

Screen Producers Association of Australian (SPAA)
Submission to the Inquiry into the provisions of the
Tax Laws Amendment (2007 Measures No. 5) Bill 2007



SPAA

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Dear Senators,

**Re: Inquiry into the provisions of the Tax Laws Amendment
(2007 Measures No. 5) Bill 2007**

This is an omnibus bill containing 12 schedules. The Screen Producers Association of Australia (SPAA) submission is confined to **Chapter 10** which relates to the film production offsets and the impact of the legislation relating to the Producer Offset on the Australian film and television production sector.

SPAA has made recommendations on a number of technical issues which go to the operation of the legislation. However, there is a major issue that impacts across both film production and television documentary and drama production (both adult and children's, animation and live action) that if not addressed will compromise the Government's stated objectives with regard to the intent of the entire screen media package.

SPAA

SPAA is the industry body that represents Australian independent film and television producers on all issues affecting the business and creative aspects of screen production.

SPAA members include television, feature film, animation, documentary, TV commercials and interactive media production companies as well as services and facilities providers such as digital effects and post-production, finance, distribution, casting agencies, law firms and other service based companies.

SPAA is a not-for-profit association, funded from producer member levies and fees.

SPAA's standard definition of Independent Producer for the purposes of this paper is

"A program producer shall be classified as "independent" unless the producer or a related company holds or controls either, a broadcast or subscription licence under the Broadcasting Services Act, or is a program supplier as defined in the Broadcasting Service Act. In respect of feature film production, "independent" means independent of a associated distribution and/or exhibition company."

Chapter 10 of the Tax Laws Amendment (2007 Measures No. 5) Bill 2007

Policy Intent

The explanatory memorandum for Tax Laws Amendment (2007 Measures No 5) Bill 2007 states on page 184:

'The introduction of the Producer Offset represents a major new support mechanism for film producers and will assist the industry to be more competitive and responsive to audiences.'

page 189 section 10.9: *'The Offsets are designed to support and develop the Australian screen media industry by providing concessional tax treatment for expenditure.'*

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. SPAA particularly welcomed the Government's stated objectives in its 2007 Federal Budget announcement that the intent of the Producer Offset was to grow the sustainability of production companies (and hence, we submit, diversity), and increase private investment into the Australian film and television production sector.

However, the legislation currently drafted has an unintended consequence, which if unaddressed, will have the opposite impact to that intended and reduce the potential for industry growth in an internationally competitive production industry. There is an inherent contradiction in the notion of broadcaster access to the Producer Offset (tax rebate) in order to fulfil their core public service obligations under the terms of their Broadcast Licences.

The issues

Eligibility for the Producer Offset in Schedule 10, item 1, subsection 376-55(1) of the ITAA 1997, together with subsection 376-55 (4)

currently allows full access to the offset by commercial free-to-air broadcasters and Pay TV operators.

Under this regime, networks are encouraged to produce their content quota programs in-house so as to maximise their rebate eligibility. Currently, with the exception of the Seven Network, 80% of Australian documentary, children's programming and adult drama is outsourced to the independent sector.

Access to the Producer Offset will see Broadcasters obtaining a public subsidy of at least 20% (and in some cases as high as 40%) by taking production of their qualifying programs in-house. This will rebate and discount the cost to commercial free-to-air broadcasters and Pay TV operators (at taxpayers expense) of meeting their legislative requirements to produce Australian screen content. The effect of this one aspect of the legislation will be to diminish, rather than "support and develop", the Australian independent production industry.

There are two pieces of legislation which evidence Government policy in relation to Australian film concessions, being:

1. The Broadcasting Services Act 1992 ("Broadcasting Act");
and
2. Division 376 included in the Tax Laws Amendment (2007 Measures No. 5) Bill 2007

1. The Broadcasting Services Act 1992 ("Broadcasting Act");

- The Broadcasting Services Act 1992 requires a minimum level of commitment to the local industry for both commercial free-to-air and pay TV broadcasters (collectively referred to as "**broadcasters**") in order that these bodies be granted (or continue to be granted) the right to hold a broadcasting licence.
- In relation to commercial free-to-air broadcasters, the Broadcasting Services (Australian Content) Standard 2005 ("ACS") states there must be a minimum level of Australian programming broadcast by commercial television broadcasting licensees between 6am and midnight, pursuant to section 122(1) of the Broadcasting Act (the Transmission Quota).
- Sub-quotas for first release Australian drama, documentary and children's programming subsist

within the overall Transmission Quota.

- The drama quotas are regulated through an annual and triennial drama score system. The drama score for an Australian drama program is calculated using a complex formula involving both the duration and format of the program. Acquisition and transmission of local feature films are included in the drama quota.
- Documentary and children's programming sub-quotas are based on a number of transmission hours per year.
- With regard to Pay TV, the Australian Communications and Media Authority ("ACMA") requires that Pay TV drama channels spend at least 10% of their total program expenditure on new eligible (Australian and New Zealand) drama programs.
- Whilst the quotas differ between commercial free-to-air and pay TV broadcasters, the Government expects that entities granted broadcasting licences will make the required minimum level contribution to local production, which will be funded from the profits those entities make from exploiting their relevant licences i.e advertising revenues.
- It is clear that the policy intent behind the Broadcasting Services Act is to encourage qualifying entities to produce Australian films, such as feature films, mini-series, documentaries, television drama and television series.

2. Division 376

- SPAA notes with concern that there are no provisions in Division 376 to exclude broadcasters from claiming the Producer or Location Offset (the "**tax offsets**").
- If Broadcasters (free-to-air and Pay TV) were entitled to receive a tax offset for expenditure on programs required to meet their required Australian programming quota level, this would be inconsistent with the policy objectives of the Broadcasting Services Act. Broadcasters have an obligation to local programming in respect of their licence. SPAA asks the fundamental question, why should public funds in the form of the Producer Offset be extended to Broadcasters (free-to-

air and Pay TV) in order to meet their core obligations under the Broadcasting Services Act? This is effectively awarding them a discount for meeting a licence condition.

Some Facts about Broadcasters and Independent Producers

- The commercial networks are a protected oligopoly, and as a result are the most profitable networks in the world.
- 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.
- Broadcasters can be producers but producers cannot be broadcasters.
- Australian independent television is the engine room of the Australian film and television industry, where writers, directors, producers, actors and crew can hone their craft. There is constant cross-over between television, feature film and documentary production.
- Many of the best-loved programs on Australian television are made by independent producers across a range of adult drama, children's programs and documentaries.
- Australians who are now global household names – Nicole Kidman, Heath Ledger, Hugh Jackman, Rachel Griffiths, Toni Collette, Russell Crowe, etc - all began their careers on Australian television, in short films or low budget Australian feature films.
- Independent producers contribute to necessary diversity and multiple points of view in Australian programming.
- Independent producers operate in a wider market context than the networks, routinely relying on international financial equity from foreign sales agents and broadcasters.
- The licence fees paid to Australian independent producers for adult and children's drama and documentary programs by Australian networks do not cover the cost of programs. Despite the fact commissions are usually made to fulfil the networks' Content Standard quota, the independent producer has to go elsewhere to find the rest of the budget, usually to

international sales agents and distributors and to the Film Finance Corporation and State funding agencies and until now, private investors via 10BA.

The impact of allowing Broadcaster access to the Producer Offset

It is reasonable to suggest that *support and development* of the Australian screen industry would lead to increased production levels, and SPAA would expect to see as a result an increase in:

- Australian technical and creative employment;
- Australian screen industry export earnings;
- Supply and demand for all Australian screen production;
- The number and diversity of profitable Australian screen production companies resulting in increased market competition, and
- Diversity of screen product, including commercial screen content requiring no direct subsidy.

SPAA believes that allowing the commercial networks to access the Producer Offset will negate all of the above potential and the consequences will be:

- More in-house production at the networks, reducing market access for independent production companies and further consolidating the Broadcasters market power.
- A downturn in production competition and reduced incentive for the networks to make innovative programming that the Australian audiences time and again have proved they want to watch.
- Reduced Australian seller interaction with the international screen sector.
- Less diversity of viewpoints on Australian television and a downturn in creative participation.
- Accessing the rebate will not lead to an increase in more Australian content from the Broadcasters. Broadcasters have shown virtually no willingness to expend resources on Australian content beyond their minimum required quotas both in free-to-air and Pay TV.

SPAA contends that there is no public benefit in allowing the networks a 20% or 40% rebate on their Australian content obligations under the terms of their licence with Government. If the legislation is left unamended, broadcaster access will severely undermine any prospect of growth and sustainability in the independent sector and reduce the value of the Government's public policy in relation to broadcasting, whilst increasing the cost to the public.

New legislation should deliver a fair and equitable package that will drive new investment and build stronger businesses in the independent Australian film and television production industry across Australia.

SPAA's preferred position is that Broadcasters or their associates not be eligible to access the Producer Offset for any programs.

SPAA could accept as a minimum the Bill being amended in Section 376-C to ensure that Broadcasters and Pay TV channels cannot access the Producer Offset for the Australian content they are mandated by law to provide. If these entities choose to invest in the production of new Australian content beyond their legal minimum obligations, this additional content would be eligible for leveraging the rebate.

Feature Film Issues within Division 376

In order for the Producer Offset to work effectively across all genres, but in this instance specifically for feature films, producers need certainty along all steps of the rebate pathway. Without upfront certainty independent producers are disadvantaged in their ability to attract investors, access the rebate and/or grow their businesses.

Item 10.33 states:

'A project may commence as a feature film, seeking an offset of 40 percent, but not be picked up for Australian cinema distribution. In such a case, providing the film can achieve distribution on another platform, it may be considered to be a single episode programme' i.e. not a feature film.

In real terms this means a rebate eligibility drop from a level of 40% (the Producer Offset for feature film) to a 20% (the Producer Offset for television) rebate.

This interpretation creates uncertainty. There is a simple solution.

Item 10.130 of the Explanatory Memorandum of Understanding states 'To be satisfied that a film is a feature film, the film authority will require evidence of an Australian commercial agreement that provides a feature film with a theatrical release in a commercial cinema. Such an agreement would be expected to be a bona fide arrangement for the theatrical release of the film, and would not be justified by a contrived arrangement, for instance for release on one, or a very small number of screens.'

SPAA seeks clarification that a feature film with a contracted industry standard distribution agreement as part of its financing structure will retain its feature film qualification in the event that the distributor does not deliver a theatrical release. Non-delivery of a theatrical release can happen for reasons that have little or nothing to do with circumstances that could be predicted or compensated for by the producer.

Australian distributors have the right – despite the so-called the nomenclature of the agreement being 'distribution guarantee' - to refuse to distribute a feature film project on a number of grounds that provides them with potential 'get-out' clauses.

The following is an example of a standard clause within an Australian Distribution Guarantee: "If, notwithstanding that Distributor has exercised all reasonable efforts to do so, the Distributor is unable to secure commitments from exhibitors for the theatrical release of the Film "day and date" on at least 10 screens in aggregate in the central business districts of the Australian State and Territory capital cities, then the Distributor, the Licensor and the FFC will conduct good faith negotiations with a view to reaching agreement for the theatrical release of the Film "day and date" on less than 10 screens in aggregate in the central business districts of the Australian State and Territory capital cities, with reduced P&A Expenditure (subject to the prior written approval of the Licensor and the FFC not to be unreasonably withheld) or, where appropriate, for a straight to video release (subject to the prior written approval of the Licensor and the FFC not to be unreasonably withheld)."

In this event, the producer should not be penalized, have their work artificially 'downgraded' and be left with a potential 20% financing debt. This will bankrupt producers and work directly against the intended aims of the Producer Offset.

It also creates uncertainty in the financing phase which then prevents those independent producers who are not capitalised to cash flow the rebate themselves – the majority - through financial and lending institutions, who naturally need certainty that any loan arrangements be acquitted fully and at the appropriate time.

Capitalised vertically integrated companies such as distributors and exhibitors, who can control their cash flow and release patterns, are not penalised in the same way.

In order to create greater certainty, specifically at the time of financing, SPAA recommends the legislation be amended to reflect industry custom and practice in relation to distribution agreements.

SPAA continues to support all measures to ensure that all theatrical release arrangements are bona fide, arm's length and are not artificially contrived.

Therefore we suggest replacing Item 10:33 with:

If a project has a distribution guarantee that has been approved as 'bona fide' by the film authority and it is manufactured and delivered according to accepted industry feature film practice, and that has contracted its cast under the local feature film industrial agreements, it will be entitled to the 40% offset regardless of whether that 'guarantee' is honoured by the distributor.

Other tests could include any international distribution arrangements, underlying contracting documentation and the specific intent to make a film for cinema release.

This will create the certainty needed by producers and their investors to ensure that the Producer Offset meets stated Government objectives.

Item 10.130 also specifies that the distribution agreement must be an 'Australian commercial agreement'.

An interpretation of an 'Australian commercial agreement' that requires only a local distributor be attached would be severely limiting. By limiting the "commercial agreement" to an Australian company it potentially limits the size and scale of films that can be made – with no benefit to Australian film and television production. Bringing international financial and distribution players into the Australian marketplace can only make the industry stronger.

SPAA seeks clarity to ensure such agreements can be made between producers and foreign entities; for example, an international foreign sales agent who acquires sales and/or distribution rights for Australia as part of a wider acquisition territory.

SPAA recommends clarification in the memorandum of understanding to remove the requirement that distribution agreement be 'Australian commercial agreements'.

Items 10.12 and 10.125 cover the areas of discretion that the film authority has in offering certification for the Producer Offset. There is concern that certain companies that may well have a core business in film production but not in the production of Australian film can access the Producer Offset, when those companies should be accessing the Location Offset or the PDV Offset.

SPAA believes there is a lack of clarity regarding the film authority discretion in deciding on the eligibility of companies accessing the Producer Offset.

SPAA recommends that legislation be clarified so that the film authority can exercise its discretionary powers to disregard opportunistic Producer Offset claims by foreign entities that should be accessing the Location Offset.

This means that the film authority can ensure that companies who already have access to Location Offsets do not also have an open door to the Producer Offset.

Animation series

There is an issue within the current draft of legislation with regard to animation series of multiple, 15 minute commercial quarter-hour episodes fitting in to standard series definitions.

The definition of series is outlined in Schedule 1, item 1 paragraph 376-65(5), subparagraph 376-55 (2)(c)(i) Tax Laws Amendment (2007 Measures No. 5) Bill 2007.

The definition within the current legislation specifies a series must comprise of two or more episodes with a minimum length of 30 minutes per episode.

Long form animation series are traditionally produced and delivered internationally in two formats – either 26 or 52 x 30 minute

commercial-half hours or 26 or 52 x 15 minute commercial quarter hours. The adoption of the commercial quarter hour format for animated series is consumer-driven – children, (particularly the younger audience), prefer shorter stories. Quality animation is expensive to produce and Australian broadcasters contribute only (approx) 25% of the total budget. Australian animation producers therefore often co-produce with international partners. The commercial quarter-hour format is commonly used for such co-productions and it is important that Australian producers are not discouraged from producing in this format.

The current version of the legislation defines a series as episodes comprising not less than 1 x commercial half-hour. Therefore, although 52 x 15 commercial minutes is a long form series, and one which the international animation production community deals with in the same manner as 26 x 30 minutes, a 15 minute commercial quarter hour animation series would be excluded from the Australian definition of series.

These programs would therefore be counted as short form animation. Unfortunately this means that while the minimum Qualifying Australian Production Expenditure (QAPE) is only \$250,000, the average per hour QAPE needs to be \$1,000,000.

Without a legislative amendment in this area, 15 minute commercial quarter hour animation series, even 15 minute x 52 episode series, are unable to access the Producer Rebate because of the default threshold test that would apply in the absence of series status, which would be the short form series category. This short form series category requires a minimum QAPE of \$1million per hour. SPAA Animation Division members assert that this is impossible to achieve on any level.

This is a real issue for the animation community as many series, both here and internationally, are produced as 15 minute commercial quarter-hour episodes, and transmitted by broadcasters as 2 episodes per commercial half-hour.

SPAA calls upon the Committee to support an amendment to the definition of 'series' for animation so that a 'series' comprises of 'a minimum twelve episodes with a minimum length of a quarter a commercial hour each' or in the case of animation projects 'a series may also comprise of a minimum of four episodes with minimum commercial quarter hour duration'.

AUSTRALIAN SCREEN COUNCIL SUPPORT

The Australian Screen Council also supports the position on Broadcaster access to the Producer Offset. A letter outlining the ASC's position has been distributed to all committee members and is enclosed as appendix 1 for your reference.

SPAA Contact: Bethwyn Serow, SPAA Policy Manager, tel: 02 9360 8988.

appendix 1

AUSTRALIAN SCREEN COUNCIL
the peak body for the independent film and television industry



IN CONFIDENCE

Dear Senator,

Re: **BILL TO INTRODUCE A NEW PROVISION OF THE TAX ACT
– DIVISION 376
Film and Television Production Rebate – Amendment
Proposition**

Thank you for considering the film and television industry's position in regard to the new tax package for the industry.

As you are now aware, the industry believes the package has a major unintended flaw – access to the rebate for television production for commercial broadcasters. The effect of broadcaster access will directly contradict the stated objectives of the Government, which are to ensure the growth and sustainability of the industry.

It is not good public policy to provide a financial subsidy to assist highly protected and profitable oligopolies fulfil their public service obligations. Commercial broadcasters, as a requirement of their licence, must invest in Australian content, to a minimum level specified by government, in exchange for exclusive access to the broadcast spectrum.

The argument applies equally to free-to-air broadcasters and subscription television channels in respect of their obligations for Australian content.

The industry strongly supports the Bill being amended to remedy this flaw.

Preferred Position

The industry's preferred option is to amend the Bill to limit access to the producer rebate to bona fide "independent producers", as

defined in the Broadcasting Services (Australian Content Standard Variation 2004) - No. 1.

This has precedent in two federal areas – the Film Finance Corporation limits funding to “independent producers”, and the regulator ACMA differentiates between “independent producers” and broadcasters.

Alternative Position

The industry has also developed an alternative position. As a minimum, the Bill must be amended to ensure that Broadcasters and subscription television channels cannot access the Producer Offset for the Australian content they are mandated by law to provide. If these entities choose to invest in producing new Australian content beyond their legal minimum obligations, this additional content would be eligible for leveraging the rebate.

This alternate eliminates the public policy issue of broadcasters being subsidised by taxpayers to fund their regulatory obligations. It also provides an incentive for broadcasters to make additional Australian content above the current quotas, which would be a benefit for Australian audiences.

Both positions would ensure the new legislation would deliver a fair and equitable package that will drive new investment and build stronger businesses in the Australian film and television production industry across Australia.

We would be happy to provide any further information, and are available to meet with you in your electorate or in Canberra. We can be contacted in the first instance by contacting either Jacqueline Woodman, AWG Executive Director, tel: 02 9281 1554 or Bethwyn Serow, SPAA Policy Manager, tel: 02 9360 8988.

Yours sincerely,

Geoff Brown
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Signed on behalf of Trish Lake SPAA President

Jacqueline Woodman
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