



4 December 2008

**SPAA SUBMISSION TO REFUNDABLE TAX OFFSETS -
STATUTORY REVIEW OF DIVISION 376 IN RELATION TO
CERTAIN PRODUCTION LEVELS**

1. Introduction

SPAA welcomes the opportunity to make a submission to the statutory review of Refundable Tax Offsets as legislated in Division 376 of the Income Tax Assessment Act 1997.

SPAA recognises that the scope of this review is restricted to comments on the impact of the Offsets on: the levels of production, the balance between independent and network in-house production, and license fees.

2. Public Policy

SPAA has worked closely with Government in the development of the Offset provisions, and has had meaningful input into the legislative process. There is therefore much that SPAA can commend in the legislation.

However, SPAA would like to restate its position that allowing the television broadcasters and pay television operators to access the Producer Offset (PO) is an error in public policy. The policy intent of the legislation was to stimulate growth in the independent production industry by allowing producers to retain substantial equity in their productions and build stable and sustainable production companies; and increase private investment into the Australian film and television production sector.¹

¹ In the Ministerial media release of May 8, 2007 Senator Coonan said, "A new Producer Rebate will replace the 10BA and 10B schemes and allow producers the capacity to offer significant returns to investors for productions with wide audience appeal." Minister for the Arts and Sport, Senator Brandis said, "It provides a real opportunity for producers to retain substantial equity in their productions and build stable and sustainable production companies, and should therefore increase private investor interest in the industry."

Australia's television networks and pay television operators principal business is exhibition and transmission. They are mandated to broadcast and transmit across the public free-to-air spectrum and through publicly licenced subscription television services. They are not mandated to produce programs. They acquire the rights to broadcast and transmit programming and while they engage in some production, it is not the primary focus of their business.

One of the government's aims for the PO is to increase production in the industry. Increasing production is not really the focus of network television and there is little evidence so far that the networks are utilising the PO with a view to increasing the level of production in Australia (see the data below). Using 2006/07 as the base year (the industry was generally aware that the PO was to be introduced at this point) the number of long form series dramas has reduced by two but in-house production has increased by 50%.

Source: National Survey of Feature Film and TV Drama Production 2007/08

	NO. (IN-HOUSE)	HOURS	TOTAL BUDGET \$M	SPEND IN AUST. \$M	AV. COST/HR \$M
AUSTRALIAN PROGRAMS					
2003/04	16 (3)	456	106	106	0.233
2004/05	14 (4)	502	119	119	0.238
2005/06	14 (2)	389	87	87	0.223
2006/07	20 (3)	436	131	131	0.299
2007/08	18 (4)	465	135	134	0.291
5-yr av.	16 (3)	450	116	115	0.257

It should be remembered that television networks are currently prohibited from applying for funding from Screen Australia (SA). The policy intent of SA funds is for the support of the independent production industry. When the federal government announced its Screen Production Incentive in the May 2007 budget (which the PO is a part of), it flagged that if the PO became successful over time, direct subsidy appropriations to Screen Australia might be reduced. Indeed the combined Screen Australia funding envelope is scheduled to be reduced by \$10 million next financial year. In other words the federal government views the PO as a funding mechanism in conjunction with

SA's investment funds. It follows that if the broadcasters are able to access the PO then it will be at the expense of the independent producers and it will be defacto taxpayer funding of the television networks. This is a major policy flaw in the federal government's Screen Production Incentive.

Australia's television networks enjoy a privileged position and are protected from open market competition by exclusive access to public spectrum in the form of a license from the taxpayer. In the fifty years of Australian television this license has provided the license holders with exceptionally consistent profits and a position of considerable cultural and commercial power in Australian society. In return for the license the commercial broadcasters and now the subscription operators are obligated to broadcast original Australian content. If they are allowed to dip into the PO their obligation can only be diluted.

Australia's commercial television networks and subscription service operators are businesses with enormous operating cash flows. The high level of liquidity allows them to be able to cash flow tax offsets without resorting to the high money market costs faced by the much smaller enterprises of independent producers. This is a major distortion in the current operation of Division 376. By virtue of their capitalisation and revenue streams through advertising, the commercial networks can realise the full 20% benefit of the rebate i.e. they can cashflow without borrowing, need not bond the program and can amortise the legal and financing costs across other business activities. By contrast, because the costs of borrowings are ineligible for QAPE, as are the costs of bonding (always required to secure the borrowings) and legal costs, the net value of the PO to an independent producer is more like 13%. As a consequence, already established businesses with scale i.e. broadcasters, achieve a 35% premium on the PO over smaller businesses.

In view of the already overwhelming market power of the Nine, Seven, and Ten networks and Foxtel over independent producers, it is hard to justify additional taxpayer subsidy. Additionally, any subsidy which increases network in-house production at the expense of independent production can only limit cultural diversity and impoverish the richness and quality of our culture. Many of the most iconic programmes in Australian television history, from *Homicide* to *Underbelly* and almost all of the landmark documentaries from the Oscar nominated *Frontline* to *Rats in the Ranks* have been originated and produced by the independent sector not the television networks.

Commercial broadcasters are responsible to their shareholders and are necessarily profit driven. It follows that network management will seek to minimise costs and increase margins wherever possible. This includes taking advantage of public policy measures not specifically designed to benefit them. By way of example, broadcasters have claimed New Zealand programs as Australian content quota points, an unintended policy consequence of the CER between Australia and New Zealand.

The commercial free-to-air broadcasters have an obligation under the Broadcasting Services Act 1992 to screen minimum levels of first release Australian adults and children's drama and documentary each calendar year. This is a requirement of their licence. The Pay TV operators, Foxtel and Austar, have a similar obligation based on overall program expenditure rather than minimum hours. An unintended consequence of the PO legislation is that the broadcaster's licence obligations can be reduced either by developing more in-house production, reducing licence fees for independent production or by requiring that the independent producer treat the PO as program revenue returned to the broadcaster or Pay TV operator.

SPAA believes that allowing television broadcasters and pay television operators either direct or indirect access to the PO is poor public policy and will not deliver the outcomes the policy was designed for. Moreover, it is contrary to the objects of the Broadcasting Services Act 1992.

3. Impediments to Offset take-up

While SPAA welcomes the government's commitment to reviewing the Offset, we contend that 12 months is not a long enough timeframe for evaluation. Screen Australia also believe the time frame is too short and expect that figures released in this years national Drama Production Survey will become the benchmark for measurement in future years.² At the time of writing only 13 final certificates have been issued totalling \$23.97 million in Qualifying Australian Production Expenditure with a tax offset value of \$5.4 million.³ However the most significant reason for the slow take-up is that the Offset is not yet

² One of the aims of the incentive is to increase production levels; however, it is too early to expect such an impact to be evident in this year's survey, particularly in the case of the Producer Offset, where operational guidelines were not introduced until late 2007. Screen Australia. National Survey of Film & TV Production 2007-08.

³ Screen Australia, December 4, 2008.

functioning properly as it is being restrained by some critical issues such as the significant interest costs as a result of end of financial year tax acquittal and the difficulty of borrowing finance in the current volatile credit market to cashflow the Offset.

SPAA believes that as a matter of urgency to ensure the PO delivers on its policy intention, the government explore a mechanism for the return of the PO to the producer in a timely manner following the issue of a final certificate. The Australian Tax Office has ruled that it is currently not willing to exercise its discretion to accept early assessments and recommends the industry approach government for a legislative fix.⁴ SPAA estimates that producers of an average budget Australian film that completes in July and must wait 11 months for assessment could face interest costs of up to \$250,000.

The high cost of money will lead to a practice of 'bunching' in the industry where producers will attempt to time their productions to deliver at the same time in order to minimise interest costs. This practice occurred during the early years of Division 10BA and had negative consequences for the industry as the demand for personnel and services also became bunched leading to a feast and famine employment cycle.

It is becoming increasingly difficult to borrow money at reasonable rates in the current financial crisis. Producers have been quoted interest rates as high as 15% from financial institutions with considerable fees on top. Further, many financial institutions are still not prepared to lend against the PO. SPAA recommends that the government resource Screen Australia to cash flow the PO, at least until the credit market regains some stability.

The combined result of the current tax acquittal regime and the high cost of money means that a great deal of the benefit of the PO is going to financial institutions and not to the growth of the producer's business as originally intended. SPAA urges the government to address both the tax acquittal and cashflow issues to ensure that the PO is taken up by the industry and delivers the stated outcomes.

The slow take-up is particularly evident in documentaries. So many Australian documentary productions are produced in an international context, in both content and finance. Our independent documentary

⁴ See Attachment 1. Letter to Ms Serow at SPAA from Bruce Collins, Assistant Commissioner of Taxation.

industry is world class having attracted several academy award nominations over the years. Yet SPAA producers are reporting that with the QAPE restrictions on international costs and archive acquisition and the high cost of both administering the PO and borrowing money, any benefit from the 20% Offset is negligible. SPAA documentary producers believe the Offset should be increased to 30% for documentary to see the kind of industry growth that the policy is intended to deliver. As documentary budgets are modest, Cost To Revenue implications for the federal government of a 10% increase would be extremely minimal.

SPAA will submit to government a separate paper on this issue and other PO related problems in the new year.

4. Impact of Offset on Trade Practices

In relation to the questions of the impact of the PO on trade practices between the networks and independent producers SPAA intends to comment only in broad terms. Many of the contractual terms and negotiations are of course confidential between the parties. However SPAA urges the government to accept the principle that allowing the broadcasters access to the PO is bad public policy regardless of the amount of quantitative evidence that might be received.

The government must understand that many producers will be reluctant to provide evidence in fear of being commercially penalised. It is after all a market in which the networks hold all the power. The network's financial viability is not really dependent on Australian independent programming and the options for independent producers to take their programs elsewhere are very limited.

4.1 License Fees

SPAA can report that approaches have been made from some broadcasters to some producers seeking to lower license fees citing the reduced equity cost base for the producer (as a result of the Offset) as reason enough. In this approach, the benefit of the PO could be seen to be shared between producer and network. This is not in the spirit of the legislation. As previously submitted, given the market power exerted by the broadcasters, independent producers find the networks requests extremely hard to resist.

SPAA is able to report that a public broadcaster has in program negotiations openly demanded that that the producer surrender the

value of the PO to the network. The broadcaster was proposing both to take an equity stake and to acquire the license to broadcast. Initially the network proposed a 20% drop in the license fee. When the producer objected, the network then requested that the value of the Offset be returned to the network as revenue, which the producer also objected to. Finally the network proposed to reduce their equity position and the overall budget by the value of the Offset. In any evaluation, this is clearly contrary to the spirit of the legislation.

The viability of the independent sector is dependent on the maintenance of established floor price levels for commissioned programs. If the Producer Offset becomes a bargaining chip it does open the door to destabilising license fees. This could be damaging in the future if the Offset is discontinued.

4.2 Network Appropriation of the Offset Rebate

SPAA can report that approaches have been made from some broadcasters to some producers seeking equity participation in addition to providing a license fee and then seeking to characterise the rebate as revenue and participate in this revenue stream.

By allowing the broadcasters access to the PO, the networks not set up for in-house production are in a position to observe the cost savings enjoyed by the Seven Network and feel entitled to share in the same spoils. The Seven Network is now effectively able to reduce its drama programming cost by up to 20% on its eligible programming. In the famously hothouse world of inter-channel competition this has the potential to become an incentive for the other networks to try and gain similar benefit from the PO.

Any attempt by a network to claim a share of the rebate as revenue is contrary to the objective of the legislation to help build sustainable independent businesses.

4.3 Subscription Television

SPAA can report that some Pay TV operators have taken an interest in the PO and that it has been discussed in license fee negotiations. Pay TV operators have a statutory obligation to acquire original Australian programming based on a percentage of their expenditure on overall program acquisition. Any equity participation in an eligible PO project would allow a Pay TV operator to claim all of the value of that equity position as part of their regulatory obligation. However if the Pay TV

operator also claimed their share of the rebate, it could result in a net lower original spend on original programming than required prior to the PO. If this were to transpire, the PO would undermine the integrity of the subscription television drama expenditure scheme of the Broadcasting Services Act 1992.

5. In-house Production

Since the PO was announced in the May 2007 budget in-house production has increased in Australian television networks. The Seven Network has increased their series production by 100%. Prior to the PO, the Seven Network produced *Home and Away* and *All Saints* in-house and commissioned adult drama series from the independent sector including *Blue Heelers* and *Last Man Standing*. Since the PO was first suggested, they have produced *Packed to the Rafters* and *City Homicide*, both in-house.

The Nine Network has regularly commissioned adult drama from the independent sector for many years. Since the PO was introduced, the Nine Network has produced *Canal Road*, a \$10 million series, in-house.

It is clear from discussions with the SPAA membership that the PO has been raised and discussed in contract discussions for new projects with the commercial television broadcasters and pay television operators.

The ABC have signalled a policy direction away from in-house production and indicated that they will be commissioning drama programs from the independent sector.

SBS commission all their drama programs from the independent sector. SPAA producers working on SBS commissions have indicated that SBS are now reducing licence fees for programs where the independent producer is accessing the Producer Offset.

SPAA contends that it is too early to properly evaluate the issue of in-house production and that more than 12 months will be needed.⁵ However a pattern is emerging in relation to negative broadcaster conduct surrounding the PO. The PO take-up is still very formative with only thirteen final certificates issued at the time of writing. A

⁵ Figures released by Screen Australia in the National Survey of Film & TV Production 2007-08 show that: For television drama, the Offset accounted for an estimated \$9 million in the finance plans of 11 programs – 10 local titles and one co-production. For the feature film, the Offset accounted for an estimated \$19 million in the finance plans of 11 projects – eight local titles and three co-productions

wider take-up has been impeded by the difficulties involved in financing.

RECOMMENDATIONS

1. SPAA recommends the federal government alter the legislation to expressly prevent Australia's major television networks and subscription service operators from claiming the PO as it is contrary to the spirit of the legislation and will not deliver the intended policy outcomes.
2. SPAA recommends the federal government strengthen the current legislation to expressly forbid broadcasters and Pay TV operators from claiming the benefits of the PO through discounting of program licence fees or by requiring the independent producer treat their PO as gross receipts back to the network.
3. SPAA recommends the federal government alter the legislation to enable tax acquittal of projects with a final certificate in the most timely manner.
4. SPAA recommends the federal government resource Screen Australia to cashflow the PO.
5. SPAA recommends the federal government commission a further wide-ranging review of the PO in 18 months time.