Submission to the Department of Communications, Information Technology and the Arts Review of Divisions 10B and 10BA

November 2005

PART 1 INTRODUCTION AND CONTEXT

1.1. Introduction

The Australian Film Commission (AFC) is an Australian Government agency, operating as part of the Commonwealth Film Program to ensure the creation, availability and preservation of Australian audiovisual content. The AFC aims to enrich Australia's cultural identity by fostering an internationally competitive audiovisual production industry, making Australia's audiovisual content and culture available to all, and developing and preserving a national collection of sound and moving image.

As the major collector and analyser of data about the industry, the AFC leads opinion, outlook and policy about the audiovisual industries and screen content in Australia

The AFC is appreciative of the government conducting this review of the film tax concession schemes of Divisions 10B and 10BA. Private investment incentives are a vital element of a healthy and sustainable audiovisual industry. Twenty-five years ago, when 10BA was first introduced, Australia led the world in terms of provisions to encourage private sector participation as part of the overall matrix of support for film and television production. Unfortunately, this is no longer the case. The AFC believes generating a higher level of private sector participation in the audiovisual industry is key to increasing local production levels and, the commercial performance of Australian productions.

The AFC is strongly of the view that tax measures must not be seen in isolation – the interconnectedness between these and other support measures for the audiovisual industry must constantly be borne in mind.

Part 1 of the AFC's submission addresses the context and history of the film tax concession schemes, vital to an understanding of the current operation of the tax incentives. Part 2 of the AFC's submission addresses the Terms of Reference of the Review.

1.2. Rationale for industry support

The audiovisual production industry is a cultural industry and as such it has significance in the life of the nation that distinguishes it from other industries.

Culture is a vital element of our national sovereignty, providing the opportunity for the expression of the nation's regional, ethnic and historical diversity. The development of a national culture, shared values and national identity, as expressed through our cultural production is a sign of good governance.

Successive Australian governments have accepted that without government intervention it is extremely difficult for small nations like Australia to produce cultural products that give full expression to our stories, ideas and images. The Australian government invests in cultural programs; just as it does in other

activities such as public health, education, sport and the environment that impact on the well being of its citizens and which make a secure, harmonious and healthy society.

The output of cultural industries is clearly different from other tradeable goods and services. This is because the culture of one nation is not interchangeable with that of another, and because for most nations the intervention of government is essential to the maintenance and development of their culture.

The Commonwealth has established a range of measures - regulatory, budget and tax, designed to support the Australian audio-visual industry:

- Direct subsidy for production and development through the AFC, the Film Finance Corporation, Australia (FFC), Film Australia Limited and the Australian Children's Television Foundation;

- Regulation of Australian Content through the standards imposed on commercial television by the Australian Communications and Media Authority (ACMA) and the drama expenditure requirement for subscription television;

- Support through taxation concessions for investment in feature films, television miniseries and documentaries which includes –

    - Concessions under Division 10BA of the Income Tax Assessment Act for investment in qualifying Australian films;

    - Concessions under Division 10B for investment in intellectual property;

    - the Film Licensed Investment Company Scheme (FLICS); and

    - the Refundable Tax Offset introduced by the Taxation Amendment (Film Incentives) Act 2002.

- Other measures include:

    - Funding of national broadcasters: ABC and SBS;

    - Direct support for training through the Australian Film, Television and Radio School.

    - Regulation of temporary entry of foreign actors, crew and performers under Migration Regulations;

    - International co-production treaties and MOU arrangements;

    - Direct support for promotion of Australian production resources to AusFilm;

- Rules governing foreign ownership of media;

These measures are supplemented by initiatives undertaken by the various state governments.

In conducting his review of Commonwealth assistance to the film industry in 1997, David Gonski identified the fundamental importance of 'diversity, innovation and creativity in achieving the cultural objectives under which the government supports the film and television industry'. Importantly, these measures act at various points along the value chain and encourage an environment where decision-making is distributed effectively between the public and private sector to maximise diversity and creativity.

The level of direct government support has a natural limit derived from the operating budgets of the various screen agencies. Increased private investment is the key to growing the audiovisual industry and extending the diversity of its funding base. However the challenge for Government is that investors require a level of certainty, difficult to achieve in film financing, which overall provides a negative rate of return.

1.3. History of tax concessions

The first tax concessions specifically for film were introduced in 1978 when Division 10B of the Income Tax Act (ITAA) was amended to allow an accelerated write off of capital expenditure involved in the production of a film over a two year period starting in the year in which the film began to earn revenue. The 100 per cent deduction that could be claimed was restricted only to those films certified by the Minister for Home Affairs as Australian films. The definition of an Australian film and the factors that were to be considered in certifying films was drawn from the *Australian Film Commission Act 1975.*

This concession on its own was not sufficient to encourage private investment and some form of gearing-up was required to increase the attractiveness of the investment. The most common form of gearing was where the investor obtained a non-recourse loan that 'geared up' by a ratio of three to one the actual amount invested and the deduction claimed. The non-recourse nature of the loan meant it was not repayable until the film started making money.

New film tax concessions, in 10BA of the ITAA, were enacted in May of 1981. The first 10BA scheme had the following features:

- Capital expenditure on film production could be written off in the year the expenditure was made at a rate of 150 per cent, as long as the capital so committed was expended on the production of the film within 12 months of the end of the financial year in which the commitment was made;

- Earnings to the tax payer from the film's exploitation were tax exempt up to 50% of the value of their original investment;

- Concessional investment could only be made in eligible Australian feature films and television drama (telemovies and mini-series). Documentary was not added to the list of eligible films until some time later;

- Only eligible films certified by the Minister as Australian would qualify, with initially a provisional certificate being issued and a final certificate issued on completion;

- The Tax Commissioner could disallow the deduction if he was satisfied the film would not be completed or distributed;

- The investment had to be 'at risk' with practices such as pre-sales and non-recourse loans being regarded as reducing the level of risk and therefore the deduction that could be claimed.

Problems of interpretation with 10BA arose almost immediately and in the absence of substantive guidelines from Treasury and Home Affairs were usually settled by the Tax Commissioner. The concept of 'at risk' began to be refined and the Tax Commissioner started ruling certain items of expenditure as non-deductible e.g. completion guarantees, insurance, marketing and legal fees.

In January 1983, the Treasurer announced that 10BA would be changed to address the problem of bunching production in one part of the year. Investors could now claim the deduction in the year the investment was made, but the film had to be completed within two years of the end of the financial year of that investment.

At the same time as the Government was trying to develop a tax scheme to support private investment in Australian films, there was also competition for investment dollars in other film related schemes. From 1980 United American and Australasian Film Productions (UAA) and others promoted schemes that used other parts of the ITAA, like s. 51(1), to leverage the deduction investors could claim for investment in Hollywood studio films to a level higher than that of 10BA. These schemes were shut down by early 1983.

Revenue forgone began to exceed initial projections. As a consequence in the August 1983 budget the level of deduction was reduced to 133 per cent on capital expenditure and 33 per cent on revenue. Nevertheless the cost to revenue from 10BA continued to grow and the level of deduction was again reduced to 120/20 in September 1985.

The cost of 10BA to Commonwealth revenue peaked at $131 million in 1987/88, which was the year that the FFC was introduced and the level of capital deduction was reduced to 100 per cent and the tax exemption for revenue scrapped altogether.

The AFC feels that there is an unfortunate tendency to regard the period when the 10BA deductions were at their most generous as one in which films were simply made for the tax deal and not to find an audience. This era in modern Australian cinema was both artistically rich and commercially successful. Films such as

Crocodile Dundee, The Year of Living Dangerously, Gallipoli, The Man from Snowy River and *Mad Max* were thrilling audiences in Australia and around the world. Moreover, during the 1980s the Australian box office share was robust, taking over ten percent for four years of that decade.

The availability of tax concessions proved attractive to investors and brought to the industry a level of funding that allowed much more ambitious and better-resourced projects to be made. The tax concessions meant that productions could largely be funded from Australia, stimulating export revenue. In the contemporary climate it would be difficult to make films like these on the equivalent budget without significant foreign finance.

1.4. Contemporary environment for Australian film and television production

The Australian film and television production sector operates within the context of the domestic and international market and in each of those it has to contend with continuing market failure.

The profit from film and television is not in production, but in distribution and exhibition. While production clearly adds value to the economy through employment and the use of services, and is highly significant culturally, it is not production that actually generates revenue; but rather the exploitation of the market commodity that has been created i.e. the intellectual property in the film.

While the capital cost of production is high the marginal cost of reproduction is relatively small. This results in three effects. First the cost of distribution of the finished product is low and it is possible for that cost to be borne by someone other than the producer of the film. Second, this makes it possible for the price to vary from market to market since the price being charged is not dependent upon the actual cost of production. Third, as a result of their control over channels of distribution and exhibition it has long been the case that distributors and exhibitors recoup their costs and take a profit before any revenue is returned to the producer.

Production in itself is a very risky undertaking and it is the chief reason why the Hollywood model is based upon the vertical integration of production, distribution and exhibition. The Hollywood studios are distribution led entities that have access to the revenues generated by theatrical, home video, cable television and other forms of exploitation to offset in part the risk involved in production.

Far more films fail than succeed. Few television programs become hits. But these large entities have the cash flow and the accumulated value of their libraries to write off the failures and to attract finance from other sources. The partnership between Warner Brothers and Village Roadshow Pictures is a good example of the way in which risk has been shared and a critical mass achieved to reap the benefit of success when it does come.

Vertical integration and the ability to reduce the risk involved in production when combined with the size of the domestic market place give the US a huge comparative advantage in the international market place. These factors have made the US the largest audiovisual market in the world and the largest exporter of film and television.

In contrast, the Australian domestic market place is small and far less vertically integrated. While distribution and exhibition tend towards integration and concentration, production of drama is largely independent and fragmented. Few Australian producers have a business link with a distributor or a broadcaster, fewer still have their own capital to fund development. As a consequence, most Australian producers are obliged to pre-sell their rights to assist in the raising of capital to fund production.

Exhibitors and distributors take most of the revenue generated from the theatrical box office. Even a successful domestic theatrical release returns a relatively small part of the cost of production. Domestic television licence fees do not cover the cost of drama production. As a consequence drama producers go to the international market place in order to finance the 'gap' by raising distribution advances or presales. This reduces the ability to recoup profits. Australian producers must compete with the high volume of US product and also with producers from other small nations seeking to raise deficit finance for their own domestic productions.

This underlying context of market failure is not only a contributing factor to the current decline in the levels of production for both feature and television drama production but is a crucial reason for government intervention and support.

In 2004/05 there were 19 feature films made in Australia for a total production value of $61 million. This is less than the ten-year average of 24 per year. Significantly 14 of these were made on budgets of less than $3 million, with seven made for less than $1 million. Eleven were funded substantially from private sources with the majority of finance raised under 10BA. Most private investment in feature films was made in films with budgets under $3 million; there was one higher budget title *Jindabyne.* The latter was solely responsible for the increase in the amount of private sector investment in 2004/05.

Australian producers of television drama confront a similar situation. While the production value of TV drama in 2004/05 remained static, the number of hours declined to 575, well below the ten-year average of 684; and the total number of programs also declined to 29, again below the ten-year average of 39. Private investment in television drama has also declined substantially from $27.8 million in 2001/02 to $4.6 million in 2004/05. Private investment contribution to TV drama has averaged only $12 million over the last five years.

Over the longer term the Australian industry has been very successful for its size, but it is now operating in an environment where there is increasing pressure on budgets and where financing is tighter than ever before. This constraint on resources further undermines Australia's competitiveness in the international

market place. In the international television sector, there has been an increase in local content quotas, an increase in the number of broadcasting services and consequent to this, lower licence fees. In the international feature film sector, Australian films face greater competition from US studios who have set up their own art house production companies and strong national support systems such as in the UK, which are increasing the level of local productions. Consequently, this review of tax measures to stimulate private investment comes at an important time and presents an opportunity to address the very real issues that are inhibiting private investment as an essential part of the interconnected structure of support for the audiovisual industry.

During the Eighties the Government utilised the 10BA measures as a mechanism to create the foundation of our modern industry. At the time, this was perceived by other nations as being an innovative and constructive approach to stimulating the film and television industry. As a result of the changes made to the tax incentives and their subsequent decline in use, Australia has fallen behind – both in terms of production levels/outcomes but also in terms of policy intervention. When compared with other international examples, the tax regime relating to the film production sector in Australia is no longer a key driver of film policy and has become relatively passive. Governments in other jurisdictions use private investment taxation regimes proactively as an instrument of public policy, allowing for governments to intervene and achieve desired policy outcomes.

The AFC is currently undertaking research into international support models for the audiovisual production industries including film, television and digital content. As a part of this research the AFC has examined indirect public funding models including tax credits and investor-based tax-incentives. A comparative analysis of international funding models is at Appendix A.

Internationally, tax incentives are used extensively as an integral tool in the mix of support essential to support a healthy film industry. Investor-based incentives are the most widespread source of public support. These are in place in Ireland (Section 481 scheme), in the UK (Section 42 and Section 48), in France (SOFICAs), in Germany (former Medien Fund) and in Brazil (Articles 1 and 3 of Audiovisual Law, Rouanet Law, Funcines). A system of tax-credits operates in a number of countries such as Canada, New Zealand and South Africa.

PART 2: RESPONSE TO THE TERMS OF REFERENCE IN THE ISSUES PAPER

The AFC welcomes the opportunity to respond to the terms of reference and will focus on those questions it feels it is best placed to provide comment upon.

2.1. Do the key provisions operate effectively, in particular in attracting private sector investment?

The steady decline in levels of private investment in film and television production over the past several years would indicate that there is room for improvement to the current tax incentive provisions.

The key barrier to attracting private sector investment is the intrinsic unpredictability of the return on investment in film and television productions. This unpredictability is associated both with the indeterminate commercial prospects of the productions themselves, and perhaps more significantly, with uncertainty surrounding legal provisions for investment and their interpretation.

Film is inherently a high-risk activity with no guaranteed returns. Determining which product will achieve success in the market place eludes even the most significant production company. This makes film and television business relatively unattractive to investors who above all seek certainty of return on their investment.

This level of unpredictability has been reinforced by elements of the current 10BA/10B provisions that in recent years have brought about outcomes which have further eroded investor confidence.

In early 1998 the Australian Tax Office (ATO) introduced the Product Ruling system as a means of giving both scheme promoters and taxpayers a level of certainty about their investment. At the same time the ATO was warning investors to be careful about investment, and film was among the products targeted by the ATO.

In 1997, David Gonski's *Review of Commonwealth Assistance to the Film Industry* recommended that measures designed to encourage private investment in film and television production through tax concessions – specifically Division 10BA of the Income Tax Assessment Act – be abolished, and replaced with the Film Licensed Investment Company (FLIC) Scheme. While a tax deduction of 120 per cent was recommended by Gonski, the concessional rate for investment in a FLIC was set at 100 per cent, the same level as 10BA, and introduced by the Federal Government in 1998.

In June 1999, the ATO issued warnings about film investment that seemed to suggest that the FLIC Scheme was problematic. Although the Tax Commissioner subsequently clarified these warnings, the FLIC licensees nevertheless believed that investor perception of the attitude of the ATO was a factor in their inability to raise the licensed amount of capital.

Two FLICs were licensed to raise up to $40 million ($20 million each) of concessional capital over two financial years ending June 2000. Just over 50 per cent, $21.4 million, of the possible $40 million was secured by that date, $16.3 million for Macquarie and $5.1 million for Content Capital. Neither the quantum planned for nor the diversification of the investor base was achieved with the FLIC Scheme attracting only a small number of investors. Nor did the model succeed in widening the film base as in most cases the FLICs co-invested with the FFC. However, the FLIC Scheme pilot provided approximately $21.4 million of additional finance to the industry, over a period of eighteen months to two years, which was a significant boost given the otherwise low levels of private sector investment.

Film investment received further bad press in 2001 when deductions claimed for films such as *Moulin Rouge* and *Red Planet* were disallowed by the ATO. The resulting controversy was a factor in the Government's decision to introduce the current tax offset for higher budget films.

There is a difficult dynamic between the government's policies of support for private investment in film and television by the granting of tax concessions and those of maximising of revenue to the Commonwealth and minimising tax avoidance.

Rightly or wrongly there is a perception in the investment community that investment in film related schemes will attract the attention of the ATO. This leads to most investors requiring that a scheme's promoter obtain a Product Ruling from the ATO. While this delivers a degree of certainty it is a time consuming and very costly exercise (in legal fees) and most suited to projects aimed at wholesale investors.

A product ruling is not however an ironclad warranty. The ATO quite clearly states that a Product Ruling does not guarantee the product under consideration. There is thus a risk that a material change in the structure of financing could jeopardize the deduction being claimed, even if the purpose of the change was not to give a greater tax advantage to the investor. Changes to financing structures in the production of a film or television project are common.

A crucial factor in determining whether or not to invest is the certainty on the part of an investor that all or part of the tax deduction they claim is not subsequently disallowed.

Divisions 10BA and 10B are officially sanctioned methods of not paying the tax on revenue so invested. The Commonwealth has enacted these provisions as additional measures to support the industry and it is willing to forego revenue to achieve this end.

In the AFC's view the following initiatives would assist in encouraging investor confidence and help stimulate investment:

1. *Clarification by Government of the importance of tax measures as a key platform of support for the audiovisual industry.*

Government should make clear that the policy of encouraging private investment by means of tax concessions is a vital element of its cultural support measures. A clear signal needs to be sent to the investment community that support for the audiovisual industry is an overriding intention of the Government.

2. *The administration of the tax provisions by the ATO needs to be more efficient and transparent.*

The government needs to reduce the level of ambiguity that appears to exist in the minds of the investment community about administration of the whole system.

3. *Part IVA should not be applied to disrupt an otherwise deductible benefit*

There needs to be a clearer understanding of what 'at risk' means in relation to audiovisual production. As this submission has stressed, audiovisual production is inherently a risky venture, more so than most other kinds of investment. There is first of all the risk that a film will not be completed and there is the additional risk that it will fail to return any money. The fact that State film agencies provide cash flow financing is an explicit recognition of that risk as banks in Australia are extremely reluctant to lend money for film production with no security against which to lend.

The AFC acknowledges the legitimacy of the 'at risk' test. However, the cultural/industry assistance intentions of 10B and 10BA must be paramount considerations.

Provided the requirements in Divisions 10BA or 10B are complied with, Part IVA should not disrupt an otherwise deductible benefit.

2.2. Are there issues of consistency of interpretation that could be clarified or improved?

The AFC congratulates and supports the ATO for initiating the Film Industry Partnership (FIP) and fostering an open dialogue between the ATO and the film industry through an ongoing series of meetings to identify general industry issues, areas of specific concern for the industry and potential compliance issues. The partnership has led to an improved relationship between the ATO and the film industry with discussions and action relating to: the creation of an information website on tax issues for the film industry; streamlining the product ruling process; supporting education needs for the industry; and a working party formed to examine technical issues with the Film Tax Offset. The AFC considers this work to be crucial to promoting greater mutual understanding between the ATO and the film industry and each other's practices, and recommends its continued priority.

2.3. What is an appropriate length of time to allow for completion of productions?

The current period to complete a production using 10BA or 10B is 24 months from the end of the year in which the investment was made. While this is generally sufficient for both feature films and television drama, it may be insufficient for a feature film with complex digital effects or animation, for which a period of three years may be more realistic.

2.4. Are all appropriate formats eligible under Division 10BA?

The current definition of the eligible formats was written some twenty-five years ago and reflects the understanding then current of the formats that were in need of support largely because of market failure. It was for this reason that television series and serials were excluded from accessing the benefits of concessional investment. This was at a time when it was possible to fully finance serial drama and much series drama from an Australian television broadcaster's investment. In comparison, telemovies and the then developing genre of mini-series were difficult to finance. As a result tax-based investment played an important part in underwriting the flowering of Australian mini-series production that occurred during the eighties.

The contemporary reality is that it has become increasingly more difficult to raise finance for Australian television drama in all formats. Costs have risen and the amount of finance that can be raised from domestic licence fees and international distribution advances and pre-sales tends to leave a gap that cannot be met. In this context the AFC believes that there is merit in extending 10BA to include series and serial drama.

The AFC would also recommend extending 10BA to include short form animation. The present requirement of 10 minutes for animation series does not match current commercial practice. Five minutes or less is much more common in short form animation with mobile phone content varying between 15 seconds and three minutes. Notwithstanding its support to extend taxation support, the AFC does not support investment by the FFC in series or serial drama.

As more entertainment becomes produced and distributed digitally, broadcasters, distributors, and audiences increasingly expect content to be interactive and multi-platform. Australian content producers in the future will be working predominantly with digital content with consumers viewing and interacting with content across a number of platforms which do not differentiate one screen from another – television, mobile, internet, DVD, or games consoles. Content is being repurposed across a range of platforms and projects that start out as electronic games are being made into feature films and television content and vice versa.

The AFC and other screen agencies are actively engaged in promoting the convergence of traditional and new modes of content and delivery. The AFC's

Broadband Production Initiative (BPI) and funding for Interactive Digital Media and Experimental Digital Production are assisting producers to develop digital interactive content created specifically for the internet, mobile phones, DVD, games consoles and interactive television.

The electronic games sector, and the digital content sector as a whole, is an important part of the audiovisual industry in Australia. The significance of the digital content sector has been recognised by the Commonwealth Government, which is developing a comprehensive digital content strategy. The goal is to accelerate the development, production, distribution and marketing of digital content domestically and internationally.

In developing its digital content strategy, the government-initiated a Digital Content Industry Action Agenda (DCIAA), an industry-led framework to build critical mass and scale. The AFC has played a central role in supporting the DCIAA process. Key priorities of the DCIAA are to attract and stimulate higher levels of private investment in the digital content industry, and to support the creation and retention of intellectual property assets in Australia.

To reflect commercial practice more broadly, the AFC also supports extending Division 10BA eligible formats to include other forms of interactive content such as games, broadband and mobile phone content. The cultural test inherent in 10BA eligibility would need to be redrafted to take into account new genre platforms, but should still be a vital determinant of support.

2.5. Are all appropriate delivery platforms captured under Division 10BA?

Since the framing of the Division 10BA legislation the number of delivery platforms available has extended beyond theatrical exhibition and television broadcasting, although they continue to be the dominant channels of distribution. The internet, mobile phone services, digital subscription television, digital iPods and games consoles may not have supplanted more traditional delivery mechanisms, but are rapidly becoming important mechanisms in their own right.

It is clear, for example, that DVD is rapidly growing in importance. For the major Hollywood studios revenue from home video is now three times as great as that from theatrical exhibition and the closure of a number of cinemas in Australia has partly been attributed to the extent of DVD penetration. Theatrical feature films are already being released directly to DVD and major films will shortly move to worldwide simultaneous DVD and theatrical release. In addition the combination of internet marketing and DVD distribution presents filmmakers with a relatively low cost option to self distribute their work and maximize returns to their investors by eliminating distributor commissions. Although this is not currently a very viable model for feature films it is already so for documentary productions.

For these reasons, the AFC believes the legislation must move away from a platform-based test. The AFC recommends therefore that eligible delivery platforms should not be specified in the legislation. Of relevance in distribution should be the stipulation of commercial quality and the delivery to a wide

audience whether via cinema release, television broadcast, direct to DVD or otherwise.

2.6. Can Divisions 10B and 10BA eligibility criteria, as defined in the ITAA and as described and applied by DCITA, be better targeted to suit the contemporary industry?

The cultural objectives of 10BA remain as relevant as ever. The AFC does not wish to see this objective diminished in any way. Therefore, the AFC believes that the current definitions of 'significant Australian content' and 'made wholly and substantially in Australia' should remain.

The definitions do not act as a barrier to the raising of finance. Diluting these will not, in the AFC's view, lead to the creation of film or television that has greater international appeal. The AFC strongly believes that those films and television programs that have retained a high degree of Australian cultural specificity have been, and will continue to be, the most successful programs in the international marketplace.

2.7. Identify enhancements to the current schemes to improve the level of certainty for investors, while fully maintaining the integrity of tax concessions?

The AFC recommends consideration be given to a number of changes to include new mechanisms that would be more useful in raising money and would reward success. These include:

a. *A 50 per cent deduction in respect of earnings of a project*

The AFC believes that a further way in which the tax concessions could be made more attractive to investors is if there was a reinstatement of the tax exemption for revenue that existed under 10BA up to 1988. As indicated above this allowed the investor a tax-exempt revenue stream originally up to 50 per cent of their initial investment. Now that the level of deduction stands at 100 per cent of the capital investment, this is essentially only a deferral of the investor's tax obligation since they must pay tax on any revenue returned from the project. By granting an exemption for revenue earned up to 50 per cent of the original investment the period of tax deferral is greatly enhanced.

The attraction of revenue-related concessions is that they reward success and serve to encourage investment in projects that may have a reasonable prospect of commercial return.

b. *Combine existing Commonwealth funding with the 12.5 per cent Refundable Tax Offset.*

The AFC believes that Australian producers should also be able to combine existing Commonwealth Government funding (usually FFC) or incentives (10BA

or 10B) with the 12.5 per cent Refundable Tax Offset. Where government funding is investment (eg FFC), this funding would be excluded for the purposes of calculating the QAPE eligible for the tax rebate. For example, if the budget is $10 million, and $4 million is contributed by government funding, only $6 million would be eligible to attract the Tax Offset.

The NZ Government is currently examining a similar model as a means of further support for its film industry.

The 10BA and 10B concessions only bring forward investors' ability to receive a deduction. Under 10BA the owners of the copyright can write off the cost of their investment in one year instead of five years (the deemed life of the asset); under 10B it is over two years. Tax is still payable on profits from the film. Combining incentives will not affect the revenue overall, but it will make Australian screen production substantially more attractive to private investors.

As described above, screen production levels are low, partly as a result of low levels of private investment. Making investment more attractive will deliver increased economic returns; through increased economic activity and through the development of the Australian audiovisual industry. When intellectual property is owned here, the offshore returns are repatriated.

Offshore production in Australia is completely dependent on the existence of a strong and energetic local production sector: so that people and infrastructure are available to service foreign productions; and to keep the pool's skill level up to date with technological advances.

Foreign producers will only take the risk of bringing big productions here if they are assured they will actually get the results and the technical quality they need. The duration of the current downturn in local production endangers that.

Combining the Tax Offset with 10B will improve the industry's attractiveness to major offshore productions.

Tax Offset claims are made after completion of the film. The claim must be supported by actual, audited expenditure on making the film. Compliance is easy to monitor.

c. Lower the threshold for the 12.5 per cent Refundable Tax Offset

In addition the AFC believes that the budget threshold for the Refundable Tax Offset should be lowered. As it stands, the Tax Offset currently excludes most Australian productions as their budgets fall well below the eligibility threshold of $15 million. There have been few Australian films in the recent past made with budgets above $15 million – *Ned Kelly*, *The Proposition (*Australian/UK co-productions)*, Collision Course*, *Swimming Upstream* and *Happy Feet* (still in production).

The existing policy recognises that the larger the budget of a film, the more economic benefits it creates. The money is paid to Australian individuals and enterprises, who on-spend it and who pay more tax. Lowering the threshold for the Tax Offset would also increase local production activity, creating similar economic benefits.

3. Recommendations

i. To assist in encouraging investor confidence and help stimulate investment, the AFC submits that:

   - The Government needs to clarify that tax measures are a key platform of its support for the audiovisual production industry.

   - The administration of the provisions by the ATO needs to be more efficient and transparent;

   - The inherently high-risk nature of audiovisual production is acknowledged so that the 'at risk' provisions entailed in Part IVA cannot be applied to disrupt an otherwise deductible benefit.

ii. The AFC supports the extension of Division 10BA eligible formats to drama series and serials, short form animation, and other forms of interactive content such as games, broadband content and mobile phone content;

iii. Eligible delivery platforms should not be specified in the legislation, given the expansion of legitimate distribution via newer technologies. Of relevance in distribution should be the stipulation of commercial quality and the delivery to a wide audience whether via cinema release, television broadcast, direct to DVD or otherwise.

iv. The existing definitions for Australian programs should be retained to ensure the cultural specificity of eligible programs;

v. Investors should be able to claim a 50 per cent deduction in respect of earnings from a project, as another means of making the investment in film and television more attractive and of providing an incentive for commercial success;

vi. Australian producers should be able to combine existing Commonwealth Government funding (usually FFC) or incentives (10BA or 10B) with the 12.5 per cent Refundable Tax Offset. This should be combined with a lowering of the threshold for the 12.5 per cent Refundable Tax Offset to enable more Australian productions to utilise the scheme.

Appendix A: International indirect public funding models

There are two major forms types of tax incentives around the world: tax credits and investor-based tax-incentives. Tax credits are offered to producers, whereas investor-based incentives are offered to investors (either individuals or companies) in the audiovisual industries.
These forms of support are commonly administered directly by tax offices; sometimes they are under the shared responsibility of funding agencies. Australia and France have both forms of tax-incentives in place, but other countries usually have one form or the other.

Tax Credit Model

The most recent trend in terms of incentives is towards the implementation of tax-credit model for large budget films.

In this model, a government grants a production company a tax credit against that company's tax liabilities by reference to an agreed percentage of spend. The defined spend is usually local spend or an element of this.

The exact form of the tax credit model varies from country to country yet it generally takes the form of a refundable tax credit. The credit is firstly applied against taxes payable by the production company. When the credit exceeds the production company's tax liabilities, a cash payment for the excess is made.

International models

Tax-credits are in place in Australia since 2002, Canada since 1997 and New Zealand since 2003 and South Africa since 2004.

Canada: There are two federal tax-credits based on labor expenditures for film and video productions: the FTC targeting the domestic production sector and the PSTC aimed at foreign-owned producers (US applicants at 95 per cent). A different rate is available for both tax-credits (25 per cent for domestic, 16 per cent for foreign owned).

New Zealand: The Large Budget Screen Production Grant was introduced in New Zealand in 2003 and is largely based on the Australian 12.5 per cent tax-offset. The main differences with the Australian scheme is that it offers a straight refund on production costs for qualifying productions and it is opened to series with possibility of bundling to reach the minimum expenditure.

South-Africa: South Africa introduced a tax-credit in June 2004. It is open to film, television series and documentaries and offers the possibility of bundling. It offers a different rate for domestic (25 per cent) and foreign productions (15 per cent) directed at growing its domestic industry and attract foreign productions.

France: A tax credit was introduced in France in January 2004 to help productions with below the line costs including post-production. It is open to foreign productions as long as the work is carried out by French companies in France. Producers are able to write off between 10 to 20 per cent of below the line costs (including crew, art and set work, camera, wardrobe, electrical, transportation and post-production). There is a cap per film (€500,000/approx. $A867,000). There is as yet no estimate of the value of support is available for the tax-credit.

United States: The United States has tax-incentives in place at both federal and State level. The US federal tax credit was introduced in October 2004 in order to fight against the flow of run-away productions. Films and television productions (with budget below $A21.5 million and spending at least 75 per cent of their budget in the US) can write-off 100 per cent of production costs for tax purposes. State governments also offer tax-incentives, those can represent significant levels of indirect support ($A67.8 million in Louisiana, $A38 million in Hawaii or $A11.5 million in Pennsylvania).

	Australia	Canada		New Zealand	South Africa
Name	**12.5% refundable tax-offset**	**Canadian Film or Video Production Tax Credit (FTC)**	**Film or Video Production Services Tax Credit (PSTC)**	**Large Budget Grant Scheme (LBGS)**	**Large Budget Film and Television Production Rebate**
Type	**Tax Credit**	**Tax Credit**	**Tax Credit**	**Tax Credit**	**Tax Rebate**
Introduced	2001	1996	1998	2003	June 2004
Primary Focus	**Foreign**	**Domestic**	**Foreign**	**Foreign**	**Foreign and Domestic**
Operated by	DCITA	Canadian Audio-Visual Certification Office (CAVCO) and Canada Customs and Revenue Agency (CCRA).		NZ Film Commission Inland Revenue Department	Trade and Industry
Products	Film, Television drama and series (extension)	Canadian film and video productions developed, produced and exploited by Canadians	Film and video productions produced in Canada where local labour is used	• Film, Television 'movie of the week and series • Possibility of bundling for series only	• Film, Television 'movie of the week, series and documentaries • Possibility of bundling to reach the expenditure requirement with a slate of project in 12 months
Mechanism	Producer claims **12.5% of the expenditure** in Australia, providing that : at least A$15million are spent in Australia And at least 70% of the budget (except for production >A$50 million)	**Refundable tax credit of 25%** of qualified labour expenditures (salaries and wages) CAVCO issues a certificate providing an estimate of the tax credit which the producer can use to raise finance from a bank	**Refundable tax credit of 16%** of qualified Canadian labour expenditures incurred for an accredited production (minimum expenditure and eligible genre)	Producer claims a **12.5% refund on the NZ production costs** providing the spend is : at least A$13.8 m (NZ15 m) and at least 70% of the project total budget (except for production >NZ$ 50 million)	• Local companies will be given **25%** of their South African spend • International companies and co-productions will be awarded a **15 % rebate** on qualifying South African production expenditure A minimum R25m must be spent in South-Africa and at least 50% of principal photography – min. 4 weeks of filming – must be filmed in South Africa.
Cap	Minimum expenditure : A$ 15 m	Minimum expenditure : A$1m (C$1m)		Minimum expenditure : A$ 14m (NZ15m)	Max A$2.1 million rebate (R 10 m)
Comments	• Need to lower the minimum cap of A$ 15 million for Australian productions (Average budget of production of an Australian production = 2.3 million AUD in 2003)	• Credit paid **after completion of the production** • CAVCO : point system according to the position occupied by Canadians	•Complements the FTC with a **different rate** •The PSTC is open to both Canadian and foreign-owned companies - a special rule prevents producers from being able to claim both FTC and PSTC with respect of the same production	• Films that qualify for the LBGS are not eligible for any other NZ film finance or tax incentive other than development	• Designed to help the producers to find the last 20% of finance. • Different rate for foreign and local companies • For national productions – the rebate can be claimed even if the project has received funding from other national funds.
Value / Cost (tax benefit)	• **A$ 37.7 m** benefits for companies for 6 applications (June 2004, DCITA)	• The federal tax credit was worth approximately **A$ 228 m** (C$225 m) in 2004.		• The government planned a cost of **A$37 m** per year (NZ$40m) - but only A$2.8m (NZ$3m) were claimed for *Last Samurai*	• Ceiling for the scheme : R252 m over three years (**A$17.8m** per year)

Investment based model

The Investment-based model varies from country to country, however, the basic principle remains the same: the taxpayer is given a tax deduction for investing in a production (typically in a particular film or a fund which invests in film production) with the risks and rewards being shared in some agreed proportion between the film producer and the taxpayer.

International examples

Investor-based incentives are the most widespread source of public support. It is in place in Ireland (Section 481 scheme), in the UK (Section 42 and Section 48), in France (SOFICAs), in Germany (former Medien Fund) and in Brazil (Articles 1 and 3 of Audiovisual Law, Rouanet Law, Funcines). The Irish, UK and German schemes have all led to some form of abuse.

UK: Tax reliefs are available in the UK for investments in production and acquisition of British qualifying films under Section 48 and Section 42 of the Finance Act. Section 42 was introduced in 1992 and is aimed at high-budget UK qualifying productions. A film producer or film owner can benefit from a 33.3 per cent income tax relief annually over a three-year period. Section 48 was introduced in 1997 and is aimed at UK qualifying productions budgeted up to GDP 20 million ($A48.8 million). A film producer or a film owner can benefit from a 100 per cent tax relief during the year the film is completed. To qualify as a British film, at least 70 per cent of the production activity must take place in the UK, UK or European union nationals must represent 70/75 per cent of the pay roll and it is necessary to set up a UK company. The UK schemes (Section 42 and 48) have been reviewed in 2004 to limit the practice of double dipping.

Ireland: The Irish investor based incentive was introduced in 1997. Section 481 provides a tax deduction for Irish investors – individual or companies – who buy shares in Irish film production companies. Investors can invest up to €31,750 ($A53,800) in any one year. 80 per cent of the amount can be written off for tax purposes, with the possibility to carry forward unrelieved amount. Companies can invest up to €10.1 million ($A 17.2 m) per year, with no more than €3.8 million ($A 6.4 m) in any given production. Any excess over the 3.8 million limit must be invested in a film production with a €5 million budget ($A8.6 million). To qualify a film must have an Irish co-producer and 75 per cent of the production work must be done in Ireland. It can easily be combined with other tax-incentives available in the UK or other countries signatory of the European co-production convention.

Germany: The German Medien Funds have existed since the 1970s. Those funds were not the result of a government initiative, they are based on loopholes in Commercial Laws. Private and corporate investors can deduct from their tax statement the expenses incurred by an intermediary film fund in the production and exploitation of films. Medien funds have annual yield rate of 10-15 per cent over a period of nine years. Investors receive interest on all the revenues of the film from theatrical release in the country and other territories, exploitation in DVD video and other rights. In case of commercial failure, the fund has to

reimburse a minimum of 80 per cent of the amounts invested. In theory, to be able to benefit from this tax-advantage, funds' investors have to be involved directly in the decision making process. There is no condition of money to be spent in Germany, nor for the production to be German. In May 2005, the German government brought to an end these tax-driven media funds.. Without any condition of local spend, 80 per cent of the amount invested in those funds were going to US productions. The German government is currently working on a new film financing system more targeted at helping German films.

France: In France, investors in SOFICAs (sociétés de financement de l'industrie cinématographique et de l'audiovisuel) – companies collecting funds and investing them in audiovisual works – can obtain a tax deduction up to 25 per cent of their total net income for individuals (the highest tax rate in France is 54 per cent), and companies benefit from an exceptional amortisation up to 50 per cent of the invested amount. Investments are locked for a period of 8 years with an annual yield rate of 6-7 per cent compared to 5-5.5 per cent interest rates on secured investments, with a guaranteed 95 per cent reimbursement of capital. In addition, investors earn revenues from the receipts on the future exploitation of the work. SOFICAs must invest in either audiovisual works previously approved by the CNC or in a company dedicated to film and TV production. The SOFICAs has been in place since 1985 and has recently been questioned by the French government. SOFICAs have a relatively low impact on the financing of French feature films for a relatively high cost for the producers and the government. It failed at increasing the number and quality of productions. Most of the investments are going to French productions already co-produced by a free-to-air network. Yet, the system has been maintained because it brings some gap financing to productions (up to 50 per cent of the investment before filming).

Brazil: Brazil relies mostly on investor-based incentives to support its film and television industry. The three main Brazilian tax-incentives were introduced by law in the 1990s in order to make investment in film, television and video-productions more attractive to private investors. Under Article 1 of Audiovisual law, Brazilian investors and companies can invest up to 3 per cent of their income tax in shares in one or more local productions (Brazilian film, television or video production). There is a limit of 3 million Real per project ($A1.4 million). If the production is profitable, the investor shares the profit. Projects must be approved by the national film agency (the Ancine). Foreign producers can participate in tandem with a local producer. Under Article 3 of Audiovisual law, foreign films distributors can invest up to 70 per cent of their tax due in Brazilian films productions. Under Rouanet Law, companies can deduct four per cent of their income tax (six per cent for individuals) for donation and sponsorship to a Brazilian film, television and video production. In 2003, the Brazilian government introduced a new incentive for investors in film investment funds (FUNCINEs). This scheme is based on the French model of SOFICA and is aimed to stimulate private investment in other sectors of the industry such as the exhibition sector which is currently underdeveloped in Brazil. It entitles investors to benefit from a tax-credit of up to four per cent of the sums invested in shares in a company engaged in marketing, production, distribution or exhibition of independent

Brazilian productions. The investment is completely deductible from taxable income and the investor gets a percentage on the profits of the film.

	Australia	Brazil	France	Germany	Ireland	UK
Name	**10BA**	**Article 1, 3 Audiovisual Law, Rouanet Law, FUNCINE**	**SOFICA**	**Medien Fund**	**Section 481**	**Sale and lease back procedure (Section 48)**
Type	Tax allowance	**Investor based**	**Investor Based**	**Investor Based**	**Investor Based**	**Taxation Relief**
Operated by	DCITA	Brazilian Stock Commission (CVM)	SOFICAs - companies collecting funds and investing them in audiovisual works		Ministry of Arts, Sports and Tourism	
Introduced		1990s, Nov 2003	1985	1970s	1997 until end 2008 (since 1994 as section 35)	Recent reform to avoid abuse
Description	To encourage investors to invest in local films	Encourages investors to commit financing to film and television production but also to exhibition and distribution	Upon investment, individual investors obtain a tax deduction up to 25% of their total net income (the highest tax rate in France is 54%) Companies benefit from an exceptional amortisation up to 50% of the invested amount	Investors can off-set 100% of their investment for tax purposes. Since the 70s, first for tax exoneration and now for pure investment	Tax deduction available to Irish investors who buy shares in Irish film production companies	The production budget of UK films can be written off for tax purposes in one year. This allows investors to reduce tax liabilities in the year the investment is written off Reform in March 2004 to avoid abuse (double dipping)
Mechanism	Investors acquire copyright of new Australian films and receive a **100% tax concession** on the fllm amount of their investment in the year it is made	FUNCINE : Investors purchase shares in a company engaged in marketing, production, distribution exhibition of independent Brazilian productions. In exchange the investors benefit from up to 34% of tax credit of the sum invested the investment is also deductible of taxable income	Investment for a period of 8 years. Annual yield rate of 6-7% compared to 5-5.5% interest rates on secured investments, with a guaranteed 95% reimbursement of capital. Investors earn revenues from the receipts on the future exploitation of the works.	Annual yield rate of 10-15% over a period of 9 years. Interest on all the revenues of the film from theatrical release in the country and other territories, exploitation in DVD video and other rights. In case of commercial failure, the FICA had to reimburse a minimum of 80% of the amounts invested.	An Irish company is established to make on film only.	Smaller investors group into partnerships purchase a film project and lease it back to the producer Financial benefit to producers varies between 5 - 9%
Cap					Max : A$ 25m	Max : A$ 51.7m
Comments	A prospectus has to be issued when investment of less than A$500,000. Can be claimed simultaneously with direct investment from FFC, but not simultaneously with tax offset.		•Introduced in 1985 to fight the scarcity of resources available for production with tax incentives to stimulate private investors •Almost exclusively - French production with a preference for big productions	Funds are turning to TV productions - animation - generating important receipts at export and merchandising	Money usually available to the producer at an **early stage** of the production process Most investors seek projects which have the possibility of **securing pre-sale agreements** that will give them a reasonable return on their net investment when the film has been delivered	Producers use the system to retain certain rights for themselves (for instance by selling and leasing back all territories but one which they exploit for their own benefit ; It helps them built portfolios of rights an asset for the companies future growth.

Levels of Indirect Public Funding

Thirteen out of the fifteen countries reviewed had some form of tax-incentives in place. Denmark and Japan have no tax-incentive for audiovisual production in place. No comprehensive estimates were available for the value of tax-incentives in place in India, Korea, Spain and the US. For the nine countries for which estimates was available, the average level of support through tax-incentives for 2003-2004 was $A170.4 million and $A4.6 per capita.

Tax – incentives - Value of support

		Value of Indirect public funding in million AUD			Population	Value of Indirect public funding in AUD per capita		
	Main schemes	Tax credit	Investor based tax incentive	Total	in million inhabitants for 2004	Tax credit	Investor based tax incentive	Total
Australia	12.5% 10 BA / 10B	17.2	16	33.2	19.9	*0.86*	*0.8*	*1.7*
Brazil	Audiovisual, Rouanet Laws, Investment certificates		54.9	54.9	181.8		*0.3*	*0.3*
Canada	Federal and provincial tax credits	584.5		584.5	31.9	*18.3*		*18.3*
Denmark	No tax-incentives in Denmark							
France	SOFICA Tax-credit on below the line costs	na	30	30	59.9	*na*	*0.3*	*0.3*
Germany	Medien Fund		390.7	390.7	82.5		*4.7*	*4.7*
India	Some tax-incentives for infrastructure or at provincial level, but no amount are available							
Ireland	Section 481		34.5	34.5	3.92		8.8	8.8
Japan	No tax-incentives in Japan							
Korea, Rep	Tax-incentives have been introduced recently, no amounts available							
New-Zealand		2.8		2.8	3.9	*0.7*		*0.7*
South-Africa	Large Budget Tax Rebate	17.8		17.8	45.6	*0.4*		*0.4*
Spain	Tax-incentives are in place in Spain, no amounts available							
United-Kingdom	Section 42 Section 48		340 / 440	390 (average)	59.8		*5.7 to 7.4*	*6.5 (average)*
United-States	Tax-incentives available at federal and State level, partial figures available only (Louisiana, Hawaii, Pennsylvania)							
Average		***155.6***	***152.7***	***170.9***		***0.9***	***4.5***	***4.6***

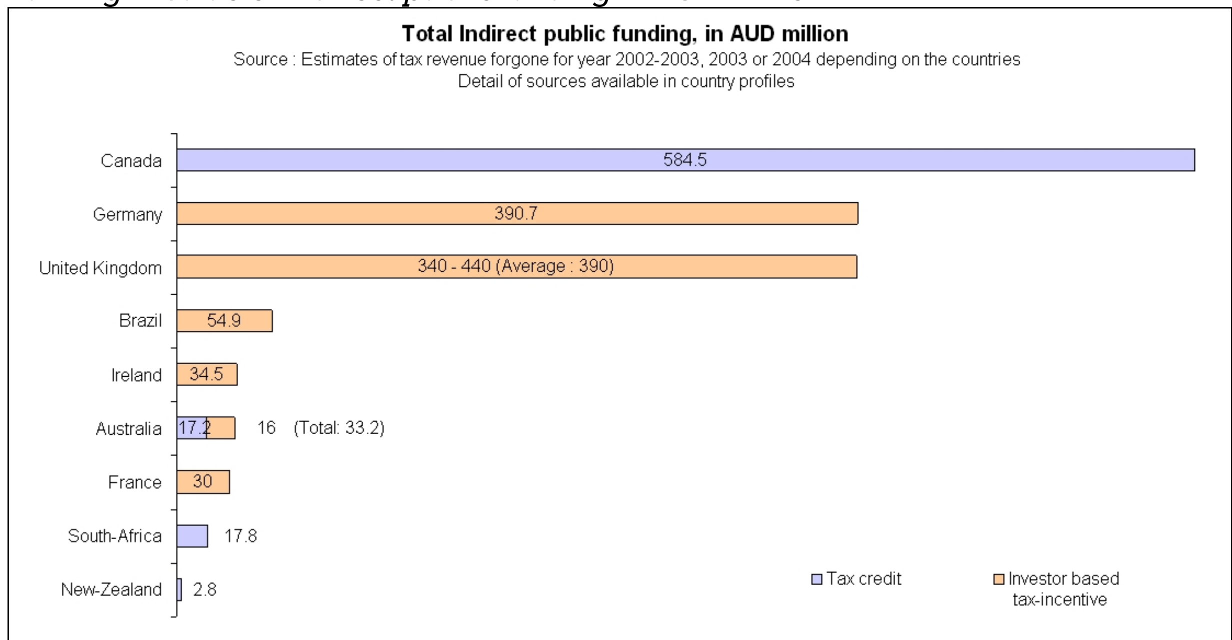
Australia data for 2002-2003 ; Brazil for 2004; Canada 2003-2004 ; France annual average based on 19985-1996 figures; Germany for2003 ; Ireland forr 2003 ; New Zealand for 2003 (only one grant worth $NZ3, the actual government estimate for cost of the scheme was $NZ40 million) ; South Africa estimate by Trade and Industry at the time of launch June 2004 ; UK range based on estimates of House of Commons for 1998-2003 and estimate form UK Tresury for 2003-2004

The ranking of the countries in terms of their value of indirect support through tax incentives differs depending if the ranking is based on the total level of spending in Australian dollars or on spending per capita.

Out of the nine countries for which data is available, Australia positions itself 6th with a total value of indirect support through tax incentives of $A33.2 million. But in level of spending per capita, Australia ranks 5th with a total of $A1.7 per capita.

Both tax-credit (12.5 per cent tax-offset) and investor-based tax-incentives (10 BA and 10 B concessions) are place in Australia. Each represented approximately half of the value of indirect support in 2002-2003 (0.86 per capita for 12.5 per cent tax-credit; and 0.8 per capita for 10BA/10B). The value of indirect support from FLIC scheme is not included in this estimate. France is the only other country to have both mechanisms in place. In 2004, The French governement made the choice of a tax-credit rather than a investor-based incentive for a new scheme aimed at supporting the production services and post-production sector.

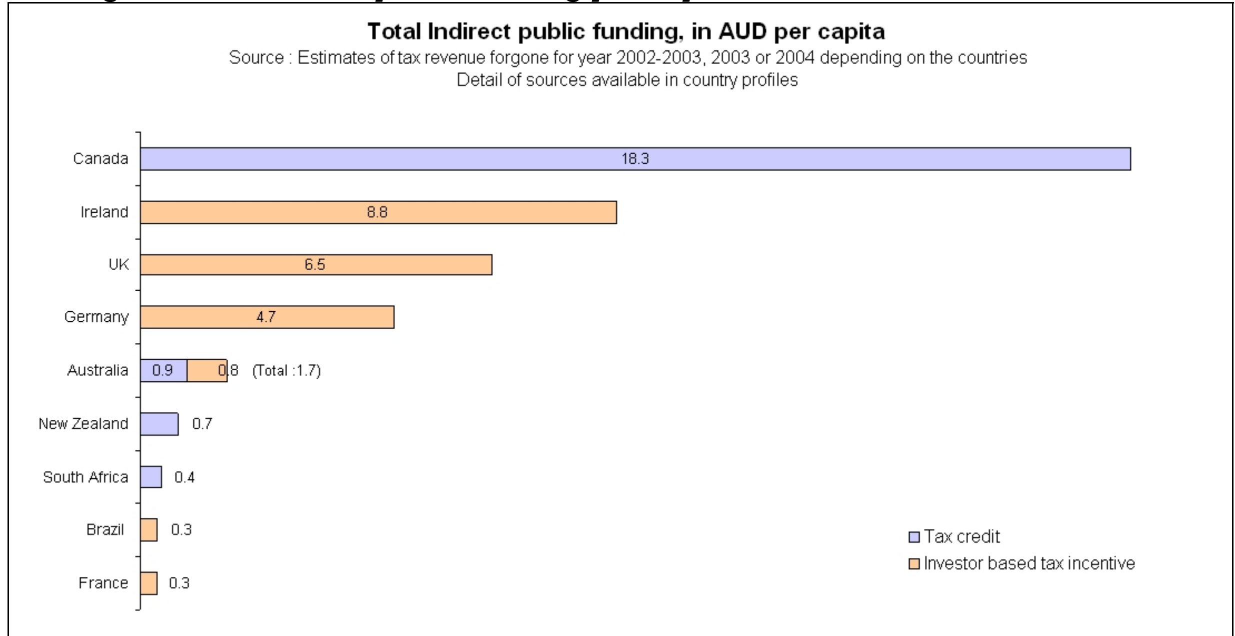
Ranking in value of indirect public funding in AUD million



Canada is the country with the highest level of indirect public funding in both ranking with a total of $A584.5 million through federal and provincial tax-credits. This represents a level of spending per capita of $A18.3. Ranging between Canada and Australia, are Germany, the UK, Brazil and Ireland. All four countries have investor-based incentives in place. The United Kingdom can be second with up to $A440 million spent in Section 42 and Section 48 schemes according to the House of Commons, or only $A340 million according to the UK Treasury. On average, this represents a level of indirect public support similar to Germany ($A390.7 million). Brazil and Ireland have significant level of funding through investor-based incentives, respectively $A54.9 million and $A34.5 million.
France, South-Africa and New Zealand have levels of indirect support below Australia. The value of support for New-Zealand's tax-credit is based on only one grant ($NZ3 million, $A2.8 million for *The Last Samourai*), it is below the estimated cost forecast by the government – $NZ40 million

($A37 million), which would have meant a higher level of indirect support per capita ($A9.5).

Ranking in value of direct public funding per capita



Canada has the highest level of support through tax-incentives per capita ($A18.3), of which 40 per cent ($A7.4 per capita) is coming from the federal incentives and 60 per cent ($A10.9 per capita) from provincial incentives.

It is followed by Ireland, the UK and Germany, which all have investor-based incentives in place.

Despite its higher level of funding in total, Brazil ranks below Australia in terms of spending per capita.

France, South-Africa and New Zealand are below Australia both in absolute value and for spending per capita.