



Australian Government



PRODUCER OFFSET FACT SHEET: Interested Parties/ Arm's Length Transactions

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

SCREEN AUSTRALIA PRODUCER OFFSET AND CO-PRODUCTION UNIT

Street

Level 7, 45 Jones Street
Ultimo NSW 2007

Post

GPO Box 3984
Sydney NSW 2001
Australia

Ph +61 2 8113 1042

Fax +61 2 8113 5999

Switch +61 2 8113 5800

Producer Offset

Web: www.screenaustralia.gov.au/producer_offset

Email: POCU@screenaustralia.gov.au

Co-production

Web: www.screenaustralia.gov.au/coproduction

Email: POCU@screenaustralia.gov.au

Summary

- Under the Producer Offset legislation, where a transaction is not conducted at arm's length, the expenditure able to be claimed as qualifying Australian production expenditure (QAPE) will only be the amount that would have been incurred if the parties were dealing at arm's length.
- Often the reason why parties do not transact at arm's length is because there is a corporate or business relationship between those parties – one party has some kind of interest, either direct or indirect, in the other. Screen Australia has previously referred to such parties as 'related parties'. To avoid confusion with the definition in the *Corporations Act 2001*, Screen Australia will now describe these parties as 'interested parties'.
- Screen Australia must be satisfied that expenditure incurred by an applicant on acquiring goods or services from an interested party is commercially reasonable, reflecting a fair market price.
- At final certification, applicants must complete an Interested Party Expenditure Breakdown for any expenditure incurred by the applicant in acquiring goods or services from an interested party.

The arm's length principle

Under the Producer Offset legislation, Division 376 of the *Income Tax Assessment Act 1997* (the Act), expenditure can only be claimed as QAPE if it is incurred on an 'arm's length' basis.

Section 376-175 of the Act states that:

For the purposes of this Division, if any 2 or more parties to:

- (a) an arrangement under which a company incurs expenditure in relation to a film; or*
- (b) any act or transaction directly or indirectly connected with expenditure that a company incurs in relation to a film;*

do not deal with each other at arm's length in relation to the arrangement, or in relation to the act or transaction, the expenditure is taken to be only so much (if any) of the expenditure as would have been incurred if they had been dealing with each other at arm's length in relation to the arrangement, or in relation to the act or transaction.

The basis of the arm's length principle is to ensure that expenditure incurred by the applicant company for goods and services is commercially reasonable – that the transactions between the parties have involved real bargaining, and the outcome is not inflated compared to the fair market price.

What is an 'interested party'?

An interested party is a party who has an interest in the receipt of the Producer Offset by the applicant company. The mere fact that goods or services are provided to the applicant company does not itself make the provider an interested party.

A clear example of an interested party is the parent or sister company of an applicant established as a special purpose vehicle (SPV). Other examples of an interested party on a project would include:

- an Executive Producer
- an equity investor
- a company with common directors with the applicant, or its parent company
- any party associated with the project that has a financial interest in the applicant's receipt of the Producer Offset.

This list is not exhaustive, and other aspects of a transaction may give rise to Screen Australia identifying a connection or association which would classify it as an interested party transaction.

For example, if the applicant company were to retain the services of a post-production house and in addition to those services, one of the company principals of the post production house were to take an executive producer role on the film, the service provider would be regarded as an interested party for the purposes of the Producer Offset.

Some common examples of transactions between 'interested parties':

- an applicant company hiring or leasing equipment or facilities from a parent company or sister company (eg camera and lighting, office space)
- an applicant company purchasing post-production services from a parent company or company in a corporate group
- a parent company providing the services of in-house personnel to the applicant company
- reinvestment deals with post-production houses.

What does this mean for the Producer Offset?

Where QAPE is claimed for expenditure between interested parties, Screen Australia will test the transaction using the arm's length principle as follows:

- Was the expenditure genuinely incurred?
- What was the expenditure incurred for (ie, what goods or services were provided in exchange for this expenditure)?
- Would a company acting at arm's length actually contract for those particular goods and/or services?
- Once satisfied of the above, is the quantum of the fee paid an arm's length price – are the fee/rates paid higher than those that would be paid to an independent, non-interested party?

If the fees/rates have been inflated, only the arm's length price for those goods or services will be considered QAPE by Screen Australia.

What needs to be submitted for assessment purposes?

Where an interested party is involved in a project, the onus is on the applicant to substantiate its claim that the transaction with the interested party meets the arm's length principle, ie, is commercial reasonable. At final certification, an applicant must supply the following documentation:

- **Interested Party Expenditure Breakdown** – at final certification applicants must complete the template for interested party expenditure transactions, which is attached to the final QAPE spreadsheet (Worksheet 'e'). This breakdown should not simply be a 'dump down' of the general ledger. It requires detailed information to be entered manually to ensure that any transaction between the applicant and an interested party is broken down to clearly identify the date, the payee, the services, the period of time, the weekly rate and the overall total paid.

It is important to note that an application will be considered incomplete and the assessment process will not begin until the Interested Party Expenditure Breakdown is received in the correct format.

- **Detailed general ledger** – the general ledger needs to accurately record the details of all transactions and be coded under the appropriate budget categories (such as Development, Producer Fees, Camera Equipment & Stores and Accommodation, Living & Catering). Lump sum payments without detail will not be accepted. The general ledger should have category headings, subtotals and an overall total so it can be reconciled with the QAPE spreadsheet. If there are any lump sum payments with a single line entry in the general ledger, Screen Australia will require a detailed breakdown itemising the individual transactions which comprise the lump sum.
- In some cases (and always where the expenditure being paid to an interested party/ies exceeds 50 per cent of total expenditure on a film), an applicant company may also need to present the detailed general ledger of each interested party to which a payment was made, clearly outlining all expenditure line by line.
- Applicants may also be asked to supply third party quotes or valuations from alternative (arm's length) providers for the same or equivalent goods/services.
- The applicant may also be asked to supply supporting documentation such as invoices, purchase orders, work orders and change orders to substantiate the lump sum amount.

If an applicant does not adequately break down interested party expenditure or substantiate any lump sum payments claimed as QAPE, Screen Australia will regard the expenditure as non-QAPE.

For example, if an applicant supplies a general ledger with a line item in post production titled 'editing room', paid to an interested party for \$100,000 with no further detail, this would not be acceptable and would be considered non-QAPE without further substantiation.

Screen Australia would expect to see this amount listed on the interested party worksheet, with a full breakdown of what the \$100,000 was spent on.

If the applicant cannot provide the required documentation that supports the claim of \$100,000, Screen Australia will exclude this amount from QAPE.

The assessment process

As outlined above, Screen Australia may request additional information in connection with interested party expenditure and may ask the applicant to supply relevant third party quotes.

In considering the question of arm's length pricing and commercial reasonability, Screen Australia draws on its substantial experience and market knowledge, gained over five years of Producer Offset assessments.

Screen Australia is also assisted by independent film production consultants (IFPCs) who are engaged to assist in the assessment of QAPE on some projects and to provide advice as to current, market rates in the context of assessing commercial reasonability. IFPCs are selected on the basis of their relevant industry experience and expertise and in addition receive specific training by Screen Australia before undertaking QAPE assessments.

Remember, the Producer Offset operates under tax legislation

It is important to note that in assessing Producer Offset applications, Screen Australia is acting under, and subject to, the *Income Tax Assessment Act 1997* and accordingly, expects applicants to provide evidence of expenditure and substantiation of arm's length pricing in the same manner as is required when substantiating expenditure for other income tax purposes.

Criminal and civil penalties apply to persons who make false or misleading statements to Screen Australia or the Australian Taxation Office. In addition, if a final certificate issued by Screen Australia is obtained by fraud or serious misrepresentation, Screen Australia can revoke the certificate.

For further information, please contact the Producer Offset & Co-production Unit.