

SUBMISSION BY
MEDIA, ENTERTAINMENT & ARTS ALLIANCE
TO
THE TREASURY
REGARDING
REFUNDABLE FILM TAX OFFSETS REVIEW
NOVEMBER 2008



The Media, Entertainment & Arts Alliance

The Media, Entertainment & Arts Alliance (Alliance) is the industrial and professional organisation representing the people who work in Australia's media and entertainment industries. Its membership includes journalists, artists, photographers, performers, symphony orchestra musicians and film, television and performing arts technicians.

The Media, Entertainment & Arts Alliance appreciates the opportunity to make a contribution to the review of the Refundable Film Tax Offsets.

The Alliance appreciates that the review is a legislatively triggered review in accordance with Division 376-275 of the Income Tax Assessment Act 1997 requiring “a review of the effect of this Division in relation to levels of production by the Australia independent production sector compared to levels of production by Australian television broadcasters” to be initiated before the end of twelve months after the commencement of the Division.

The review seeks comment on:

- whether television production has shifted from independent producers to in-house production by the commercial television broadcasters;
- the impact on negotiated licence fees since the introduction of the offset, and
- the impact of the location and post, digital and visual effects production offsets on levels of independent and in-house television broadcaster production.

Timing and data

While understanding that the review is legislatively required, the Alliance nonetheless considers that this review is being undertaken too soon following the introduction of the offsets.

There are three offsets, namely:

- the producer offset
- the location offset, and
- the post, digital and visual effects production (PDV) offset.

The producer offset is available to production in relation to Australian qualifying expenditure (QAPE) incurred on or after 1 July 2007.

The location offset at 15 per cent is available to productions commencing on or after 8 May 2007.

The PDV offset is available to productions commencing post-production, digital or visual effects production on or after 1 July 2007.

Data on production output for the period under review, the financial year 2007-2008 is not as yet available – Screen Australia’s National Production Survey for the financial year has yet to be released. Thus whilst data is available for the years prior to the implementation of the offsets, data is not as yet available for the period of operation of the offsets.

Further, given that the offsets are established within the Income Tax Assessment Act, data regarding the utilisation of the offsets is available only in the aggregate and there is no way of knowing how many of the provisional certificates issued for the producer offset are productions that are underway or have been completed during the period subject of the review or have yet to commence pre-production or indeed how many will ever proceed to production.

It is virtually impossible to analyse the results of a government initiative when one data set is not yet released and the other is opaque.

Compounding these two impediments is the fact that many of the contracts for television productions that have been financed with an expectation of utilising the producer offset are commercial in confidence or subject to non-disclosure provisions.

Anecdotal evidence that cannot be attributed indicates that there have been some examples of free to air commercial broadcasters requiring the producer offset to be sought and passed on, in part or in full, to the broadcaster. However, it is not possible to establish to what extent this is true nor what impact it might be having, including whether it is causing downward pressure on licence fees.

In any event, even were the data available for analysis, it is likely that twelve months of operation is an insufficient period of time to analyse more than first time experiences. Trends will only emerge after a longer period of implementation.

To that end the Alliance recommends that the operation of the offsets be monitored on an ongoing basis by Screen Australia and the Department of Environment Water Heritage and the Arts and a further review be conducted in say 18 months time.

In-house capacity

The discussion paper notes that the ABC has not undertaken any in-house drama in recent years, that SBS has no in-house capacity, that Network Ten has no in-house drama production capacity and the Nine Network has made only limited use of in-house capacity, asserting that only the Seven Network has maintained any significant level of in-house capacity.

This, however, does not mean to say that the ABC, SBS or Network Ten could not have in-house capacity. Rather it merely reflects the various broadcasters' current operational decisions. In-house capacity could easily be achieved if any of the broadcasters, especially the commercial broadcasters, chose to make a commercial decision to do so.

Operational issues concerning the producer offset

One serious problem has been identified concerning the operation of the producer offset. It serves to erode the benefit of the offset, trigger unnecessary expenditure on financing costs, increase production budgets and will cause cyclical employment and utilisation of film industry facilities, equipment and services.

Most Australian producers need to cashflow the producer offset. They are typically not able to raise 100 per cent of their production budget. The offset is sought following delivery. Consequently, they need to access a cash flow facility, be it a revolving film fund operated by a state film agency, or bridging finance available from only a handful of banks, mostly located overseas. Whatever mechanism producers are able to access to cash flow the offset comes at a cost. The longer the period before the funds are repaid, the higher the cost of the money. Axiomatically, the higher the cost of cash flowing the offset, the less beneficial it becomes to the producer. Importantly, it will also impact on the government's objective to build a sustainable industry comprised of sustainable businesses. The more the benefit of the offset is eroded, the less likely is the government to see their policy objectives realised.

Some productions are able to schedule in such a way as to take account of the timing of the end of the financial year and lodgement of tax returns. Most will seek whenever possible to do so. Some, for reasons such as needing to film at a certain time of year may not be able to do so. Others cannot. In any event, for those that can, bunching of production is likely to occur, leading to premium demand for personnel, facilities and equipment at the same time. By way of example, if productions are aiming to deliver at a point in time to minimise the cost of cashflowing the offset, most productions will be seeking mixing facilities at the same time.

That bunching is likely to occur can be seen in the operation of the Division 10BA in its first years when productions needed to be completed and delivered within one financial year to qualify for the deduction. When bunching occurs, competition for personnel and services and facilities is concentrated, leading to employment and facilities usage patterns becoming a series of troughs and peaks. Premium demand for limited film facilities will lead to increased costs during the peak periods to compensate for reduced income during the troughs. This will inevitably lead to pressure on production budgets, forcing budgets to necessarily be higher than might otherwise need to be the case with a flow-on effect to the offset itself. Additionally, when employment becomes seasonal, many committed to the industry leave as they are unable to survive over the longer term when work is available only at certain times of the year. The phenomenon of bunching was well demonstrated during the initial years of Division 10BA and could only be resolved legislatively.

In respect of the producer offset, the problem would obviously be alleviated if the Australian Tax Office (ATO) could allow for early assessments under Section 168 of the Income Tax Assessment Act

1936 where the company has no further taxable activity in Australia for the year of income in question. Alternatively, the ATO could allow eligible companies to apply for a Substituted Accounting Period.

The ATO has advised the Screen Producers Association of Australia (SPAA) that, whilst recognising the industry's concerns are "reasonable on commercial grounds", only the early assessment option is considered possible.

Whilst possible, the ATO has advised it is "not willing to exercise the relevant discretion at this point in time". The reasons cited for so doing are as follows:

- "The timing problem identified by industry is inherent in the design of Division 376 and government could have chosen to deal with the timing issue differently if so desired. Given the government chose to use the income tax system (with its inherent income year lodgement requirements) to deliver the incentive, it may be more appropriate that industry approach the government for a legislative fix. Relevantly, government costings are based on this annual income tax system and to bring assessments forward will affect government forecasts and revenues – the latter, for example, by loss of investment opportunity.
- "The administrative arrangements in place to ensure the integrity of the film offsets are still relatively new and may require further assurance and development in some areas.
- "There is a risk that if early assessments are allowed, some film producers may inappropriately distort the timing of the derivation of income and deductions so that can meet the requirement of having no further taxable activity in Australia for the relevant year of income.
- "Early assessments are ordinarily provided in circumstances where the entity is either physically or legally impeded from fulfilling their usual lodgement obligations – eg, individuals leaving Australia, death or company liquidation.
- "The regulatory regime relating to liquidation requires the rigour of an independent entity winding up the company and ensures no further taxable activity will occur in the income year following lodgement of the final return."¹

The Alliance is certain that it was not the government's objective to see the benefit of the offset eroded by financing costs.

If the ATO is unable or unwilling to expeditiously address the problem, it will require urgent legislative attention.

Finally, the Alliance considers that for the Producer Offset it is not appropriate that fees and wages paid to overseas personnel be eligible as Qualifying Australian Production Expenditure. The Producer Offset is designed as a mechanism to support Australian productions. In this way, it is distinguished from the Location Offset and the PDV Offset which are principally designed to attract offshore production to Australia.

¹ Letter to Bethwyn Serow, Screen Producers Association of Australia from Bruce Collins, Assistant Commissioner of Taxation, Australian Taxation Office, dated 19 November 2008, and circulated by the ATO to members of the ATO's Film Industry Partnership.