**THE PREMIUM MOVIE PARTNERSHIP –**
**SUBMISSION –**

# STATUTORY REVIEW OF THE FILM TAX OFFSET REGIME (DIVISION 376 INCOME TAX ASSESSMENT ACT 1997)

## A. STATUTORY REVIEW

The Premium Movie Partnership (**PMP**), trading as "Showtime", thanks the Rudd Government for the opportunity to make submissions to the Statutory Review of Division 376 of the Income Tax Assessment Act 1997 of the effect of this Division in relation to levels of production by the Australian independent production sector compared to levels of production by Australian television broadcasters.

## B. BACKGROUND – THE PREMIUM MOVIE PARTNERSHIP

The Premium Movie Partnership owns and operates the premium Subscription Television movie channels Showtime, Showtime 2, showcase, and Showtime Greats. The channels are distributed on the FOXTEL, AUSTAR, and OPTUS platforms. The channels are made up of new release and library feature films, original tv drama series' and theatrical documentaries, as well as locally produced news and review programmes. The PMP channels have a reach of over 2 million viewers each week.

PMP was established in 1995 and is an Australian registered partnership with its head office located at The Entertainment Quarter in Sydney. PMP is jointly owned by 20th Century Fox, NBC Universal, Paramount Pictures, Sony Pictures and Liberty Media.

## BACKGROUND – PMP'S CONTRIBUTION TO THE AUSTRALIAN FEATURE FILM & TV DRAMA INDUSTRY

Since inception in 1995, PMP has played a significant role in the investment in, and development of, Australian film. Since 1995, PMP has been the largest consistent private supporter of the Australian feature film industry. PMP is now establishing a significant and unique presence in the commissioning of high-end Australian television series drama.

To date, PMP has contributed in excess of A$60 million towards the Australian feature film and tv industry by way of equity investment, cashflowed pre-license fees, and licensing. PMP's first investment in Australian films was **The Boys** in 1998. Since then PMP has invested in, and supported into production, over 90 Australian feature films and four tv drama series. The total investment to 30 June 2008 is A$43.3 million.

The overwhelming majority of PMP's support has been directed to the independent production sector, and has contributed to the steady flow of feature film, and now tv drama, product crucial to the commercial viability and cultural vibrancy of the local industry.

## BACKGROUND – PMP's EXPANSION INTO ORIGINAL COMMISSION TV DRAMA

PMP has expanded its production investment and pre-licensing activities into original commission high-end tv drama series.

PMP commissioned the third season of **Love My Way** – 8 by 1 hour episodes with a budget of A$[confidential] million (100% funded by PMP and AUSTAR), and licensed Seasons 1 and 2. PMP has also commissioned (and 100% funded) the original tv series titled **Satisfaction** (10 by 1 hour drama series) with a budget of approximately

A$[confidential] million, and **Satisfaction (Series 2)** (10 by 1 hour drama series) with a production budget of A$[confidential] million (100% funded by PMP). PMP has also recently commissioned the new drama entitled **Tangle** from Southern Star/John Edwards (the makers of The Secret Life of Us and Love My Way) with a production budget of A$[confidential] million (near 100% funded by PMP and AUSTAR).

All of these programmes have attracted significant domestic attention and viewer acclaim; and substantial international interest – realised in terms of commercial activity and audience numbers.

PMP's productions have been, and will continue to be, high-end in terms of budget, production values and concept. This is an ongoing commitment on PMP's part.

## C. GENERAL SUBMISSION ON REQUESTED ISSUES

PMP acknowledges that the offsets are designed to support and develop the Australian screen media industry by providing concessional tax treatment for Australian expenditure. PMP also acknowledges the stated specific concerns of the independent television production sector, as stated in the issues paper, in relation to the film tax offsets package.

PMP submits that:

- while PMP is unable to comment on whether television production has shifted from independent producers to in-house production by the commercial television broadcasters, PMP's direct experience is that 100% of the film and tv drama productions that PMP has been directly involved with that have utilised the producer offset have been produced by the independent production sector;

- there is no difference in the manner that producers and PMP as a broadcaster have set and/or negotiated license fees since the introduction of the tax offsets;

- any evaluation of the effect of the producer offset would benefit from a consideration of the broader issues involved in the complex process of production financing.

## D. SPECIFIC SUBMISSIONS ON REQUESTED ISSUES

### QUANTITATIVE DATA ON PRODUCTION LEVELS AND WHETHER THERE HAS BEEN A SHIFT TO IN-HOUSE PRODUCTION

PMP's direct experience

It is not PMP's experience that there has been a shift to in-house production since the introduction of the producer offset. This applies in relation to both feature films and tv series drama.

All of the projects that PMP has been directly involved in (by way of commissioning; equity investment; pre-licensing) have been produced by the independent production sector.

All *tv drama series'* that PMP is involved with and that have or plan to access the producer offset are being produced by independent producers. These include (title and producer) the following:

- **Satisfaction (Series 2)** – Roger Simpson, Andy Walker
- **Tangle** – John Edwards / Southern Star Entertainment Pty Limited.

All *feature films* that PMP is involved with and that have or plan to access the producer offset are being produced by independent producers. These include (title and producer) the following:

- **Balibo** – John Maynard
- **My Year Without Sex** – Bridget Ikin
- **Beautiful Kate** – Bryan Brown, Leah Churchill Brown
- **Charlie & Boots** – Dean Murphy, Shana Levine, David Redmond
- **Animal Kingdom** – Liz Watts

Third party activity

PMP is not aware, nor has any evidence to support a proposition, that television production has shifted from independent producers to in-house production by the commercial television broadcasters.

## HOW PRODUCERS AND BROADCASTERS HAVE SET AND/OR NEGOTIATED LICENSE FEES SINCE THE INTRODUCTION OF THE TAX OFFSETS

In PMP's direct experience, the producer offset has had no impact on license fee structures (including how license fees have been set and/or negotiated). This applies to both feature films and tv series drama productions.

PMP submits that license fees, as with any other element of the funding matrix, continue to be negotiated on a project-by-project basis.

It is PMP's experience that copyright ownership, fee entitlements and revenue splits – as well as other factors such as recoupment structures – remain as matters that are highly relevant to the issue of feature film and tv series drama production financing and exploitation.

## E. SPECIFIC SUBMISSIONS ON OTHER ISSUES RAISED

### THE REGULATORY ENVIRONMENT

PMP notes the Australian Content Standard (applicable to all commercial open television licensees) and the New Eligible Drama Expenditure Requirement (applicable to subscription television licensees) and the stated intention to encourage greater independent production.

PMP's submits that, while the different schemes are designed to achieve different policy objectives, their net effect is to generate irrational economic behaviour (with respect to matters that include windowing, license fees and financing structures).

### LOCAL TELEVISION TRENDS

PMP notes the statement that local television drama producers are facing similar funding stresses to the feature film sector through increasing production budgets, fluctuating levels of private investment and the contraction of the international marketplace. PMP submits that, in PMP's experience, the difficulty is primarily in the area of sourcing and structuring finance (given the various regulatory regimes and divergent policy requirements).

### UPTAKE OF PRODUCER OFFSET

PMP notes that the uptake described and submits that the scheme, and structural requirements indicated by the relevant film authority (Screen Australia), will not necessarily deliver the desired outcome of providing an environment for the expansion of the industry.

## F. FURTHER SUBMISSIONS ON RELATED ISSUES

PMP understands that one of the stated aims of the producer offset is to build a more sustainable film and television industry and to grow levels of Australian production. This, in part, would be achieved by giving the producer the ability to attain a greater level of participation by being able to bring the benefit of the offset to a potential production (and translating this into copyright ownership and participation in the revenue sharing from exploitation).

It is PMP's submission that too narrow a focus on just license fees structures and whether a project is produced by independent producers will not necessarily achieve the stated aims of the producer offset. If considered, they should be in the context of the whole funding matrix.

It is PMP's further submission that the review would benefit from a consideration of the following areas:

- the anomalous treatment of film and television in the level of the offset (40% versus 20%);
- the manner in which Screen Australia proposes to fund feature film and television series drama development and production;
- the outmoded distinction between the treatment of drama for the purposes of the Australian Content Standard and the New Eligible Australian Drama Expenditure Requirement;
- recoupment structures;
- the loss of 10B and 10BA of the ITAA;

all of which, PMP submits, have or will add to the difficulties being faced by the Australian industry.

<u>Value of tv series drama to feature films</u>

PMP accepts the cultural imperative of feature films. PMP submits that the relative commercial and audience success of the tv drama sector, and its ability to provide a consistency of employment and skills acquisition, will itself drive and provide a stronger and deeper economic and creative base from which feature film producers may draw – and in turn contribute to a more successful feature film sector.

<u>Development and Production Financing</u>

The process of sourcing and cashflowing development and production financing is complex and increasingly difficult. PMP submits that these challenges are best met by remaining flexible with respect to the models that are applied to any given production – rather than requiring an adherence to an imposed or supposed "standard" deal structure.

Further, PMP submits that it should not matter how the dollars flow into any given development and production budget (whether equity, license fee, presale/advance). These are commercial decisions made on a project-by-project basis. All are funds that are required for the development and production process. Any distinction sought to be drawn on the basis of license fees is significantly eroded when all funds are used for the development and production process.

Disparity in the level of the offset

The different levels of the producer offset available to producers between film (40%) and television drama (20%) disadvantage the tv series drama sector in its ability to attract financing and expand its range of activities.

It seems illogical that producers of tv series drama should only be entitled to a producer offset of 20% compared to producers of feature films who are entitled to receive a 40% offset.

PMP submits that the level of the producer offset for television be made equal to the level for the film sector. Alternatively, any disparity in the quantum of the producer offset should be met through direct funding from government.

Proposed Screen Australia funding model

PMP makes reference to the Screen Australia Draft Program Guidelines (January to June 2009) ("Guidelines").

The disparity in the treatment of feature films and tv series drama under the Guidelines will not assist in the creation and expansion of a stronger and more vibrant tv series drama sector – nor, PMP submits in turn, a more vibrant and successful feature film sector.

As both an investor in and user of both feature films and tv series drama, PMP has a very strong interest in seeing the advancement of both the feature film and tv series drama sectors.

Screen Australia appears to have adopted the position that it will not contribute to the funding of development of tv series drama.

PMP does not accept, nor understand the underlying rationale for, the disparity between the contribution cap (which combines the producer offset and Screen Australia investment) of:

- 75% for feature film; and

- 40% for tv series drama (defined “adult mini-series”).

Further, PMP comments that if the aim is to create a stronger industry then there is no reasonable commercial rationale for the producer offset and the Screen Australia investment being grouped for the purpose of Screen Australia determining a cap. While both are Government funding (one direct; the other indirect) they should operate independently – otherwise it remains “just Government money” with the two unable to operate in separate realms and therefore attract non-Government funding. This, in turn, further compounds the position of private equity that has lost the ability to access the former 10B and 10BA ITAA tax provisions.

<u>The disparity in the rules that apply to Open Broadcast TV licensees and Subscription TV licensees</u>

PMP submits that any investigation into license fee structures must take into account the difference in the economics of Subscription TV (or Pay TV) and Open Broadcast TV (or FTA) where the licensing models and assumptions are fundamentally different. The importance of this necessary distinction is emphasised in the context of the distortion of the market that is created by the two competing regulatory requirements imposed on Subscription TV and Open Broadcast TV.

In brief, the current regime requires that a tv drama series program run first on Open Broadcast TV and then second on Subscription TV (in order that it may satisfy both the Open Broadcast TV Australian quota obligation that includes Australian drama, and, the Subscription TV new eligible Australian drama expenditure rules). In order for Subscription TV to “deal with” this artificial distinction and consequent distortion of rational economic behaviour and rational windowing patterns, Subscription TV may chose (or, necessarily, be forced) to finance tv series drama productions in a way that does not fit the artificial and inappropriate model contemplated by the Screen Australia Guidelines.

PMP further submits that, as a corollary, this distorting effect impacts on the financing models that may be negotiated and agreed with respect to tv series drama that are commissioned by Subscription TV (and Open Broadcast TV).

<u>Funding and Recoupment structures and the producer offset</u>

PMP submits that the review should also take into account how the producer offset itself is financed.

The producer offset is not paid until after the relevant production has been completed and audited. Prior to this point, the producer has to be able to trade or cashflow the anticipated value of the producer offset. One way that a producer is able to do this is in the form of a cashflow loan against the payment of the producer offset in the future. Any loan comes with a cost of finance – which detracts from the value of the offset in the producer’s hands. Alternative funding models provide for one or other of the financiers to cashflow the loan – with no cost of finance, thus preserving the full amount of the value of the offset in the producer's hands.

PMP further submits that the manner of recoupment should also be a relevant consideration in the assessment of the application of the producer offset. One financing model might provide that the producer offset, when paid, is a quarantined stream of money which is preserved solely for the benefit of repaying any cashflow loan against the producer offset. This should be balanced against what, if any, was the cost of money to the particular producer. Consideration should also be given to whether a quarantined stream results in an inequality in recoupment by the other parties that have contributed to the financing of the production (with the latter only recouping from gross receipts). Also consider a model where one of the investors cashflows 100% of the value of the producer offset loan – and then seeks repayment from the quarantined stream. An alternative funding model, especially in the form of a zero cost cashflow loan against the producer offset provided by one or other of the other financiers, could see the producer offset payment made into gross receipts and therefore flowing to all that have contributed finance to the production.

The various model raised above are not intended as an exhaustive list of possible scenarios, PMP submits, but merely illustrate the multitude of factors that are balanced in any commercial decision on financing.

<u>Benefits to the producer</u>

PMP submits that it should be open to the producer, as one of the parties contributing to the production process, to negotiate their preferred position based on the strength of the factors they bring to the project. These factors will include their credentials, creative and managerial skills, third party finance that they have attached – as well as the value of the producer offset. The producer is entitled to negotiate the manner in which they take their returns including by way of line item fees, creative royalties, bonuses, revenue splits – as well as license fees.

These factors are also relevant considerations with respect to the level of copyright required and held by the producer.

<u>The loss of 10B and 10BA ITAA</u>

PMP submits that the above factors, when considered in the context of the loss of 10B and 10BA ITAA, make it increasingly difficult to attract private sector equity investment to feature film and tv series drama.

<u>Financing models – general</u>

PMP's submission is that financing models need to be flexible and take into account all factors (some of which are set out above) that are relevant to the funding matrix.

PMP further submits that flexible funding models, that are able to evolve, are best able to enable producers and commissioning parties to work with the finance community in a way that would ensure the involvement of various sources of funding. PMP's submission is that, if able to work with producers on terms that reflect current and evolving industry practice, and in-turn attract private equity, a larger pool of money may be created from which to finance feature films and tv series drama. Such would create a financing environment that would enable more production. Any scheme that forces the application of rigid or arbitrary principles will keep production financing locked-up in small isolated pockets of money and will not allow for existing levels of production to be maintained or increased.