

Tax deductibility of film investments

Garth Symonds discusses a recent Federal Court decision which held that reimbursement of expenditure already made on films may still qualify for 10BA deduction

The decision of the full Federal Court in *Federal Commissioner of Taxation v Faywin* (1990) provides a significantly greater degree of flexibility in structuring proposals for film and television financing.

In a production it often happens that the private investors are seeking a tax deduction under Division 10BA of the *Income Tax Assessment Act* ('The Act'). It used to be thought that any monies provided by a private investor to reimburse another party for expenditure which had already occurred on an Australian production would not be eligible for a deduction under Division 10BA. Thus, according to this view, where the Australian Film Finance Commission (FFC) has agreed to invest in a production and the producer wants the FFC to help finance items which are deductible under Division 10BA, private investors can not reimburse the FFC for its expenditure on deductible expenditure and then obtain a deduction themselves for this expenditure.

The case

F*aywin* concerned the production of the film 'Hoodwink'. In January 1981 the production of the film, which had been financed by the NSW Film Corporation, was almost complete. In anticipation of the impending enactment of Division 10BA, the taxpayer and two other groups invested in the film. The monies were paid into a film production account and were immediately applied to reimburse the Corporation.

For the 1981 and 1982 income years, the taxpayer claimed a deduction under Division 10BA in respect of its investment. The Commissioner disallowed the deduction on the basis that the taxpayer's monies had not been spent on producing the film but had simply been applied to reimburse the Corporation. The taxpayer appealed to the Federal Court which found for the taxpayer. The Commissioner appealed unsuccessfully to the Full Court of the Federal Court.

Section 124ZAF(1)(a) of the Act makes reference to two different situations in which expenditure of capital monies may give rise to a deduction under that section. The first limb of paragraph (a) refers to monies expended in producing a film, while the second limb refers to expenditure by 'way of contribution to the cost of producing a film'. Section 124ZAA(6) defines 'money expended in

producing a film' to mean money expended 'directly' in the production of a film.

The Court's findings

The Full Court held that a narrow construction of the word 'directly' would unduly limit the range of legitimate commercial arrangements that may be entered into in the financing of film production. The Court found that the requirement that monies be expended 'directly' in production is no more than a requirement that there be a sufficiently close connection between the outlay and the production process.

The Court considered that the word 'directly' in section 124ZAA(6) will not necessarily exclude a payment made to some intermediary or agent who pays it to a producer who in turn applies it acquire to goods or services which are used in or comprise elements of the process of production. Nor, in the Court's view, would the term 'directly' exclude the payment of monies to a producer for the purpose of repayment of bridging finance borrowed and expended on such goods and services. The Court found, depending on the circumstances of the case, a payment made by a taxpayer to be applied by way of reimbursement of funds contributed by a government film body is similarly capable of constituting a direct expenditure.

Apportionment

It is practice in the film industry for investors' funds to be paid into a production account and then expended on the making of the film. The effect of section 124ZAH is to provide a facility for apportioning among investors contributing to a production account the benefit of production expenses according to their respective contributions, although the Commissioner is not bound to apportion on that basis.

The taxpayer's investment in *Faywin* was paid into a production account from which the Corporation was then reimbursed. The Court found that section 124ZAH assisted in the characterisation of an appropriate proportion of a taxpayer's contribution to a production account as money expended in producing a film and that the section avoids the need to engage in a tracing exercise.

The Court noted that sometimes monies

paid into the production account may be categorised as monies expended in producing the film and other payments may not. In this case, the monies may be subject to the apportionment authorised by section 124ZAH between contributors of production and non-production expenditure paid out of the account.

Summary

The Court held that the money contributed by the taxpayer, although paid into the production account, was intended to be applied and was applied to immediately reimburse the Corporation in part for its investment. In the circumstances, the relevant connection between the taxpayer's outlay and the cost of production was sufficiently close to answer the description of a direct expenditure within the first limb of section 124ZAF.

As to the second limb of section 124ZAF the Court found that an amount expended by way of contribution to the cost of producing a film is not deductible under Division 10BA except to the extent that it is 'expended in producing the film' within the meaning of section 124AG(1), which, by virtue of section 124ZAA(6) means 'expended directly in producing' the film. Again, the Court's views on the meaning of 'directly' and section 124ZAH referred to above was applied to the interpretation of the second limb.

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