



30 April 2010

SPAA RESPONSE TO GOVERNMENT REVIEW OF THE INDEPENDENT FILM AND TELEVISION PRODUCTION SECTOR

Executive Summary

SPAA acknowledges the consistent and considered approach the federal government has taken to the regulation and support of Australia's media industries and in particular the vital mass media film and television sectors. This regulation has produced both economic and cultural dividends to the nation and has helped to position Australia to our advantage in the world.

The recommendations we enclose are offered in the spirit of enhancing viability – both culturally and economically – and we thank the government for the opportunity to do so.

RECOMMENDATION 1: Measures to Strengthen Australian Content

That government direct the ACMA to introduce the following measures:

An immediate lift in adult drama, children's drama and documentary sub quotas in the Australian Content Standard (ACS).

- The increases are:
 - adult drama to 380 points a year
 - children's drama to 42 hours a year
 - documentary to 30 hours a year
- These quota increases to be applied to digital multi-channels
- This assists the government's goal of sustaining Australian content through the digital switchover
- The USAUSFTA allows for upward movement in genre sub quotas
- The Government will be both protecting Australian content and incentivising digital pick-up prior to switchover.

RECOMMENDATION 2: Encouragement of private financing in Australian Feature Films

That government supports a commercially driven, market door film debt facility to encourage distributor financing in Australian feature films in the budget range of \$7 million to \$30 million.

RECOMMENDATION 3: Withdrawing the Broadcasters' Entitlement to the Producer Offset

That government withdraw the FTA and Subscription TV broadcasters' entitlement to the Producer Offset and directs the ACMA to increase the Independent Producer Incentive for adult drama from 3 points per hour to 3.5 points per hour.

RECOMMENDATION 4: Extension of Producer Offset for Children's live Action Drama beyond 65 Episodes

That the Producer Offset Legislation and Rules be varied to allow Children's live action drama programs to qualify for a reduced PO of 15% after the first 65 episodes.

RECOMMENDATION 5: Children's Animation programs to be eligible for Producer Offset based on hours.

That the Producer Offset Legislation and Rules be varied to allow 5 to 15 minute children's animation programs to qualify for the PO for up to 65 hours of production in aggregate

RECOMMENDATION 6: Documentary and the Producer Offset.

That government consider the specific PO issues impacting on the documentary sector including the option of increasing the PO for this genre. In the interim eligible QAPE specifically for documentary and factual producers should be expanded to allow above the line research and development components

RECOMMENDATION 7: Enhanced incentives to attract offshore production.

SPAA calls on the government to revise the current PDV and Locations Offsets to ensure Australia remains competitive internationally. SPAA recommends the following policy initiatives:

- The maximum refund allowable under the PDV and Locations Offsets should be raised to ensure that Australia remains competitive in a globally competitive environment.

- Relaxation of the requirement to spend 70% of the production budget in Australia for productions with budgets between \$15 and \$50 million.
- Lowering of the PDV threshold from \$5M to \$500,000.
- The introduction of a frequent spenders reward incentive where companies that bring in projects worth in excess of \$50 million automatically qualify for the Offset on any subsequent projects brought in within two years to encourage repeat business and strengthen business relations.
- The introduction of a Refundable Film Tax Offset provision for very high budget television commercials with a QAPE in excess of \$1 million to attract footloose productions of this kind to Australia.

RECOMMENDATION 8: Producer Offset on-costs.

That 50% of the on-costs associated with cash flowing the PO be allowable expenditures under QAPE.

RECOMMENDATION 9: Earlier acquittal of the Producer Offset.

That government amends Division 376 of the Income Tax Assessment Act 1936 to allow the PO to be acquitted on “completion” without the need for a liquidated SPV.

RECOMMENDATION 9: Reduced Producer Offset threshold for feature films.

That government amend Division 376 of the Income Tax Assessment Act 1936 to allow feature films with budgets greater than \$500,000 to qualify for the PO.

RECOMMENDATION 10: New definition of “theatrical release”.

That government amend the Rules under Division 376 of the Income Tax Assessment Act 1936 to allow greater flexibility with regard to “Theatrical Release” of a feature film.

RECOMMENDATION 11: Administration of the Producer Offset to be transferred to DEWHA.

SPAA strongly advocates that both the Provisional and Final Certificate application procedures be administered within DEWHA.

RECOMMENDATION 12: Improved data collection and dissemination.

While respecting taxpayer confidentiality obligations the Producer Offset branch of Screen Australia should be required to provide on a regular basis general observations

and comment concerning areas of controversy or interpretation arising out of Provisional and Final Certification adjudications.

RECOMMENDATION 13: Local content regulation.

That government not be constrained by the AUSFTA in determining appropriate local content support mechanisms for the digital future.

RECOMMENDATION 14: Minimum licence fees for qualifying Australian programs under the Australian Content Standard.

That government instruct the ACMA to introduce minimum license fees for sub-quotas under the Australian Content Standard.

This would ensure;

- New Zealand's Government funded locally produced drama could not be dumped here for a fraction of the cost of production and masquerade as Australian content: and,
- New Zealand producers would receive a meaningful return if their programs are to be counted as Australian drama content.



SPAA SUBMISSION TO GOVERNMENT REVIEW OF THE INDEPENDENT FILM AND TELEVISION PRODUCTION SECTOR

INTRODUCTION

The Government's Review of the Independent Production Sector meets a commitment made in the lead up to the 2007 election and proclaimed in its Arts Policy platform. The original wording embraced a broader review than contemplated in the current terms of reference.

"Labor will conduct a review of the viability of the independent production industry, commencing within 12 months.

Labor will work with all sections of the film and television industry to develop a Strategic Film and Television Industry Plan, ensuring the commercial production industry has every opportunity to flourish." - New Directions for the Arts, September 2007.

The Terms of Reference for the review do seem to have sufficient scope to deal with the major structural and policy issues facing the industry at this time. The clear intention of the Labor Party was to conduct this review with a view to implementing appropriate measures to support the sector in the transition from analogue mediums to digital and beyond, and the film sector by helping to create sustainable business models. We expect the Strategic Film and Television Industry Plan will address all relevant issues including, most critically, the role and function of Australian Content Regulation in the new digital landscape.

1. THE INDUSTRY

a) Definitions

SPAA thinks it important to define the industry before setting objectives and goals for the future. In this regard we note that in the past the ABS has based its surveys on a definition that included broadcasting and did not distinguish between businesses supplying film and television programs and others, including small operators working in video production for corporates, weddings etc.

For the purposes of this review and the future collection of data in our sector, we suggest that the following definition apply:

Independent Film and Television Production Sector

Australian companies or individuals working more or less exclusively in the production, post-production, servicing or facilitation of film, television and new media programs for viewing by the general public. The controlling commercial interests in these companies must be independent of Australian Free-To-Air and Subscription broadcasters and US studios.

b) Economic Contribution

If we analyse the industry on these terms using the above definition, the SPAA membership base would probably represent 80% of all businesses working in the industry. Our membership stands at 500 including 360 business entities with one or more broadcast television and/or film, production, post-production, servicing or facilitation on-screen credits.

The range of businesses SPAA represents includes large publicly listed companies e.g. Beyond, to middle level private companies e.g. Jigsaw, to small home office based operations. Extrapolating from SPAA production levies paid by members, SPAA members generated \$313.6 million of Australian production in the year 2008/09. This is conservative noting that the major production houses have their SPAA levies capped at \$60,000 per annum. Using the accepted ABS multiplier for our industry of 2.5 this production generated economic activity worth \$941 million in that year. In other words, SPAA members on their own contributed approximately \$1 billion to the national economy during the GFC.

SPAA members employ actors and crew and engage with local businesses. SPAA compiled data in relation to the SPAA supported ABC bid for extra funding in 2008 which clearly established the overall economic activity created by the industry as a consequence of television commissions. A sampling of the range of SPAA businesses is attached at Annexure A along with data showing the economic and employment activity generated by the commissioning of additional hours of Australian production on the ABC.

c) Trade Contribution

Independently produced Australian children's drama and animation has been exported to 54 countries and has generated over \$250 million in revenues or production contributions through co-venturing over the last 10 years. It has been said that you cannot go anywhere in the world without seeing an Australian produced children's program on local television channels. Between 2008-10, Australian theatrical feature films at high budget levels achieved substantial international release at previously unprecedented levels.

Australia achieved an international theatrical gross of just under US\$150million; plus just under US\$50million from the US and Canada. *Knowing* achieved an international theatrical gross of over US\$80million and another US\$80million in the US. *Daybreakers* is nearing US\$20 million in international box office and grossed US\$30million in the US. These films are

financed by US studios and mini-majors, largely due to the existing track record of the filmmakers (who all began their careers on low budget films); the calibre of these financiers and distributors are exactly the entities SPAA wishes to attract with the distributor-led Fund in Annexure B.

These worldwide earnings speak to the potential of mainstream Australian cinema and can only increase if the PO can be made to work in the \$6m-\$30m range as well as the high end budget range.

d) The Cultural Imperative and Independent Television Production

The culture of a nation is “the whole complex of distinctive spiritual, material, intellectual and emotional features that characterise a society or social group” (UNESCO World Conference on Cultural Policies, Mexico 1982). It is both the representation of its identity and character and the making of those representations by the people of the nation.

Consequently the culture of a nation cannot be made elsewhere and must be firmly rooted in the land and people that comprise the nation. Unless the people of the nation participate in the creation of cultural products then the nation does not own its culture.

As a nation Australia has placed a high value on the development of a distinctive Australian culture and identity allowing Australians to speak confidently to themselves and to the world. Successive Australian governments have introduced policies and programs and allocated resources designed to support and enhance cultural development.

It is a continuous undertaking, particularly as Australia faces the challenges of globalisation in the world economy and the profound transformations occurring in the information era. Like many nations Australia seeks to benefit from the potential of new global networks in trade and commerce, at the same time as we strive to maintain those aspects of our culture that make us unique in the world.

The Government and the ACMA recognise the importance of public policy settings that provide a framework for growth and adaptive change that meet the social, cultural and economic objectives of the nation.

SPAA argues from the point of view of those engaged in the creation of Australian culture for Australian television. Our industry’s product matters to everybody. What the industry makes contributes to the social reality in which we live. It is still a medium for the masses.

Watching information and entertainment on television is a big part of people’s lives. It affects how people see themselves, how they fit in, what they feel like and how they act as part of their community. For children, their first wider view of society emerges on the television screen.

Consequently we see the place of free-to-air broadcasting as central to delivering the cultural outcomes desired by the nation. The nature of the domestic and international market has required regulatory intervention to achieve these outcomes. But, as the markets change the regulatory response needs to change to meet the challenges of new circumstances.

The rationale for Australian quota is cultural and social, and the production of this culture is inexorably linked to the existence of a cultural industry. This is an industry that encourages economic growth in Australia. The by-product is an efficient and dynamic industry. Production of local and overseas television programs, advertising and films utilises Australian resources and boosts the economy.

The broader economic benefits of the screen production industry include:

- increasing employment in the film, television and other related industries;
- increasing demand for Australian goods through international exposure for Australia;
- increasing awareness of Australian creative talent and abilities;
- increasing foreign investment in Australia;
- increasing exports of Australian products;
- increasing tourism expenditure; and
- increasing Australia's skills base.

SPAA strongly believes that these 'broader economic benefits' should be given the same weighting as the cultural objective of the Standard.

The New Landscape

Australia is moving to a digital television broadcasting system for technological and economic reasons, not for cultural or social reasons. While there are particular technological and economic changes that this migration will bring, they do not necessarily negate the cultural and social objectives of our current broadcasting system.

SPAA strongly advocates a technological system that places access and cost for the Australian consumer as the highest priority. Furthermore, the users most reliant on television as their primary media are often the more disadvantaged and rural Australians. The prospect of 'blank screens' for those citizens unable to afford the new technology is unacceptable and does not mesh with the goals of successive Australian governments.

Broadcast television is destined to remain the most dominant form of mass media in Australia for the foreseeable future. The audience for broadcast television is likely to remain large and therefore continue to be attractive to mass market advertisers. Consequently these broadcasters will have access to significant revenue to support the cost of transition to digital and the fulfilment of their cultural and social obligations.

Our members, both program makers and facility providers (editing facilities, film processing, sound, equipment hire) have also been upgrading to digital, with substantial costs involved in doing so. This needs to be recognised in the cost structures imposed by broadcasters in producing for digital television and in the opportunities that are opened up in the digital environment.

The creation and management of content will be a key feature of the future for independent producers in the digital environment.

In the digital age, SPAA will continue to campaign for Australian content as the base of cultural policy decisions on the media. Independent producers make the content. They invest in and develop talent, a very risky business. We are committed to ensuring that Australian's efficient and creative producers will be able to find a fair market and price for their product, therefore delivering the government's objectives to the people. The best vehicle for ensuring these cultural and economic objectives is the Australian Content Standard.

The Operation of the Content Standard

For decades the free-to-air networks have had control of a very highly valued commodity, broadcast spectrum, in return for which they are to meet social and cultural obligations set for them by Parliament.

We argue that the oligopoly, while making generous profits year after year, barely meets its level of obligation.

We therefore implore government to commit to maintaining drama, documentary and the children's subquotas in the new digital multi-channeling environment.

RECOMMENDATION:

That government direct the ACMA to introduce the following measures:

An immediate lift in adult drama, children's drama and documentary sub quotas in the Australian Content Standard (ACS).

- **The increases are:**
 - **adult drama to 380 points a year**
 - **children's drama to 42 hours a year**
 - **documentary to 30 hours a year**
- **These quota increases to be applied to digital multi-channels**
- **This assists the government's goal of sustaining Australian content through the digital switchover**
- **The USAUSFTA allows for upward movement in genre sub quotas**
- **The Government will be both protecting Australian content and incentivising digital pick-up prior to switchover.**

2. INTENT OF THE PRODUCER OFFSET

The stated intent of Producer Offset legislation was and is to empower independent producers to sustain and grow their businesses. The original intention was to reduce dependence on direct Government subsidy and to stimulate private investment, which together with the utilisation of the Offset would thus become the primary source of funding for commercial projects. SPAA recalls Senator Rod Kemp's vision for the new mechanism, which was for the Offset to sit side by side with Federal agency funding, and as the Offset achieved take up from the private sector, the Federal agency appropriation would not be reduced. The figures spoken of at that time were \$70m per annum estimated from Offset and \$70m per annum to the agency (about the aggregate of production investment funding available to the then three agencies, AFC, FFC and Film Australia).

Senator George Brandis, the then Minister for the Arts, issued a press release in February 2007, in which he said "Further, the Government expects the Producer Offset will provide a real opportunity for independent 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".

SPAA at the time argued that the previous indirect tax incentive 10B and 10BA should stand side by side with the Producer Offset for a reasonable 'hand-over' period so that take up by the private sector could be established. In the years leading up to the Offset, private investment in the film industry had become negligible, with the majority of activity at the lower budget end for feature film, from 'angel investors' who were not investing in industry corporate infrastructure, but in individual projects for a variety of reasons, often personally motivated.

Minister Peter Garrett, in his speech at the Melbourne Film Festival opening night on the 25 July 2008 said that, "With the introduction of the Producer Offset, we no longer have a funding model almost totally reliant on direct Government funding. If this new model is to work as intended, the Producer Offset must be the Government's primary funding mechanism. It is intended to be the first port of call for the many productions with commercial potential, which previously would have had to plead to Government agencies for direct funding against a range of competitors. The new indirect funding model is designed to be market driven and to attract more private investment to the sector".

No one could have foreseen the depth and extent of the global financial crisis that hit worldwide markets in September 2008, shortly after the implementation of this new suite of support measures for the Australian film industry. The effect of the GFC compounded the existing problem that pre-sales for film world-wide had virtually dried up, and many speciality film distributors (historically buyers of Australian films) closed down. In addition hedge funds collapsed, banks previously involved in gap financing closed their media divisions, buyers and distributors became even more risk averse. The landscape has now changed irrevocably as a result. There were then and still are few avenues of finance internationally for low to medium budget Australian films. The rising value of the Australian dollar also negatively impacted on pre-sale potential.

Added to this, Screen Australia's funding budget began to be reduced from day one of its operation, coinciding with the official start of the Producer Offset scheme, in advance of any evidence that the Producer Offset could work independently of the agency as an alternative financing mechanism for Australian feature film. Screen Australia was always going to co-invest with the Producer Offset to spread their diminishing funds across a larger number of socially and culturally relevant projects. The difficulty has been a lack of consistent policy on investment within Screen Australia – cultural and emerging filmmakers versus commercial outcomes. The PO should be for commercial outcomes. SPAA feels that Screen Australia falls uneasily between these two remits, hence the variously shifting guidelines and reversal of policy settings over one financial year in 2008-09.

It was never intended for the Offset to be part of the new agency's financing arrangements, and yet what has happened is that co-investment with the agency requires producers to put in a significant amount of their equity entitlement as part of their financing plan, thereby reducing much upside opportunity and leaving little room for any private sector participation. This is borne out by Screen Australia's recent analysis of Offset funding, which reveals that there is no take-up by private sector funding for features in the \$10-30m range.

SPAA maintains that the intention of the Producer Offset was to empower producers to have an increased participation in their own projects, which they could use to attract investors as they saw fit both to increase their profit position, to reduce the ask on the agency, and to build a portfolio of assets.

These original intentions for the Producer Offset have not eventuated largely due to little or no take up from private sector, compounded by the global financial crisis and the sudden decrease in Screen Australia funding. The industry does not have the scheme that was intended; instead the Offset has of necessity evolved into something different. What is particularly questionable as a result is the notion that the Offset is growing businesses. Film and television programs are getting made, but many producers feel that they remain effectively reliant on Government funding. Notwithstanding the PO has been successful in some genres as dealt with below:

3. THE EFFECT OF THE PRODUCER OFFSET

a) The PO and Australian Feature Film

There is no doubt that the PO is working at the top end of production budgets with films like *Australia*, *Knowing* and future releases like *Mad Max: Fury Road*, *Tomorrow When The War Began* and *Legends of The Guardians*. These films and their production entities can attract major financing from offshore and use the PO to create local equity. Most of these producers had pre-existing relationships with the US Studios before the introduction of the PO.

However the lack of private sector take up of the PO for films in the next category down - \$7m to \$30m - has placed great pressure on SA appropriations and created funding distortions. The SA investment door was intended to fund culturally significant films. The commercial market place was supposed to use the PO to leverage investments in more populist mainstream cinematic fare. The PO planners and architects grossly overestimated the engagement of institutional and private investors in film in the post 10BA era and of course the onset of the GFC further complicated the situation.

In an effort to stimulate investment in films in this budget range, SPAA has developed a funding model that relies on the distribution arms of the US majors to supplement the PO along with a loan/debt facility from the Commonwealth of \$30 million a year for three years. This will test the effectiveness of the PO sitting alongside distributors' hard money in the range of \$2 million to \$10 million plus P & A costs. It is SPAA's strong view that both private investment and the market need to be encouraged through private/public partnerships of this nature. The SPAA Producer/Distributor Film Fund proposal is at Annexure B to this submission. If this scheme fails to attract the interest and commitment of the Government, then Government should look at some form of indirect tax break in the manner proposed by SPAA in 2007 in its 10BB paper.

RECOMMENDATION 2:

That government supports a commercially driven, market door film debt facility to encourage distributor financing in Australian feature films in the budget range of \$7 million to \$30 million as per SPAA's proposal at Annexure B.

b) The PO and Australian Television Adult Drama

The 20% PO for television drama is generally working as intended. It has generated producer equity in strong performing programs like *Underbelly* and producer equity will be a key factor in the ABC's plans to develop its new slate of drama programming following the top up funding it received in 2009. However the industry remains perplexed and frustrated by the government's decision not to withdraw broadcaster access to the PO in respect of their own drama programming.

Both the Coalition in government and the Labor Party in opposition agreed at the time of the introduction into parliament of the PO legislation that allowing the broadcasters to access the PO for their own in-house productions was a mistake and contradictory public policy i.e. the PO was intended to make the independent sector more competitive vis a vis the broadcasters' market power. In allowing the broadcasters the same break on costs it further entrenched their market power, particularly the Seven Network's.

There has not been a single external drama commission from the Seven Network since the introduction of the PO in July 2008. Network Nine has recently taken a drama series production *Cops* in-house. A table of the

Seven Network's externally commissioned adult drama programs prior to the introduction of the PO is attached at Annexure C.

Each in-house series production takes away the bottom line of an independent producer. The networks are buyers and suppliers of programming which gives them enormous market power. Moreover they enjoy competitive advantage over independent producers in crewing and studio costs. The recent decision to grant the three commercial networks a \$250 million rebate on their spectrum licence fees further advantages the networks over independent producers.

Background

Senator George Brandis's Second Reading Speech that accompanied the PO legislation into Parliament refers to the anomaly of broadcaster access to the PO in this way:

"I take this opportunity to affirm on the part of the government its intention that the independent sector should be beneficiaries of the producer rebate. It has not been the view of the government that eligibility for the rebate should be quarantined only to the independent sector, but it is certainly the view of the government that independent producers should be beneficiaries of the producer rebate. Were it to be the case that in the early months of the operation of the scheme independent producers were missing out, it would be the intention of the government to re-look at the matter. In that regard, might I adopt the language of paragraph 11.47 of the report of the Senate Standing Committee on Economics, which says:

"It would be the committee's expectation that were the availability of the scheme for in-house production to have a detrimental effect on the independent sector then the Government on the basis of that evidence should legislate to restrict the producer offset scheme to independent producers."

The statutory review was conducted in late 2008 but despite evidence produced by SPAA members' indicating the poor conduct of some broadcasters regarding the PO when used by the producer as part of the financing plan i.e. appropriating the producer's equity position and/or reducing licence fees of the programs by 20%, government denied a problem existed and found no-case for the networks to answer. However, there are fresh examples of at least one major commercial network continuing to act aggressively with regard to the PO entitlement of independent producers and SPAA will provide that information in a separate confidential submission.

The industry fails to see the logic in public policy terms of allowing the

networks a tax break on the production costs of programs they are required to commission and screen as part of their licence obligations to government. It flies in the face of the rhetoric of strengthening the independent sector and decisions of the ACMA and its predecessor the ABA to facilitate independent production over in-house production.

The ABA's 2002 review of the Australian Content Standard introduced an incentive for the networks to out source their production. This was in recognition of the trending at the Seven Network to produce the bulk of its adult drama production itself. The ABA noted the reduced opportunities this would provide for independent producers. The incentive offered an additional 0.5 of a drama point per hour if the network externally commissioned the program and the licence fee in the production was in excess of \$300,000 an hour. In developing this model the ABA established a definition of "independent producer". The definition of "independent producer" is contained in the *Broadcasting Services (Australian Content) Standard 2005* under section 122(1) of the *Broadcasting Services Act 1992* and is as follows:

6A Independent producer

A body corporate that is the producer of an Australian drama program or a first release Australian C Drama acquired by another body corporate (***the customer***) is an ***independent producer*** of the program, in respect of that acquisition, if:

- (a) the producer:
 - (i) is not a licensee; and
 - (ii) is not a program supplier; and
 - (iii) is not a holder of a subscription television broadcasting licence; and

- (b) the customer:
 - (i) is not a licensee to which the producer is related (within the meaning of the *Corporations Act 2001*); and
 - (ii) is not a program supplier to which the producer is related (within the meaning of the *Corporations Act 2001*); and
 - (iii) is not a holder of a subscription television broadcasting licence to which the producer is related (within the meaning of the *Corporations Act 2001*).

How on the one hand can a government agency introduce incentives to prompt the networks to out-source their drama program requirements and on the other the federal government introduces a tax incentive to keep that production in-house?

Government should not underestimate the strength of feeling in the independent sector on this issue. The Labor election platform did use the

word “viability” in relation to the independent industry’s future. Government has addressed the broadcasters’ “viability” in the form of the \$250 million rebate. SPAA has proposed a group of measures to address this imbalance and strengthen Australian content on the commercial FTA networks - see Annexure D.

RECOMMENDATION 3:

That government withdraw the FTA and Subscription TV broadcasters’ entitlement to the Producer Offset and directs the ACMA to increase the Independent Producer Incentive for adult drama from 3 points per hour to 3.5 points per hour.

c) The PO and Australian Television Children’s Live Action Drama

The paucity of live action Australian children’s drama on the last three years is not so much a function of the PO (although its net value maybe a problem - see later), as is increased production costs and the appalling low licence fees paid by the networks for these programs. *Lockie Leonard*, *H2O*, *Stormworld* and *Saddle Club* are the exceptions but given there are five FTA networks representing the equivalent of 15 years of TV schedules in this period the outcome for Australian audiences is underwhelming and certainly not in the spirit of the Children’s Television Standard. By definition these programs have to reflect an Australian perspective and context in order to qualify as Australian content (the exception being *Saddle Club* which is an Aust/Canada co-production) whereas children’s animation can still be Australian but with dubbing may successfully translate into international sales.

Another mitigating factor in relation to the growth of children’s live action drama is the current restriction on using the PO after 65 episodes have been produced. Given the fragile financing plans for these productions, their rapid broadcast frequency and the attachment and loyalty of children’s audiences towards them, we think that after the first 65 episodes a reduced PO of 15% should apply. See case study at Annexure E.

RECOMMENDATION 4:

That the Producer Offset Legislation and Rules be varied to allow Children’s live action drama programs to qualify for a reduced PO of 15% after the first 65 episodes.

d) The PO and Australian Television Children’s Animation

Australian children’s animation is performing strongly on the back of strong international sales and the PO. However, the definition of QAPE remains a problem where competitive cost factors in animation processes favours the outsourcing of some production components offshore. These costs do not qualify for QAPE.

Many children’s animations are of 15 minutes duration, some are 5 or 7 minutes. Recognition of the fact that an animation series can comprise 26 x 30 minute episodes or 52 x 15 minutes episodes occurred almost at the last minute in the original discussions about what should qualify for the PO. Although 15 minute animation episodes were allowed to qualify, unfortunately an unintended consequence of this was that at 52 episodes in a first series, only one and a quarter series will qualify for the PO, compared with 2.5 series for children’s live action and up to 5 series for adult drama. Added to which, children’s television is significantly more difficult to finance, with networks usually only paying between 20-35% of the production costs. Capping the PO at 65, 15 minute episodes which in adult drama could equate to 65 hours of production, or 5 seasons, unfairly disadvantages the children’s production sector. At the very least it should be recognised that a 52 x 15 minute series is still treated internationally as 26 x 30 minutes, with commensurate cut-offs being 65, 30 minute episodes.

The qualifying length for animation is anomalous. Pre-school programming often runs at 5 or 7 minutes per episode. On the assumption that the episodes are part of a long running series comprising 52 or 65 episodes, and the dollar thresholds are met, it also seems unreasonable not to allow these formats to qualify. High quality pre-school programming is important to Australian children, and again, difficult to finance. The same issue regarding cut-off in terms of episodes arises.

RECOMMENDATION 5:

That the Producer Offset Legislation and Rules be varied to allow 5 to 15 minute children’s animation programs to qualify for the PO for up to 65 hours of production in aggregate.

e) The PO and Australian Documentary

Since its inception, the Producer Offset has been particularly problematic for documentary and factual television filmmakers. The benefits for the documentary sector have always been marginal at 20%. Evidence from senior documentary and factual television producers reveal that after discounting for QAPE exclusions, the notional 20% came down to 11% in some cases, with the average being around 13%. The commercial value of

the Offset assistance is being eroded not only by QAPE exclusions, but also by associated increased financial, legal, accounting and administration costs that further reduce the margin.

There are a number of factors conspiring against documentary and factual television in relation to the PO. The legislative restrictions covering allowable overseas expenditure impose barriers to the development and financing of Australian documentary and factual television that requires overseas shooting.

Development and research costs are a fundamental part of these projects and are contributing factors to the realisation of a project in a much higher percentage than other genres. For many projects, the majority of the creative work is done in the research and development phase. For example, international reconnoitres (recces) are often an integral part of the filmmaking process. Domestic recces are allowable under QAPE, international recces not allowable. The principle that governs the decision to do an in-depth recce for a film is the same whether it is shot domestically or internationally. In a recent documentary on the Mumbai terrorist attacks, the director of the film travelled to India, Europe, the United States and Sydney to meet with potential interviewees. Given the highly personal and traumatic nature of the contributors' stories, a preliminary recce was essential so that the director could meet with people face to face to establish trust before arriving with camera and crew. Under the QAPE rules, only the cost of the Sydney trip was QAPE-able.

Single documentaries and factual series are often constructed around international events, people and places. They often require overseas pre-production expenditure, and it is simply impractical to separate out expenditure incurred during research and development and pre-production, yet allowable QAPE is confined to that incurred during principal photography. This is but one example where the particularities of the documentary sector cannot be equated with other television genres (adult drama or children's, for example). Another example is a recent series on the global financial crisis where the presenter was an Irish economist living in Dublin. The expert and the director had to work closely together to research and develop the treatment and shooting script and it made practical sense for this exercise to be undertaken in Dublin. The Australian producer and director travelled to Dublin, and consequently their travel and associated costs were excluded from QAPE.

In the first two years of operation, it has been almost impossible to attract cash flow lenders to either single or aggregated transactions less than approx \$1.5m, which has left documentary and factual television producers who do not have access to state agency cash flow facilities with one recourse – self-funding the Offset. Ironically, the more production activity in this sector, the more producers have been required to mortgage their

own assets. Producers who get into personal debt to finance projects are cash flowing documentaries destined for free-to-air television domestic broadcast that were previously funded by federal film agencies. Producers subsidising broadcasters was never the intention of the Producer Offset.

There are recent signs that cash flow lenders can now look at single transactions and cash flow requirements of \$500,000 and below, a welcome development that SPAA will encourage in the lending sector. However, this is such a recent development it is not possible at this stage to state with certainty how many SPAA members have been able to attract lending facilities of this kind.

Allowable recoupment and equity positions mandated by Screen Australia in its terms of trade are another significant concern to the documentary and factual, which is addressed below in the Screen Australia section of this submission. At the time of writing, Screen Australia has yet to issue its new terms of trade, in which this issue may be addressed.

The various issues of concern to this sector has led some members to call for a raise the PO percentage for documentary and factual television to 40%. SPAA realises that there might be unintended consequences unless broadcaster access to the PO is withdrawn.

However, there is undoubtedly a level of dissatisfaction within which is brought about by inequities in the PO system for this sector. This would be alleviated somewhat by addressing eligible QAPE specifically for documentary and factual producers and expanding the allowable above the line, research and development components, and bona fide overseas expenditure.

RECOMMENDATION 6:

That government consider the specific PO issues impacting on the documentary sector including the option of increasing the PO for this genre. In the interim eligible QAPE specifically for documentary and factual research and development components and bona fide overseas expenditure to be included.

f) PDV & Locations Offsets

PDV stands for Australian Post Production, Digital and Visual effects (PDV). Australian PDV companies are a cornerstone of the Australian film and television industry and are the leading regular employers of labour in the independent sector. The sector has grown steadily over the last fifteen years. Nearly 200 companies employ over 2,000 people with an annual income in excess of 389 million and a wages bill of over 100 million.

Once primarily concerned with the treatment of vision and sound after it has been filmed (production) the Post Production, Digital and Visual effects (PDV) sector is now often vitally engaged at all stages of pre production and production. Hundreds of millions of dollars have been invested by private PDV companies in equipment and facilities since the advent of digital technology.

Post Production, Digital and Visual effects (PDV) companies offer services in the following areas - image editing, animation, visual effects including a huge range of image construction, rendering and optical effects, graphic design, titling and subtitling, sound design, sound editing and sound mixing, recording stock supply, film recording, film processing and film printing, format conversions, and duplication. The latest ABS survey conducted in 2002/03 revealed that the PDV sector contributed 22 per cent or \$360.5 million of a total income for the film and video production industry of \$1.597 billion. Many industry observers believe the next ABS survey will reveal that the PDV sector now accounts for almost a third of the total income for the film and video production industry.

Total expenditure by those businesses whose main source of income was from the provision of PDV services has increased from \$145.7 million in 1996/97 to \$358.1 million in 2002/03. In 2002-03, PDV expenditure on domestic and international productions was 24% of the entire expenditure of the film and video production industry of \$1.505 billion.

Australian PDV companies have recently provided computer generated images (CGI) component work to many large budget international feature films including *Charlotte's Web*, *Superman Returns*, *Harry Potter IV*, *9/11: World Trade Centre*, as well as animating the entire 3D feature *Happy Feet*.

The world market for 'footloose' international PDV work is estimated by the UK Film Council to be worth approximately AUD \$5 billion dollars per annum. Australia currently acquires less than 10% of this but has the potential to acquire much more. International PDV work benefits the local industry by paying for the latest technology and the training of skilled technicians.

The future stability of this cornerstone of Australia's industry is now facing serious challenges abroad. More attractive incentives offered by other countries is making Australia less competitive. Since Australia introduced the 15 % PDV and Locations Offsets in 2008, 9 other countries and 20 American and Canadian states have either introduced new rebate schemes or enhanced the existing ones.

In addition, the future stability of this cornerstone of Australia's industry is facing serious challenges onshore with skills shortages threatening

Australia's capacity to continue to service offshore work, and a contraction in Australian domestic market work.

RECOMMENDATION 7:

SPAA calls on the government to revise the current PDV and Locations Offsets to ensure Australia remains competitive internationally. SPAA recommends the following policy initiatives:

- **The maximum refund allowable under the PDV and Locations Offsets should be raised to ensure that Australia remains competitive in a globally competitive environment.**
- **Relaxation of the requirement to spend 70% of the production budget in Australia for productions with budgets between \$15 and \$50 million.**
- **Lowering of the PDV threshold from \$5M to \$500,000.**
- **The introduction of a frequent spenders reward incentive where companies that bring in projects worth in excess of \$50 million automatically qualify for the Offset on any subsequent projects brought in within two years to encourage repeat business and strengthen business relations.**
- **The introduction of a Refundable Film Tax Offset provision for very high budget television commercials with a QAPE in excess of \$1 million to attract footloose productions of this kind to Australia.**

g) Cash flowing the PO

Since its inception, cash flowing of the PO has presented significant problems for producers, especially those without access to cash reserves. The larger television producers and some feature film producers with studio backing have cash flowed their own productions without recourse to bank loans etc. Everyone else has had to find the funds from external sources using personal assets e.g. house mortgage and share portfolios, as security in most cases. The additional costs to productions of funds borrowings and associated items, which cannot be claimed back through QAPE, can represent up to 5% of the production budget. This impost works to deny producers the full advantages of the PO.

There are now more lenders in the market place and competition for loans has increased but lending margins remain excessive e.g. bank rate plus 6%

to 8% plus legals, fees and accounting costs. The investors currently meet these costs with the main beneficiaries being the banks. So the PO works to inflate production budgets. A representative film budget reflecting the true on-costs of servicing the PO is shown at Annexure F.

Moreover, most lenders hedge against discrepancies between the Final Certificate QAPE figure and the Provisional Certificate figure by only lending 85% of the QAPE amount. The 15% shortfall is either funded by investors or third party lenders. In some circumstances producers defer their own fees and other expense payments until their PO is acquitted fully through the tax system.

These observations relate to the efficacy of the PO and are not intended as criticisms. Anything government can do to mitigate PO overheads would be greatly appreciated by the industry. A minor adjustment to QAPE to allow 50% of these costs to be claimed through the PO would provide some relief.

RECOMMENDATION 8:

That 50% of the on-costs associated with cash flowing the PO be allowable expenditures under QAPE.

h) Acquittal of the PO

When the PO scheme was introduced the industry pointed out to Government that the requirement to acquit the PO in the tax year after “completion” of the film was onerous. SPAA also highlighted the distortions this would create in production cycles with most producers seeking to complete their films and TV programs as close as possible to the end of the financial year. Minister Garrett responded in a constructive manner by getting the ATO to allow liquidated SPVs trigger acquittal at the time of completion. However this remains an issue for many producers who find the costs of setting up SPVs and engaging a liquidator beyond their means. This especially applies to low budget films and documentary.

The Opposition Spokesperson on the Arts, Steve Ciobo MP, tabled a Private Members Bill in Parliament in November 2009 which sought to amend the Income Tax Assessment Act 1936 to allow timely acquittal of the PO on completion of the program where an SPV is not used. SPAA supports this initiative and requests Government implement the draft legislation.

RECOMMENDATION 9:

That government amends Division 376 of the Income Tax Assessment Act 1936 to allow the PO to be acquitted on “completion” without the need for a liquidated SPV.

i) PO thresholds

The most pressing issue in relation to qualifying PO thresholds is the level of \$1 million required for Australian feature films. This is an arbitrary and discriminatory figure which disenfranchises young, new and emerging filmmakers. Under the previous 10 BA arrangements films with production budgets less than \$1 million qualified for the tax concession. This enabled many smaller budget films to raise private investments from angel investors. Pre PO films that fall into this category include *Men’s Group* and *The Jammed*, which achieved theatrical release and critical acclaim. The former won digiSPAA in 2008 and the latter the IF Best Feature Film in 2007.

Given there is very little ‘on-the-job’ training these days with very few structured intern or traineeships being offered to emerging filmmakers, there is also a view that low budget filmmaking offers a springboard for new talent to go on to further their careers (Greg McLean, first time director, *Wolf Creek*, is a good example of this).

Lowering the current threshold in order to apply for the Producer Offset to \$500,000 would capture many of these projects and their investors.

RECOMMENDATION 10:

That government amend Division 376 of the Income Tax Assessment Act 1936 to allow feature films with budgets greater than \$500,000 to qualify for the PO.

j) Theatrical Intent

Questions have arisen as to how “theatrical intent” could be adjudged on low budget Australian films between \$500,000 and \$1m if the PO threshold was lowered. The question of whether films at the lower budget level satisfy the criteria for bona fide theatrical release will need re-examination if this measure is to be adopted, in order to ensure that a 40% Offset is warranted. SPAA is mindful of the need to attract Australian audiences to Australian films.

Investment in film is a high-risk proposition. The majority of the limited amount of private sector investment into film is currently at the lower end

of the budget spectrum, reflecting the fact that these investors are predominantly ‘angel’ investors in single projects for amounts in the \$200 - \$300,000 bracket rather than investors in businesses. The only way to justify the risk is the potential for high returns.

The way in which the production industry is currently being required to operate in, particularly with regard to the Producer Offset, removes the potential for high return to producers and financiers while doing nothing to reduce the high risk. Australian films have traditionally done most of their business in Australia, and despite this it is not unusual for Australian distributors to secure all rights for no more than 5% of the production budget. The argument that the requirement for an Australian distribution deal to be in place at provisional certification stage and as a pre-requisite for Screen Australia investment to show ‘intent’ to theatrically release a film as part of the PO is of concern. By requiring producers to pre-sell Australian rights for a fraction of the budget in a market where presales are no longer the norm means there is no potential to build production companies through breakout hits, as the upside to these projects are being retained by distributors.

Production companies must be empowered to take creative and financial risks, so that commercial success can flow back to investors and producers, which in turn will increase investor appetite for Australian films.

SPAA maintains that the only test that is required to show theatrical intent is the industrial test governing feature film. If a film’s performers and crew are contracted under the SPAA-MEAA feature film agreement, then all the relevant contractual obligations will be fulfilled. This agreement has inbuilt tests as to intent and should be adopted by the Producer Offset division and the investment division of Screen Australia. This would provide all the evidence needed to indicate intent to release theatrically. Producers would not enter into these arrangements if there were not a serious intention to release. There have been many examples of intent to release films that have then changed due to various mitigating circumstances. For example, *Mary and Max*, the animated feature produced by Melanie Coombs, started out with one distributor and was ultimately released by another due to the liquidation of the original company. At present, the power resides with distributors and exhibitors, and the producer and Screen Australia are not in control of the decision processes governing release of Australian films. See Annexure B for the SPAA Commercial Feature Film Proposal.

RECOMMENDATION 11:

That government amend the Rules under Division 376 of the Income Tax Assessment Act 1936 to allow greater flexibility with regard to “Theatrical Release” of a feature film.

k) Screen Australia's Administration of the PO

The major structural change introduced in 2008 was the merger of the former AFC, FFC and Film Australia into a new single agency - Screen Australia. SPAA supported the merger on the basis that the industry needed a modern, co-ordinated approach to the challenges facing the screen sector in the digital age. It would also offer an opportunity to present to government a strong single industry voice at the highest levels.

Consistent with this thinking government placed administration of the PO with Screen Australia. SPAA objected at the time arguing that DEWHA possessed the corporate wisdom on 10BA administration and the industry had full confidence in the department's ability to manage the function at arms length.

There are industry concerns about the administration of the Certification process within the same organisation that makes investment funding decisions. SPAA has always advocated that there be firewalls between the evaluation of projects for funding and the eligibility process for the Producer Offset. This is as much to protect the Agency from unnecessary potential conflicts of interest, as it is an assurance to the industry that there will be no undue evaluation criteria brought to bear on certification.

The industry is also concerned that any prejudicial relationship that may occur as a result of a 'marginal', or discretionary certification outcome not be carried over to a project's consideration for investment in other areas of the same agency. It is simply too small an industry for there to be a true firewall between certification decisions and investment decisions carried out by the same agency. It's important for probity and governance within the new agency that there be no perceived conflict from the outset.

There are currently serious definitional issues about definitions of documentary and factual television that are included for PO purposes, or reality and light entertainment programs that are not. At the moment, there are 3 disputes on these definitional issues before the Australian Appeals Tribunal, all relating to Screen Australia final certification allowability.

The industry needs certainty to be able to function. Some of the decisions seem arbitrary which undermines confidence of the whole industry and the financing players that producers are trying to attract with the PO.

SPAA members are also concerned about the practicality of the currency exchange aspects of the PO guidelines and rules. There can often be considerable periods between preparation of production budgets, application and approval of investments, subsequent legal documentation, and pre-production prior to principal photography. This could theoretically be upwards of a 6 month period.

It is theoretically possible that a dramatic currency movement only days before principal photography or commencement of animation may reduce the value of QAPE below the legislated threshold, rendering the film as ineligible. It would remain ineligible even if the currency moved back again on the second day of principal photography and remained there for the balance of production with QAPE always above the threshold. While a prudent producer may have hedged against this possibility, it is not a requirement of the legislation, and cannot be legally “imposed” on a producer for certification purposes. SPAA considers that this is an anomaly that in extreme circumstances has unforeseen consequences contrary to intent.

It would be rare, but possible, that this circumstance would arise with dramatic feature projects. But it is quite possible for feature documentary and IMAX or large format projects, and for documentary and television projects that are operating close to the QAPE eligibility thresholds.

SPAA is also concerned that the final calculation of QAPE uses an “average” currency exchange rate over the entire period in which QAPE is incurred. This period could in some circumstances extend over a period of 1 or 2, or even more years, during which wide variations of exchange rates could occur. This can lead to a distortion of QAPE calculations based on averaging, compared with the actual Australian \$ cost translated at the time of the transaction. SPAA considers that this is an anomaly that in extreme circumstances has “unforeseen consequences”, contrary to legislative intent.

Questions have been being raised about the level of duplicate administrative detail in the Offset papers that are being issued.

Moreover SPAA is concerned that some SAC and QAPE decisions made by Screen Australia may be inconsistent with the objectives of the Div 376 of the Tax Act. In particular SPAA remains confused as to how the film *Knowing* could qualify for a Final Certificate when it would appear to be no different in any respect from the film *Justice League of America*. SPAA strongly argued at the time that the major consideration in relation to the Subject Matter test of SAC on this film had to be “core origination”. This in effect denied that *Justice league of America* the PO (although no formal application for certification took place). Recently Screen Australia has sought to reduce QAPE calculations for Producer Fees in above the line expenses on the basis of their own arbitrary determination of what is reasonable. There is no PO rule limiting the make up of the above the line other than the 20% threshold rule. This decision has led to a further erosion of confidence in the certification process and has prompted a potential AAT

challenge at SPAA's expense.

RECOMMENDATION 12:

SPAA strongly advocates that both the Provisional and Final Certificate application procedures be administered within DEWHA.

I) Provision of Statistical Data and Disclosure

SPAA has argued in the past that the Government, through Screen Australia, should compile and publish comprehensive aggregated and averaged statistics from projects lodged with the agency for provisional and final certification and production investment, and continue to do so on a regular quarterly basis in the future. This is to inform the industry about the performance of the PO. In the absence of any other meaningful statistics, the industry is unable to apply its own analysis to the PO. Currently, SPAA relies on anecdotal evidence and case studies from individual projects from its members

Appropriate commercial in confidence requirements will need to be respected, but should not preclude substantive data being made available.

Statistics should be presented in groupings following the genres outlined in the Producer Offset legislation.

In order to maximise the benefit of such data, appropriate bands of budget range should be included to make the averaged statistics meaningful.

RECOMMENDATION 13:

While respecting taxpayer confidentiality obligations the Producer Offset branch of Screen Australia should be required to provide on a regular basis general observations and comment concerning areas of controversy or interpretation arising out of Provisional and Final Certification adjudications.

4. FREE TRADE AGREEMENTS

a) AUSFTA

In the bi-lateral free trade agreement between Australia and the United States, the US argued that the cultural attributes of the audiovisual industry should not make it exempt from trade rulings. The 'standstill' concession which was part of the outcome on audio-visual allowed for Australia to

retain existing measures and maintain current levels of market access, but would prevent Australia from enacting measures to protect cultural industries in the future in response to changing market circumstances. So, for example, the Australian content standard mandating 55% local content between 6am and midnight can be retained. However, if scaled down it could then never be increased. On the other hand, sub-quotas can fluctuate, and SPAA is currently addressing this with the Department of Broadband, Communications and the Digital Economy, to ensure that Australian content is protected for the future.

The negotiated outcomes of the AUSFTA were all about the digital future. The implications of the AUSFTA on audio-visual have not yet had much impact, but are likely to after analogue switch off, in terms of content quotas for Australian content on new digital services.

Since the AUSFTA was signed, the audio-visual industry has seen many changes; the introduction of the Producer Offset, the merger of the federal funding agencies, the formation of NITV, ABC3, co-production treaties with China and Singapore, the announcement of the National Broadband Network. New delivery systems for downloads and streaming of content, e.g. iTunes, Amazon, user generated content portals such as YouTube, social networking sites such as Facebook and Twitter, free download services such as ABC iView, the BBC iPlayer, and subscription services such as Netflix are in the same space as illegal peer-to-peer file exchanges despite tightening laws to prevent unauthorised copying, particularly in the US and France. So, the question is whether there will be any impediments to Australian innovation in this area, and that, SPAA contends, would be dependent on the cost/benefit ratio to the US of any transformative applications that came out of Australia and then were to be commercialised with the use of Government funding.

There may be few impediments to marketing and monetarising Australia's digital future and there are no precedents – it's a totally new landscape. The pace of technological change presents a challenge to any review process of the AUSFTA in relation to the audio-visual sector.

It is therefore difficult to assess at present what might be the impact of the AUSFTA and what market forces dictate in the future. It is apparent however that nearly all political and policy decisions emanating from Canberra in relation to Australian content are influenced by potential conflicts with the AUSFTA. This works to the disadvantage of the industry, particularly when it comes to discussions about the future of content regulation on digital platforms. SPAA has been told that retention let alone expansion of local content regulation is too problematic because of the AUSFTA. Australia should never have given up its sovereignty in this area. It is interesting to note that in all other bi-lateral agreements negotiated since the AUSFTA, Australia has carved out cultural content from negotiations.

RECOMMENDATION 14:

That government not be constrained by the AUSFTA is determining appropriate local content support mechanisms for the digital future.

b) CER - New Zealand programs on Australian Television

SPAA has raised its concerns in relation to the “dumping” of NZ programs on Australian television on numerous occasions. These programs, which are 100% funded by NZ taxpayers and first released in NZ, qualify as first release Australian programs under the CER. The commercial networks acquire these programs at a fraction of the price of locally produced programs and schedule them late at night rather than in premium prime time slots. These are not first release programs – Australia is the secondary market. The introduction of a minimum licence fee requirement for the three ACS sub-quotas would put the local production industry on a more competitive footing and provide NZ producers and taxpayers with real returns on their program investments.

The CER and the High Court Decision in relation to Project Blue Sky clearly established the principle of NZ programs qualifying as Australian for all purposes under the Australian Content Standard but it was accepted that contesting NZ programs would be first screened in Australia prior to NZ in order to make sense of the decision. This has not occurred. Instead we have second hand goods being passed off as new. Would a NZ manufactured vehicle with 30,000 NZ kilometres on its clock be allowed to sell in an Australian caryard as new?!

RECOMMENDATION 15:

That government instruct the ACMA to introduce minimum license fees for sub-quotas under the Australian Content Standard.

This would ensure;

- **New Zealand's Government funded locally produced drama could not be dumped here for a fraction of the cost of production and masquerade as Australian content: and,**
- **New Zealand producers would receive a meaningful return if their programs are to be counted as Australian drama content.**