owed by the customer. This would effectively cancel out the amount owed by the customer to the supplier.

The operation of either the put option or call option would effectively result in the capacity supply arrangement coming to an end, consistent with the commercial intention to allow for termination in the event of default. Given the values involved, the options should be drafted such that they can only be exercised following a significant and comprehensive dispute resolution process, similar to what would apply in connection with termination rights under a services agreement.

Conclusions

As seen from the examples in this article, the commercial requirements of parties to capacity supply arrangements typically do not match the strictures of a true IRU. The means of addressing this dichotomy will depend on the specific arrangement, as the commercial and other objectives will invariably differ in each case. Considerable legal ingenuity incorporating tax, accounting and other advice (as appropriate) is therefore often required to produce an agreement that is reflective of the commercial intent of the parties but which also complies with the requirements of the IRU and its inherent complexities. There are potentially significant benefits to be had by both the supplier and customer (such as tax and accounting effectiveness) where the parties manage to steer a successful collision of the various objectives underlying an IRU arrangement which often travel in different directions.

James Halliday is a Partner and Linh Tran an Associate at Baker & McKenzie in Sydney.

(Endnotes)

1 For example, Telstra and Alcatel-Lucent are currently constructing a Sydney-Hawaii cable; Pipe Networks has recently announced a second cable to New Zealand; and upgrades have recently been completed on the Australia-Japan Cable.

2 It may be possible to structure arrangements for the supply of capacity over other fixed transmission technologies, such as microwave and satellite, as IRUs. However, such 'IRUs' are unlikely to constitute IRUs for tax purposes.

3 The *Income Tax Assessment Act 1997* (Cth) defines an 'IRU' as 'an indefeasible right to use a telecommunications cable system' in section 995.1.

4 IRUs can in some cases also amount to 'finance leases' or 'sales type' leases for accounting purposes. A finance or sales lease is also regarded for accounting purposes as a capital asset. In some cases this can mean that the supplier is entitled to account for the entire upfront payment as revenue in the financial year in which it is received. This article does not examine the accounting treatment in detail of IRUs.

5 This is mitigated through the use of operations and maintenance agreements, described below.

6 For example, most capacity supply arrangements will, in practice, entail the supplier providing services (i.e. the supply of capacity) to the customer. Notwithstanding this, if the arrangement is to be characterised as an IRU, it must be drafted in a way that does not imply a services arrangement. At the most basic level, this means that the IRU agreement should not refer to the 'supply' or 'delivery' of capacity or services, or any words or obligations to that effect. Instead, these agreements typically refer to the 'grant of an IRU', implying a once-off, upfront provision of an asset (e.g. under a sale agreement), as opposed to an ongoing services arrangement.

The Producer Offset – A Shot in the Arm for Australian Film

Nick Abrahams and Victoria Dunn review available tax incentives designed to support the Australian screen media industry.

The recently introduced 40% producer offset for feature films has been a big success for at least one Australian production with Animal Logic's $100 Million *Guardians of Ga 'Hoole* receiving interim approval for the offset.

The *Tax Laws Amendment (2007 Measures No. 5) Act 2007* (Cth) amended the *Income Tax Assessment Act 1997* (Cth) (the ***Act***) by introducing three tax incentives to support the Australian screen media industry. Those incentives take the form of refundable tax offsets designed to encourage private sector investment in the Australian screen media industry. The three tax incentives are the producer offset, the location offset and the PDV (post, digital and visual effects) offset. The three offsets replaced the tax incentives for films available under Division 10BA of the *Income Tax Assessment Act 1936* (Cth). A company is entitled to only one of those offsets in relation to a film.

The producer offset is a considerable financial incentive available to producers of films, amounting to 40% of a company's qualifying Australian production expenditure for feature films and 20% of production expenditure for films which are not feature films. A feature film is a film of at least one hour in length that is screened as the main attraction in commercial cinemas.

Eligibility

A company is entitled to claim the producer offset in its tax return for an income year in respect of a film completed in that year if the company

- satisfies certain residency requirements; and
- holds a certificate for the producer offset for the film.

A company is not entitled to the producer offset if:

- the 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 *Income Tax Assessment Act 1936* (Cth);
- a final certificate for the film has been issued at any time under Division 10BA of Part III of the *Income Tax Assessment Act 1936* (Cth);
- a certificate for the location offset or PDV offset has been issued for the film at any time;
- the company or someone else has deducted money paid for shares in a film licensed investment company which 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 the Film Finance Corporation Australia Limited, Film Australia Limited, the Australian Film Commission or the Australian Film, Television and Radio School.

Key requirements for issue of a certificate for the producer offset

The Film Finance Corporation Australia Limited (***FFC***) is currently responsible for the issuing of certificates for the producer offset. However, the *Screen Australia and the National Film and Sound Archive (Consequential and Transitional Provisions) Act 2008* (Cth) enacted 20 March 2008 provided that this function of the FFC would be assumed by Screen Australia on 21 August 2008.

The key requirements for the issue of a certificate for the producer offset for a film are:

- the film has significant Australian content or has been made under an arrangement between the Commonwealth and a foreign country; and

- the total of the company's qualifying Australian production expenditure on the film is above the minimum set amount.

Significant Australian content

In determining whether a film has a significant Australian content, the FFC (or Screen Australia) must have regard to:

- 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;
- the details of the production expenditure incurred in respect of the film; and
- any other matters that the film authority considers to be relevant.

Further criteria apply for a film that is a series.

Qualifying Australian production expenditure

The producer offset is only available where the qualifying Australian production expenditure on a film is above a set minimum amount. The minimum amount varies with the format of the film. In respect of feature films the minimum expenditure threshold is $1 million.

A company's qualifying Australian production expenditure on a film is the company's production expenditure on the film to the extent to which it is incurred for, or is reasonably attributable to:

- goods and services 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.

It is the FFC's (or Screen Australia's) responsibility to determine a company's qualifying Australian production expenditure on a film for the purposes of the producer offset.

Subdivision 376-C of the Act sets out how a film's qualifying Australian production expenditure is to be calculated.

Other requirements for issue of a certificate for the producer offset

In addition to having significant Australian content and sufficient qualifying Australian production expenditure, the following requirement must also be met before a certificate for the producer offset can be issued:

- the applicant company must have either carried out, or made the arrangements for the carrying out of, all the activities that were necessary for the making of the film;
- the film was produced for exhibition or distribution to the public;
- the film is of a particular type, including a feature film, single-episode programme, series, season of a series or a short-form animation; and
- the film is not an advertising program or a commercial, a discussion program, a quiz program, a panel program, a variety program or a program of a like nature, a film of a public event (other than a documentary), a training film, a computer game, a news or current affairs program or a reality program (other than a documentary).

Refusal to issue a certificate for the producer's offset

If the FFC (or Screen Australia) refuses to issue a certificate for the producer offset for a film, it must give the applicant written notice of the decision, including reasons for the decision.

The notice must contain a statement to the effect that an application may be made to the Administrative Appeals Tribunal (the ***AAT***) by, or on behalf of, any entity whose interests are affected by the decision, for review of the decision.

The notice must also include a statement to the effect that an applicant may request a statement setting out the findings on material questions of fact, referring to the evidence or other material on which those findings were based and giving the reasons for the decision or determination.

However, a failure of the FFC (or Screen Australia) to comply with those requirements will not affect the validity of the decision.

Notices issued by the FFC are not available publicly.

Procedures for review of the FFC's (or Screen Australia's) decisions

The Act expressly provides for review by the AAT of a decision of the FFC (or Screen Australia) to refuse an application for a certificate for the producer offset.

At time of writing, the AAT has not yet considered any decision of the FFC in relation to the producer offset. Although the AAT has reviewed decisions in respect of certificates issued under the superseded Division 10BA incentives for films, those decision relate to the application of the certificates, rather than to the issue of a certificate itself. There is therefore little guidance as to the approach the AAT would take to the key concepts of significant Australian content and qualifying Australian production expenditure.

Conclusion

The producer offset has the potential to act as a significant incentive to companies to invest in the Australian screen media industry. It is hoped that Screen Australia's assumption of responsibility for issuing certificates for the producer offset in 2008 will bring with it increased guidance to companies as to how the requirements set out in the Act are applied.

Nick Abrahams is a Partner and Sydney Chairman and Victoria Dunn a Lawyer at Deacons in Sydney