenditure. This provision encourages foreign production companies to be located in Australia even if they make projects that do not qualify for the offset as well as projects that do, because a share of general overheads will only qualify for the offset if they are located in Australia. [*Schedule 10, item 1, subsection 376-165(1), item 1 in the table*]

10.173 Qualifying Australian production expenditure also includes a company's expenditure in relation to a person's travel to Australia to undertake activities in relation to the making of the film if the remuneration paid to that person for those activities is qualifying Australian production expenditure of the company. This provision is subject to the rule that non-cast members must work on the film in Australia for at least two weeks before expenditure on those non-cast members can be considered qualifying Australian production expenditure. [*Schedule 10, item 1, subsection 376-165(1), item 2 in the table*]

10.174 It is intended that a person's travel from Australia is not considered to be for the making of the film so is therefore neither production expenditure nor qualifying Australian production expenditure. Where expenditure on a person's travel is made by purchasing a return airfare, qualifying Australian production expenditure and production expenditure may include 50 per cent of the cost of the return ticket.

10.175 For the location offset, qualifying Australian production expenditure also includes a company's expenditure incurred in freighting an item to Australia to be used in the making of the film. It is intended that freighting an item from Australia is not considered to be production expenditure and is therefore not qualifying Australian production expenditure either. [*Schedule 10, item 1, subsection 376-165(1), item 3 in the table*]

Certification for the location and PDV offsets

10.176 The certification process for both the location offset and PDV offset are similar to that for the refundable film tax offset. The key exception is that, consistent with the producer offset, the Arts Minister must determine a company's qualifying Australian production expenditure.

Requirements for certification

10.177 A certificate of eligibility guarantees that the applicant will receive the location or PDV offset on the film's qualifying Australian production expenditure.

10.178 Certification requires that the Arts Minister is satisfied of a number of requirements. The Minister must be satisfied that the film was produced for exhibition in cinemas (in the case of a feature film), for public broadcast, including by satellite or by cable, or for public video release on tapes, DVDs or otherwise (in the case of other formats). In essence, therefore, the film must be produced for public release or distribution in some form. [*Schedule 10, item 1, paragraphs 376-20(2)(a) and 376-45(2)(a)*]

10.179 The Arts Minister must also be satisfied that the film is an eligible genre, meets the expenditure thresholds and meets the requisite level of company responsibility as outlined above for the location offset, and below for the PDV offset. [*Schedule 10, item 1, paragraphs 376-20(2)(b) and 376-45(2)(b)*]

10.180 During the certification process, the Arts Minister will determine the level of qualifying Australian production expenditure of a certified production. Providing the Arts Minister with the authority to determine qualifying Australian production expenditure will provide certainty to applicants as to the amount that a certified production will receive. A determination of qualifying Australian production expenditure is not a legislative instrument within the meaning of the *Legislative Instruments Act 2003*. [*Schedule 10, item 1, sections 376-30 and 376-50*]

10.181 The claim for the location offset or the PDV offset in the company's tax return is based only on the existence of the certificate and on the level of qualifying Australian production expenditure determined in the certificate. If the certificate is revoked, then the certificate will be taken never to have been issued, and the offset can not be claimed or, if claimed, will be the subject of amendment of the assessment to deny the offset. [*Schedule 10, item 1, subsection 376-245(5)*]

10.182 In practice, it is expected that the Arts Minister will act on the advice of the Film Certification Advisory Board when considering applications.

Requirements of the certificate

10.183 Any certificate that the Arts Minister issues is expected to be in writing, to state the company's ABN and the date of issue of the certificate, that the film is eligible for the relevant offset, and the qualifying Australian production expenditure for the film as determined by the Arts Minister. The Arts Minister must notify the Commissioner of the issue of the certificate within 30 days, and will give the company's name and address, the qualifying Australian production expenditure determined by the film authority, and such other information as the Arts Minister and the Commissioner agree. [*Schedule 10, item 1, section 376-240*]

Revocation and refusal of certificates

10.184 The Arts Minister will have the power to revoke the certificate if the issue of the certificate was obtained by fraud or by serious misrepresentation. Revocation will have the effect of requiring full repayment of any offset given through a tax return process. *[Schedule 10, item 1, paragraph 376-245(1)(a)]*

10.185 The Arts Minister may also revoke a certificate if a certified applicant does not provide the Minister with a copy of the film within 30 days after the film's completion. This provision is to provide the Arts Minister with certainty that a film which has been certified and has claimed an offset is, in fact, completed and released. Without limiting the Minister's authority, it is expected that the Minister would consult with a certified applicant prior to invoking this authority. *[Schedule 10, item 1, paragraph 376-245(1)(b)]*

10.186 Where a certificate is revoked, the Arts Minister must give written notice to the company to which the certificate was issued, including reasons for the decision. *[Schedule 10, item 1, subsection 376-250(1)]*

10.187 If the Arts Minister decides not to issue a certificate, the company seeking the certificate must receive written notice of that decision. *[Schedule 10, item 1, subsection 376-250(1)]*

10.188 The decision not to issue a certificate, and a decision to revoke a certificate, will be reviewable in the AAT on application by the company whose interests have been affected. A determination of qualifying Australian production expenditure by the Arts Minister is also a matter which can be reviewed by the AAT. *[Schedule 10, item 1, section 376-255]*

10.189 The notice of refusing to issue a certificate or to revoke a certificate need not set out the findings on material questions of fact, refer to the evidence and other material on which the findings were based or the reasons for the decision. The notice must, however, include advice that an application can be made to the AAT and that a statement outlining the above matters (unless the reasons have already been supplied) may be requested. A failure by the Arts Minister to comply with these obligations will not, however, affect the validity of the decision to refuse to issue a certificate or to revoke a certificate. *[Schedule 10, item 1, subsection 376-250(3)]*

10.190 Where a certificate issued to a company has been revoked under section 376-245, the income tax assessment of the company will need to be amended to deny the offset. *[Schedule 10, item 1, section 376-270]*

10.191 The relevant period in which the Commissioner may amend assessments will be during a period of four years starting immediately after the revocation of the certificate. *[Schedule 10, item 1, section 376-270]*

Rule-making powers

10.192 The Arts Minister is empowered to make rules in relation to the location and PDV offsets. Such rules are legislative instruments within the meaning of section 5 of the *Legislative Instruments Act 2003*.

10.193 The Arts Minister may by rules establish a Film Certification Advisory Board to consider applications for eligibility for the offset and advise the Minister on whether to issue certificates of eligibility. The Arts Minister may decide on other activities and duties in relation to the offset for the Board to undertake. The Arts Minister may specify the membership of the Board and the terms and conditions of its appointment, and may specify the procedures of the Board. *[Schedule 10, item 1, subsection 376-260(1)]*

10.194 The Arts Minister may also make rules deciding on administrative requirements for applications for certificates for the location offset and the PDV offset, including:

- the application form;
- the type of information to be provided;
- methods of verification of that information (such as requesting reports by auditors); and
- procedures around the provision of supplementary or additional information that the film authority may request.

[Schedule 10, item 1, subsection 376-260(3)]

10.195 The Arts Minister may also make rules that will outline the processes and requirements for applications for provisional certificates for the location offset or the PDV offset. It is anticipated that provisional certificates will be issued by the Film Certification Advisory Board and will provide a guide to producers who are aiming to take advantage of the scheme. They will enable a producer to receive an indication from the Film Certification Advisory Board that a proposed production will be eligible for the location offset or the PDV offset if it is made in accordance with the details on which the Board relied in issuing the provisional certificate. *[Schedule 10, item 1, subsection 376-260(2)]*

Part 3 — The PDV offset

10.196 The PDV offset is designed to attract post-production, digital and visual effects production to Australia as part of large budget productions, no matter where the film is shot.

How much is the offset?

10.197 The offset is 15 per cent of the company's qualifying Australian production expenditure to the extent that the qualifying Australian production expenditure relates to the post, digital and visual effects production of a film. Consistent with the other offsets, the offset amount is credited to the applicant company through the company's income tax return. [Schedule 10, item 1, section 376-40]

When is the offset available?

10.198 The offset will be available for post, digital and visual effects production work that commences on or after 1 July 2007. The date on which production commences on the film for which the post, digital and visual effects production work is being undertaken has no effect on whether the offset can be accessed. [Schedule 10, Part 4, subitem 91(2)]

10.199 An applicant company is entitled to the offset where:

- all eligible expenditure post, digital and visual effects production-related expenditure (see below) has ceased being incurred;
- the Arts Minister has granted a certificate to the applicant company, which requires a company to have incurred at least \$5 million of qualifying Australian production expenditure on post, digital and visual effects production work;
- the offset is claimed by the company in its income tax return for the income year in which post, digital and visual effects production work ceased; and

- the company is either an Australian resident company or a foreign resident company with a permanent establishment and an ABN. This must be the case both when the tax return is lodged and the offset is paid. While it is not strictly a requirement that the company be an eligible company when it makes its application to the Arts Minister for a certificate, it is expected that companies will meet this criterion when they make their application.

[Schedule 10, item 1, subsection 376-35(1)]

10.200 An applicant company is not entitled to the offset where:

- a deduction has been claimed in relation to intellectual property in the film under Division 10B of the ITAA 1936;
- the film has been issued with a final certificate under Division 10BA of the ITAA 1936 for the film (including concessional capital investment support under the Film Licensed Investment Company scheme and equity funding by the Film Finance Corporation Australia Limited); or
- the film has been granted a final certificate for either the producer offset or the location offset.

[Schedule 10, item 1, subsection 376-35(3)]

Criteria for certification

10.201 Before the Arts Minister grants a certificate to an applicant company, he or she must be satisfied that the film for which the post, digital and visual effects production work is being undertaken is an eligible format for the location offset. This means that the film must be, for example, a feature film (for distribution on any medium), telemovie, television series or miniseries. The film itself need not meet timing or expenditure criteria. *[Schedule 10, item 1, paragraph 376-45(2)(b)]*

10.202 The Arts Minister must be satisfied that the applicant company is the sole company responsible for all post, digital and visual effects production activities involved in making the film in Australia. Depending on the structure of the production, this could be, for example:

- an Australian company set up to manage Australian post, digital and visual effects production companies' work on the film;

- the ‘lead’ Australian post, digital and visual effects production company which subcontracts some post, digital and visual effects production work to other Australian companies; or
- an Australian production company or production services company.

[Schedule 10, item 1, paragraph 376-45(5)(b)]

10.203 The Arts Minister must also be satisfied that the application meets the expenditure threshold below, and that all eligible expenditure for the post, digital and visual effects production offset has ceased being incurred. *[Schedule 10, item 1, paragraph 376-45(5)(a)]*

10.204 Information about the process for certification and the rules about certificates are outlined above in relation to the location offset.

Eligible expenditure

10.205 Expenditure is eligible if it is:

- qualifying Australian production expenditure; and
- incurred in relation to post, digital and visual effects production.

10.206 Eligible expenditure for the post, digital and visual effects production offset is a subset of what would be considered qualifying Australian production expenditure for the location offset. Therefore, such expenditure must be production expenditure incurred on, or reasonably attributable to, goods and services provided in Australia, the use of land in Australia, or the use of goods located in Australia at the time they are used in the making of the film. However, eligible expenditure must be spent on, or incurred in relation to, post, digital and visual effects production for the film.

10.207 ***Post, digital and visual effects production*** is defined as:

- the creation of audio or visual elements (other than principal photography, pick ups or the creation of physical elements such as sets, props or costumes) for the film;
- the manipulation of audio or visual elements (other than pick ups or physical elements such as sets, props or costumes) for the film; and

- activities that are necessarily related to the activities mentioned in the dot points above.

[Schedule 10, item 21, definition of ‘post, digital and visual effects production’ in subsection 995-1(1) of the ITAA 1997]

10.208 Post, digital and visual effects production includes post-production, all digital production and all visual effects production on the film. It does not however, include principal photography, whether that footage is shot on film or digitally.

10.209 The first limb above extends to all image creation and sound creation, and includes digital creation, motion capture, animation and photography, orchestration, audio recording and sound effects recording and generation, except where that work is in fact principal photography or is the shooting of pick ups (short periods of photography to fill gaps in the film or replace footage shot during principal photography), or where the work is the making of physical items (such as sets, props and costumes). Such physical elements are not intended to encompass the construction of miniatures or models as part of post, digital and visual effects production. *[Schedule 10, item 1, paragraph 376-35(2)(a)]*

10.210 Post, digital and visual effects production also includes all manipulation of elements, whether visual or audio elements, except where it is physical manipulation of a physical item (eg, manipulating sets). Such manipulation is not intended to encompass the manipulation of miniatures or models as part of post, digital and visual effects production. Manipulation of images of physical items, whether on film or digitally, is considered post, digital and visual effects production. This provision means that all editing, compositing, and other post-production tasks are post, digital and visual effects production. *[Schedule 10, item 1, paragraph 376-35(2)(b)]*

10.211 The final limb in the definition above includes expenditure that is not strictly on post, digital and visual effects production tasks, but is necessary to them. This would therefore cover, for example:

- airfares, salaries and per diems for visual effects production staff sent to Australia to oversee or undertake post, digital and visual effects production work;
- salaries, equipment costs and hires, and facilities hire for use in a model or green-screen shoot;
- actor’s fees, per diems etc. for working on additional dialogue recording;

- freight of prints to and from the laboratory; and
- depreciation of assets owned by the applicant (eg, computer equipment and infrastructure).

[Schedule 10, item 1, paragraph 376-35(2)(c)]

10.212 The following tasks are examples of post, digital and visual effects production: 2D and 3D animation, green-screen photography (so long as the entire film is not shot against green-screen and as a result, such photography is in fact the principal photography for the film), pre-visualisation, music composition and recording, online and offline editing, still photography, matte painting and stills manipulation, credit design, models and miniatures, foley effects, additional dialogue recording and colour-correction. The hire of stages and facilities and other expenditures that are necessarily related to the undertaking of post, digital and visual effects production are also post, digital and visual effects production, as would salaries for actors recording additional dialogue or appearing in green-screen photography and expenditure on costumes for green-screen photography.

10.213 Further, if a member of the production, such as director, art director or visual effects producer, travels to Australia to oversee elements of post, digital and visual effects production, that person's salary, per diems and fringes will also be post, digital and visual effects production for the period that they are working on post, digital and visual effects production in Australia. However, non-cast members must remain in Australia and work on the film for at least two weeks in order for their costs to count as qualifying Australian production expenditure. If a non-cast member enters Australia to work on the film for more than two weeks, only the proportion of their costs that relate to post, digital and visual effects production work are eligible. *[Schedule 10, item 1, paragraph 376-155(b)]*

10.214 In considering an application for certification, the Arts Minister must determine the amount of qualifying Australian production expenditure that is incurred in relation to post, digital and visual effects production (ie, eligible expenditure for the post, digital and visual effects production offset). The Arts Minister must do so in writing as soon as practicable after receiving the application. Subsection 376-50(4) specifies that such a determination is not a legislative instrument. This provision is intended to assist readers by making it clear to them that the determination of qualifying Australian production expenditure is not a legislative instrument within the meaning of section 5 of the *Legislative Instruments Act 2003*. *[Schedule 10, item 1, section 376-50]*

What are the qualifying expenditure thresholds?

10.215 In order to qualify, the company must incur at least \$5 million of qualifying Australian production expenditure as defined above.
[Schedule 10, item 1, subsection 376-45(5)]

Production expenditure and qualifying Australian production expenditure

10.216 The rules for production expenditure and qualifying Australian production expenditure for the PDV offset are the same as those for the location offset, including specific inclusions and exclusions, currency exchange and rules related to expenditure generally.

Part 4 — Phasing out tax incentives for investors

10.217 The current investor tax incentives in Divisions 10B and 10BA of the ITAA 1936 have had limited effectiveness in recent years and will be phased out.

10.218 Divisions 10B and 10BA will be repealed effective from 1 July 2010.

10.219 Section 8 of the *Acts Interpretation Act 1901* will ensure that the repeal of Divisions 10B and 10BA of the ITAA 1936 will not affect the previous operation of the Divisions or affect any right, privilege, obligation or liability acquired, accrued or incurred under the Divisions.

Division 10B

10.220 These amendments will provide that no applications for a certificate can be made after Royal Assent of the amending legislation.
[Schedule 10, Part 2, item 2]

10.221 The first deduction available under Division 10B will only be available up until 30 June 2009. The effect of this will be to ensure that the film is producing assessable income by 30 June 2009. If a taxpayer claims a deduction in respect of a film under this Division in relation to the 2008-09 year of income, the taxpayer can also claim a deduction in respect of the film in relation to the 2009-10 year of income. *[Schedule 10, Part 2, item 2]*

Division 10BA

10.222 These amendments will provide that an application for a provisional certificate under Division 10BA must be made before the day on which the amending legislation receives Royal Assent. [*Schedule 10, Part 2, item 3*]

10.223 Division 10BA does not require an applicant to hold a valid provisional certificate in order to apply for a final certificate. From the date of Royal Assent of the amending legislation, an applicant cannot apply for a final certificate in respect of a film unless a valid provisional certificate has been issued. This will ensure that the concessions under this Division will be phased out as per the policy intent without allowing applicants to bypass the provisional certificate process. [*Schedule 10, Part 2, item 5*]

10.224 A deduction under Division 10BA is not allowable in relation to the 2009-10 year of income or a later year of income. [*Schedule 10, Part 2, item 6*]

Part 5 — Technical amendment

10.225 Division 67 of the ITAA 1997 lists tax offsets that are subject to the refundable tax offset rules. The theme statement in the guide material to Division 67 is replaced to provide a clear statement of the operation of the Division. [*Schedule 10, Part 2, items 7 to 9, and 11 to 15, section 67-10 of the ITAA 1997*]

10.226 As a result of the introduction of the producer offset, an amendment is required to the capital allowances regime in Division 40 of the ITAA 1997. The capital allowances regime allows a taxpayer to deduct an amount equal to the decline in value of a depreciating asset over its effective life. Generally, the value of the depreciating asset is its cost. However, certain assets are excluded from the operation of Division 40 by section 40-45.

10.227 Copyright in a film is a depreciating asset. Section 40-45 currently excludes copyright in a film from the application of Division 40 where a deduction is available in relation to the asset under Division 10B or 10BA of the ITAA 1936. The cost of copyright in a film is broadly the expenses incurred in producing the film, and hence creating the copyright in the film, or the acquisition cost of the copyright. Some of these expenses are also qualifying Australian production expenditure for the purposes of the offset. To ensure that the taxpayer is only entitled to one tax benefit in relation to the Australian expenditure, the cost of the depreciating asset (the copyright in the film) is to be reduced by the

amount of the producer offset to which the taxpayer is entitled.
[Schedule 10, Part 2, item 10, subsection 40-45(6) of the ITAA 1997]

Application and transitional provisions

10.228 The amendments to enhance the existing refundable film tax offset (the location offset) will apply to films that commence principal photography or production of the animated image on or after 8 May 2007.
[Schedule 10, Part 4, subitem 91(1)]

10.229 The amendments made to introduce the PDV offset will apply to a film that commences post, digital and visual effects production on or after 1 July 2007. *[Schedule 10, Part 4, subitem 91(2)]*

10.230 The amendments made to introduce the producer offset apply to qualifying Australian production expenditure incurred:

- on or after 1 July 2007; and
- before 1 July 2007, to the extent that such expenditure is attributable to goods or services provided on or after 1 July 2007.

[Schedule 10, Part 4, subitem 91(3)]

10.231 In respect of productions which are underway on 1 July 2007, it is intended that expenditure incurred will apply to services provided, or goods acquired, on or after 1 July 2007. This is regardless of when the contractual obligation to provide the services was undertaken. This means that in the case of any film in production on 1 July 2007, where contracts have been entered into prior to that date, applicants may make a reasonable apportionment of expenses (eg, crew expenses) for services provided and goods used on or after 1 July 2007.

10.232 Despite the repeal and substitution of Division 376 of the ITAA 1997, that Division continues to apply, in relation to films that commenced principal photography or production of the animated image before 8 May 2007, as if the repeal and substitution had not happened.
[Schedule 10, Part 4, subitem 92(1)]

10.233 Further, despite the repeal and substitution of Division 376, legislative instruments that:

- were made under section 376-105 of the ITAA 1997; and

- were in force immediately before the commencement of the repeal and substitution of Division 376,

continue to have effect, and may be dealt with in relation to films that commenced principal photography or production of the animated image before 8 May 2007, as if the amendment had never happened. [*Schedule 10, Part 4, subitem 92(2)*]

Consequential amendments

10.234 As a consequence of the repeal of Division 10BA of the ITAA 1936, Subdivision 375-G of the ITAA 1997 is also repealed. The effect of Subdivision 375-G is to quarantine losses arising where film deductions (broadly those deductions allowable under Division 10BA) exceed film income. Subdivision 375-G will not be required once deductions are no longer available under Division 10BA. However, a number of the concepts used in Subdivision 375-G are used elsewhere in the tax law.

10.235 There are many consequential amendments as a result of the repeal of Divisions 10B and 10BA of the ITAA 1936, and Division 375 of the ITAA 1997. [*Schedule 10, Part 3, items 26 to 62, 64 to 75, 77, 78, 81, 82, 84, 85, and 88 to 90*]

10.236 These concepts are:

- assessable film income;
- exempt film income;
- film component;
- film deductions;
- film loss; and
- net assessable film income.

10.237 These terms are currently defined in subsection 995-1(1) of the ITAA 1997 with references to Subdivision 375-G. These defined terms are amended to remove the references to Subdivision 375-G and replace them with their respective meanings. [*Schedule 10, Part 3, items 63, 76, 79, 80, 83, 86 and 87, subsection 36-40(3), definitions of 'assessable film income', 'exempt film income', 'film component', 'film deductions', 'film loss' and 'net assessable film income' in subsection 995-1(1) of the ITAA 1997*]
