



Inland Revenue  
*Te Tari Taake*

**INCOME TAX TREATMENT OF NEW ZEALAND  
SCREEN PRODUCTION INDUSTRY UNDER THE  
INCOME TAX ACT 2004**

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**PREPARED BY  
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## EXECUTIVE SUMMARY

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The New Zealand screen production industry has been subject to a special tax regime since the early 1980s. This paper provides a comprehensive analysis of the income tax treatment of the screen production industry under the Income Tax Act 2004 (the “2004 Act”). All statutory references in this paper are to the 2004 Act, unless otherwise stated.

Where a person has a “right or interest” (as defined in section CC 10(2)) in tangible assets relating to a film (i.e., the film, film prints, publicity material, etc), the amount received or receivable from the disposal, licensing, use, rental, or other exploitation of the film, is the income of that person in the income year in which it is derived (section CC 10).

Expenditure incurred in acquiring a “film right” (as defined in section OB 1) is allowed as a deduction under section DS 1. Section EJ 4 provides for a write-off for feature films over a period of 24 months. Section EJ 5 deals with non-feature films, and allows a write-off over two income years.

Section DS 2 provides for an accelerated write-off for “film production expenditure” (as defined in section OB 1). Film production expenditure incurred up to the completion of New Zealand films (as provided for in section EJ 6) can be 100 per cent deducted in the year the films are completed (section EJ 7). Film production expenditure incurred up to the completion of other films can be spread over two income years (section EJ 8). Film production expenditure incurred after the completion of films (whether or not New Zealand films) is deductible in the income year in which the expenditure is incurred. Section DS 2, however, does not apply to films for which a Large Budget Screen Production Grant is claimed.

It should be noted that expenditure on films that is allowed as a deduction under section DS 1 or DS 2 is accumulated until the film is completed (as defined in section OB 1).

Deductions allowed under section DS 1 or DS 2 can be clawed back by section DS 3 under film reimbursement schemes (as defined in section DS 4). Where section DS 3 applies, the Commissioner of Inland Revenue is entitled to assess taxpayers outside the time bar (section DS 3(6)).

Deductions otherwise available under section DS 1 or DS 2 will be deferred under sections GC 29 – GC 31 (the deferred deduction rule) provided certain requirements are met. The deduction is deferred until the investors are personally at risk of the expenditure incurred relating to films.

Deductions otherwise allowed under section DS 1 or DS 2 may be reduced by specific anti-avoidance provisions in relation to films, including sections GC 11A, GC 11B, GD 12, GD 12A and GD 12B. These provisions target at non-arm’s length transactions and arrangements which are aimed to manipulate sections DS 1 and DS 2.

In November 2003, the Government introduced the large budget screen production grant scheme, which provides a rebate of 12.5 per cent of the Qualifying New Zealand Production Expenditure to film and television production companies provided certain requirements are satisfied. The Large Budget Screen Production Grant Criteria can be viewed on the website of New Zealand Film Commission.

## **PART I. BACKGROUND**

### **CHAPTER 1 – INTRODUCTION**

- 1.1 The New Zealand screen production industry is subject to special income tax rules under the Income Tax Act 2004 (“2004 Act”). This is in line with the Government’s efforts to encourage the development of the New Zealand screen production industry. A recent development is the introduction of the large budget screen production grant scheme in November 2003.
- 1.2 The 2004 Act came into force from 1 April 2005. The new Act rewrites Parts C to E and Part Y of the Income Tax Act 1994 and makes consequential amendments to Parts A, B and F to O. The key objective of rewriting the Act is to produce tax legislation that is clear, uses plain language and is structurally consistent. The 2004 Act is not intended to contain any changes in policy, with the exceptions listed in schedule 22A.
- 1.3 This paper will provide an analysis of the income tax treatment of the screen production industry under the 2004 Act. All legislative references are to the 2004 Act, unless otherwise stated. Following the structure of the 2004 Act, this paper covers the following topics:
- income from films: section CC 10;
  - deductions and timing rules in relation to film industry expenditure: sections DS 1, DS 2 and EJ 4 – EJ 8;
  - deferred deductions relating to money not at risk: sections GC 29 – GC 31;
  - specific anti-avoidance provisions in relation to films: sections GC 11A, GC 11B, GD 12, GD 12A and GD 12B; and
  - the large budget screen production grant scheme.
- 1.4 A diagram showing how these topics interact is included in Appendix A.

## **PART II. INCOME FROM FILMS: SECTION CC 10**

### **CHAPTER 2 – INCOME FROM FILMS**

2.1 Section CC 10 deals with income from films. Where a person has a “right or interest” (as described in section CC 10(2)) in or to certain tangible assets relating to a film (set out in section CC 10(1)), the following amounts are included in income of the person (section CC 10(3)):

- (a) an amount received or receivable by the person for—
  - (i) the use of, or the right to use, the film or a right or interest in a right in the film;
  - (ii) the granting of a licence for a future right in the film;
  - (iii) the disposal of some or all of a right or interest in a right in the film;
  - (iv) the assignment of a right or an interest in a right;
  - (v) the assignment of a right to derive income from the use of a right or interest; and
- (b) an amount derived by the person from the rental, sale, use, or other exploitation of the film.

2.2 Section CC 10 applies when a person has a “right or interest” in or to certain tangible assets relating to films, including (section CC 10(1)):

- (a) a film; or
- (b) a print of the film; or
- (c) publicity material for the film; or
- (d) any other tangible asset relating to the film.

2.3 The “right or interest” is a right or interest, including a future or contingent right or interest, of any of the following kinds (section CC 10(2)):

- (a) copyright in the film;
- (b) a licence relating to the copyright;
- (c) an equitable right in the copyright;
- (d) an equitable right in a licence relating to the copyright;
- (e) any other right existing in or attaching to the film;
- (f) a right to income, or a share of income, from the rental, sale, use, or other exploitation of the film.

- 2.4 Section CC 10 is, however, overridden by section FC 21 (Amounts derived by non-residents from renting films), under which only 10 per cent of the amounts derived from New Zealand by a non-resident from certain activities is income of the non-resident person. These activities include (section FC 21(1)):
- (a) renting, exhibiting, or issuing a film, or making other arrangements for its exhibition:
  - (b) selling or hiring film containers, cinematographic or photographic materials, or equipment or accessories relating to a film:
  - (c) selling or hiring advertising materials relating to a film.
- 2.5 The rest of the amounts derived from such activities are exempt income of the non-resident person (section FC 21(2)).
- 2.6 The non-resident person is denied a deduction in relation to an amount to which section FC 21 applies (section FC 21(3)).
- 2.7 Section FC 21 does not apply to a non-resident person if the amounts derived by them from those certain activities are an insignificant proportion of the total amounts derived by them from any business carried on in New Zealand or elsewhere (section FC 21(4)).

## PART III. DEDUCTIONS AND TIMING RULES

### CHAPTER 3 – INTRODUCTION

3.1 Film industry expenditure is subject to a special deduction regime contained in Subpart DS:

- section DS 1: expenditure incurred in **acquiring** film rights (Chapter 4); and
- section DS 2: **film production expenditure** (Chapter 5).

3.2 Depending on the nature of the film, different timing rules apply:

- Section EJ 4: Expenditure incurred in acquiring film rights in **feature films**; and
- Section EJ 5: Expenditure incurred in acquiring film rights in **films other than feature films**; and
- Section EJ 7: Film production expenditure for **New Zealand films** (certification of New Zealand films is provided for in section EJ 6); and
- Section EJ 8: Film production expenditure for **films other than New Zealand films**.

3.3 It is important to note that deductions allowed under section DS 1 or DS 2 will only be available when the film is completed (as defined in section OB 1), regardless of whether it is a feature film, a non-feature film, a New Zealand film or a non-New Zealand film.

3.4 Deductions otherwise available under section DS 1 or DS 2 will be clawed back by section DS 3 under film reimbursement schemes (as defined in section DS 4). Section DS 3(6) allows the Commissioner of Inland Revenue (“Commissioner”) to reassess a taxpayer outside the normal four-year time bar set out in section 108 of the Tax Administration Act 1994. (See Chapter 6 for details of sections DS 3 and DS 4.)

3.5 The deferred deduction rule (contained in sections GC 29 – GC 31) will apply to defer the surplus deductions otherwise allowable under section DS 1 or DS 2 if certain requirements (set out in section GC 29) are met. The effect of the deferred deduction rule is that deductions are deferred until the investors are personally at risk of the expenditure incurred relating to films. (See Chapter 7 for details of the deferred deduction rule.)

## **CHAPTER 4 – EXPENDITURE INCURRED IN ACQUIRING FILM RIGHTS: SECTION DS 1**

- 4.1 Section DS 1(1) allows a deduction for expenditure incurred in acquiring a “film right” (as defined in section OB 1) **if the film is completed** (whether it is completed before, at the time, or after the film right is acquired).
- 4.2 “Film right” means a right or interest, including a future or contingent right or interest, of any of the following kinds (section OB 1):
- (a) copyright in a film; or
  - (b) a licence relating to the copyright in a film; or
  - (c) an equitable right in the copyright in a film; or
  - (d) an equitable right in a licence relating to the copyright in a film; or
  - (e) any other right existing in or attaching to a film; or
  - (f) a right to income, or a share of income, from the rental, sale, use, or other exploitation of a film.
- 4.3 “Completed”, for a film, means the completion of the film to (section OB 1)—
- (a) the stage of production at which the film has been completely edited, shot by shot, to its final length; or
  - (b) a production stage equivalent to that described in paragraph (a).

### **Timing of deduction**

- 4.4 Different timing rules will apply depending on whether the film is a feature film (refer section EJ 4) or a non-feature film (refer section EJ 5).
- 4.5 A “feature film” is defined in section OB 1 and means a film that –
- (a) is produced mainly for exhibition in a cinema; and
  - (b) is exhibited in 35mm gauge; and
  - (c) has a continuous running time of no less than 75 minutes.

### **Exclusion - section DS 1(2)**

- 4.6 Section DS 1 does not apply to expenditure that a person incurs in acquiring a film right, if—
- (a) the person operates a television station, a television network, or a cable television system, and the film right is acquired mainly to enable the film to be broadcast in New Zealand; or

- (b) the film is intended to be shown as an advertisement; or
- (c) the expenditure is film production expenditure (as defined in section OB 1). (Deductions for film production expenditure are provided for in sections DS 2 and EJ 7 or EJ 8. See Chapter 5 for details of section DS 2.)

**No other deduction – section DS 1(4)**

4.7 Where a person is allowed a deduction for expenditure incurred in acquiring a film right, no other deduction in respect of that expenditure shall be allowed under any other provision of the 2004 Act.

**Deduction for a feature film – section EJ 4**

4.8 Section EJ 4 provides for a deduction for expenditure incurred in acquiring film rights in feature films. If a person has a film right at the end of an income year, that person is allowed a deduction in that income year of an amount that is the lesser of (section EJ 4(2)):

- (a) the greater of—
  - (i) an “apportioned amount” of the deduction (which is calculated under section EJ 4(3)); and
  - (ii) the amount of film income derived in the income year (see Chapter 2 above for income from films); and
- (b) the “remaining deduction” (as defined in section EJ 4(6)).

4.9 The “apportioned amount” is calculated using the formula as follows (section EJ 4(3)):

$$(\text{completed months} / \text{non-completed months}) \times \text{deduction}$$

where –

**completed months** is the number of months in the income year (including a part of a month) for which the film is completed.

**non-completed months** is 24, reduced by the number of complete months in the period that –

- (a) starts on the first day of the month in which the film is completed; and

(b) ends on the last day of the income year before the income year referred to in section EJ 4(2).

**deduction** is the remaining deduction.

- 4.10 “Remaining deduction”, for the purposes of section EJ 4, means for an income year, the amount of the deduction for expenditure incurred before the end of the income year that has not been allocated to a previous income year (section EJ 4(6)).
- 4.11 It should be noted that under section EJ 4, no deduction may be allowed until the year in which the film is completed (provided no film income is derived in the relevant income year). Costs incurred up to the completion of the film are accumulated and the total allowed rateably over a 24-month period commencing with the month in which the film was completed.
- 4.12 An example illustrating how section EJ 4 works is set out below:

**Example 1:**

Assume a film commences production in the 2005-2006 tax year and the film will be completed on 15 January 2008. A person (“X”) acquires a film right on 20 July 2006 at the cost of \$1,000,000. The film is a feature film. Assume there is no film income. The deduction for such acquisition cost is as follows (assuming a 31 March balance date):

**Year ending 31 March 2007**

Acquisition costs \$1,000,000

No deduction allowed because the “apportioned amount” is a nil figure as the film is not yet completed.

**Year ending 31 March 2008**

Assume that the film will be completed on 15 January 2008.  
The total acquisition cost is \$1,000,000

Therefore, the allowable deduction is

$3 / (24 - 0) \times 1,000,000$  **\$125,000**

**Year ending 31 March 2009**

Remaining deduction \$875,000

Therefore, the allowable deduction is:

$12 / (24 - 3) \times 875,000$  **\$500,000**

**Year ending 31 March 2010**

Remaining deduction 375,000

Allowable deduction:

12 / ( 24 – (12+3)) × 375,000 or remaining deduction of \$375,000 (whichever is the lesser)	\$500,000
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Therefore the deduction allowed will be	<b>\$375,000</b>
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**Deduction for films other than feature films – section EJ 5**

4.13 A person is allowed a deduction under section EJ 5 for expenditure incurred in acquiring a film right if the film is not a feature film (section EJ 5(1)). Such deduction is allocated in two proportions as follows (section EJ 5(2)):

(a) **in the later of the income year in which the film right is acquired or the film is completed:**

(i) 50% of the deduction; or

(ii) if the film income derived in the income year is more than 50% of the deduction, the lesser of the amount of film income and the total amount of the deduction (see Chapter 2 above for income from films); and

(b) **in the next income year:** the remaining deduction.

4.14 “Remaining deduction”, for the purposes of section EJ 5, means for an income year the amount of the deduction that has not been allocated to a previous income year (section EJ 5(4)).

4.15 It should be noted that no deductions under section EJ 5 may be allowed until the year in which the film is completed. Costs incurred up to that date are accumulated and the total allowed over a two-year period, 50 per cent (or more) in the later of the income year in which the film is completed or the film right is acquired, and the remaining deduction in the following year.

**Example 2:**

Assume a film commences production in the 2005-2006 tax year and the film will be completed on 15 January 2008. A person (“X”) acquires a film right on 20 July 2006 at the cost of \$1,000,000. The film is not a feature film. Assume there is no film income. The deduction for such acquisition cost is as follows:

**Year ending 31 March 2007**

Acquisition costs	\$1,000,000
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No deduction allowed until the film is completed.

**Year ending 31 March 2008**

Assume that the film will be completed on 15 January 2008.

The total acquisition cost is	\$1,000,000
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Therefore, the allowable deduction is

50% of \$1,000,000	<b>\$500,000</b>
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**Year ending 31 March 2009**

Remaining deduction \$500,000

**Example 3:**

If the facts are same with Example 2 above, except that there is film income of \$600,000 in the 2007-2008 tax year. The deduction for such acquisition cost is as follows:

**Year ending 31 March 2007**

Acquisition costs \$1,000,000

No deduction allowed until the film is completed.

**Year ending 31 March 2008**

Assume that the film will be completed on 15 January 2008.

The total acquisition cost is \$1,000,000

Therefore, the allowable deduction is

\$600,000 (film income) or \$1,000,000 (the total amount of deduction), whichever is lesser

**\$600,000**

**Year ending 31 March 2009**

Remaining deduction **\$400,000**

**Deduction on disposal of film rights – sections EJ 4(5) and EJ 5(3)**

- 4.16 Where in any income year any person disposes of a film right and does not have a film right in the film at the end of the income year, the remaining deduction is allocated to the income year.
- 4.17 Sections EJ 4(5) and EJ 5(3) work to the effect that in any year where ownership of any film right is relinquished, all remaining deductions are brought forward and are allowed to be deducted as a lump sum in that income year.
- 4.18 The person must dispose of **all** his/her film rights before the deduction becomes available.

**Interrelationship with other provisions**

- 4.19 It should be noted that deductions allowed under section DS 1 for costs of acquiring film rights can be clawed back by section DS 3 under film reimbursement schemes (as defined in section DS 4).
- 4.20 Deductions otherwise available under section DS 1 may also be reduced by the deferred deduction rule contained in sections GC 29 - GC 31 if certain

requirements are met. (See Chapters 6 and 7 for details of the clawback provision and the deferred deduction rule.)

- 4.21 The application of section DS 1 is also subject to specific anti-avoidance provisions dealing with films, including sections GC 11A and GC 11B. (See Chapter 9 for details of sections GC 11A and GC 11B.)

## CHAPTER 5 – FILM PRODUCTION EXPENDITURE: SECTION DS 2

5.1 Section DS 2 provides for deductions for “film production expenditure” (as defined in section OB 1), if (section DS 2(1)):

- (a) the film is completed; and
- (b) the person has a film right in it (whether before, at the time or after the film is completed).

5.2 “Film production expenditure” is defined in section OB 1 as follows:

- (a) means—
  - (i) an expenditure or loss incurred in producing a film:
  - (ii) an amount of depreciation loss on property used in producing the film:
  - (iii) an amount of depreciation loss from disposing of depreciable property used in producing the film allowed under section EE 41 (Effect of disposal or event).
- (b) does not include an expenditure incurred—
  - (i) in acquiring an asset for which a deduction for an amount of depreciation loss is allowed:
  - (ii) in acquiring a film right after the film is completed:
  - (iii) directly in marketing or selling a film.

### **Inclusions – section DS 2(2)**

5.3 For the purposes of section DS 2(1), reimbursement for film production expenditure, prior to the completion of the film, is treated as film production expenditure. Reimbursement of interest expense can also qualify as film production expenditure. These are set out in section DS 2(2) as follows:

- If a person (person A) reimburses another person (person B) for film production expenditure that person B incurs, and does it before the film is completed, the reimbursement is treated as film production expenditure incurred by person A (section DS 2(2)(a)).
- If a person (person A) reimburses another person (person B) for expenditure on interest incurred by person B in producing the film, person A **may** treat the reimbursement as film production expenditure incurred by person A (section DS 2(2)(b)). (For a detailed explanation, see Tax Information Bulletin, Vol. 15, No. 5 (May 2003), page 75.)

### **Exclusion – section DS 2(3)**

- 5.4 Certain film production expenditure is excluded from section DS 2, if—
- (a) the film is produced mainly for broadcast in New Zealand by a person who operates a television station, a television network, or a cable television system; or
  - (b) the film is intended to be shown as an advertisement; or
  - (c) the film is one for which a large budget screen production grant is made.

### **No other deduction – section DS 2(5)**

- 5.5 Where a person is allowed a deduction for film production expenditure under section DS 2, no other deduction in respect of that expenditure shall be allowed under any other provision of the 2004 Act.

### **Timing of deduction**

- 5.6 Different timing rules will apply depending on whether or not the film produced is a New Zealand film (refer section EJ 6 for certification of New Zealand films):
- Section EJ 7: Film production expenditure for New Zealand films
  - Section EJ 8: Film production expenditure for films other than New Zealand films

### **Film production expenditure for New Zealand films – section EJ 7**

- 5.7 Section EJ 7 provides for an accelerated write-off for film production expenditure if a film has a **final** certificate as a New Zealand film under section EJ 6 (section EJ 7(1)):
- Film production expenditure incurred **in or before** the income year in which the film is completed can be 100 per cent deducted in the income year in which the film is completed (section EJ 7(2)).
  - Film production expenditure incurred **after** the film is completed is deductible in the income year in which the expenditure is incurred (section EJ 7(3)).

### **Certification of New Zealand Films – section EJ 6**

- 5.8 The New Zealand Film Commission (“NZFC”) **may** certify that a film is a New Zealand film, if the NZFC is satisfied that the film has, or will on completion have, a significant New Zealand content as determined under section 18 of the New Zealand Film Commission Act 1978 (the “NZFC Act”).

### *New Zealand content*

5.9 Section 18(2) of the NZFC Act lists out the factors that the NZFC will consider in determining whether or not a film has or is to have a significant New Zealand content:

- (a) The subject of the film:
- (b) The locations at which the film was or is to be made:
- (c) The nationalities and places of residence of—
  - (i) The authors, scriptwriters, composers, producers, directors, actors, technicians, editors, and other persons who took part or are to take part in the making of the film; and
  - (ii) The persons who own or are to own the shares or capital of any company, partnership, or joint venture that is concerned with the making of the film; and
  - (iii) The persons who have or are to have the copyright in the film:
- (d) The sources from which the money that was used or is to be used to make the film was or is to be derived:
- (e) The ownership and whereabouts of the equipment and technical facilities that were or are to be used to make the film:
- (f) Any other matters that in the opinion of the Commission are relevant to the purposes of this Act.

5.10 As provided for in section 18(2A) of the NZFC Act, a film will be deemed to have significant New Zealand content if it is made pursuant to an agreement or arrangement entered into in respect of the film between the New Zealand Government or the NZFC on the one hand and the Government of another country or relevant public authority of another country on the other.

### *Final and provisional certificates*

5.11 The certificate issued by the NZFC will be (section EJ 6(2))—

- (a) a provisional certificate, if the film is not completed:
- (b) a final certificate, if the film is completed.

5.12 Applications to the NZFC for certification of New Zealand films must be made in writing and must provide information that the NZFC requires (section EJ 6(3)). Further information about “New Zealand Certification” and application forms for both provisional and final certificates are available at the NZFC’s website: [http://www.nzfilm.co.nz/regulatory\\_approvals/nz\\_certification.aspx](http://www.nzfilm.co.nz/regulatory_approvals/nz_certification.aspx).

5.13 It should be noted that the deduction allowable under section EJ 7 requires a film to be a New Zealand film, by means of a **final** certificate issued by the

NZFC. A provisional certificate does not allow any deductions under section EJ 7 for film production expenditure.

- 5.14 However, obtaining a provisional certificate amounts to interim approval of the film as a New Zealand film by the NZFC. Once a provisional certificate is issued, it is likely that the taxpayer will be able to obtain a final certificate if the film is produced as provisionally approved.

*Notice of certificate to the Commissioner*

- 5.15 The NZFC **must** send a copy of the provisional certificate or the final certificate to the Commissioner of Inland Revenue (“Commissioner”) immediately after issuing it (section EJ 6(4)).

*Revocation of certificate*

- 5.16 The NZFC **may** revoke a provisional certificate or a final certificate, if the NZFC is satisfied that the certificate should not remain in force, because (section EJ 6(5)):

- (a) an incorrect statement was made in the provision of information for the purpose of obtaining a certificate; or
- (b) any other reason.

- 5.17 A revoked certificate is void from the time the certificate was issued (section EJ 6(6)).

*Notice of revocation to the Commissioner*

- 5.18 The NZFC **must** give notice to the Commissioner immediately after revoking a provisional certificate or a final certificate (section EJ 6(7)).

**Film production expenditure for films other than New Zealand films – section EJ 8**

- 5.19 Section EJ 8 provides for the timing rules in respect of a deduction for film production expenditure if a film does not have a final certificate under section EJ 6.

*Timing of deduction: up to completion of film*

- 5.20 If a person has a film right at the end of the income year in which the film is completed, the deduction for film production expenditure incurred **in or before** the income year is allocated in two proportions as follows (section EJ 8(2)):

**(a) in the income year in which the film is completed:**

(i) 50% of the deduction; or

(ii) if the film income derived in the income year is more than 50% of the deduction, the lesser of the amount of film income and the total amount of the deduction (see Chapter 2 above for income from films); and

**(b) in the next income year:** the remaining deduction.

5.21 “Remaining deduction”, for the purposes of section EJ 8, means for an income year the amount of the deduction for film production expenditure that has not been allocated to a previous income year (section EJ 8(5)).

**Example 4:**

Assume a film commences production in the 2005-2006 tax year and the film will be completed on 15 January 2008. A person (“X”) incurs film production expenditure of 4,000,000 in total up to the completion of the film. The film is not a New Zealand film. Assume there is no film income. The deduction for film production expenditure incurred by X is as follows:

**Year ending 31 March 2006**

Production costs \$1,200,000

No deduction allowed because the film has not yet been completed.

**Year ending 31 March 2007**

Production costs \$1,800,000

Deduction is again a nil figure because the film has not yet been completed.

**Year ending 31 March 2008**

Production cost \$1,000,000

The total production cost is \$4,000,000

Therefore, the allowable deduction is

50% of \$4,000,000 **\$2,000,000**

Marketing costs \$200,000

Total deduction allowed in the 2007-08 tax year **\$2,200,000**

**Year ending 31 March 2009**

Remaining deduction of \$2,000,000

Deduction allowed is

**\$2,000,000**

*Timing of deduction: after completion of film*

- 5.22 If a person has a film right in an income year after the film is completed, a deduction for film production expenditure incurred after the film is completed is allocated to the income year in which it is incurred (section EJ 8(3)).

*Timing of deduction: disposal of film right*

- 5.23 If a person disposes of a film right in the income year in which the film is completed, and does not have a film right in the film at the end of the income year, the remaining deduction is allocated to the income year (section EJ 8(4)).
- 5.24 Section EJ 8(4) works to the effect that in any year where ownership of any film right is relinquished, all remaining deductions are brought forward and are allowed to be deducted as a lump sum in that income year.
- 5.25 The person must dispose of **all** his/her film rights before the deduction becomes available.

### **Deduction for deferred or contingent payments – section GD 12A**

- 5.26 It should be noted that film production expenditure is treated as being incurred only at the time of payment where payment for expenditure is postponed or contingent (section GD 12A):

For the purposes of sections DS 2, EJ 7 and EJ 8, a person is treated as incurring film production expenditure in relation to goods or services only at the time of payment for those goods or services, if—

- (a) payment for the goods or services has been deferred by agreement between the supplier of the goods or services and any other person, and the Commissioner thinks that the period between the time that the goods or services are supplied and the time of payment for them is excessive; or
- (b) liability for the payment is contingent.

### **Interrelationship with other provisions**

- 5.27 Similarly to section DS 1, deductions otherwise available under section DS 2 are subject to the clawback provision contained in section DS 3 under film reimbursement schemes. The allowable deductions will also be reduced by the deferred deduction rule contained in sections GC 29 - GC 31 if certain requirements are met. (See Chapters 6 and 7 for details of the clawback provision and the deferred deduction rule.)
- 5.28 The application of section DS 2 is also subject to sections GD 12, GD 12A and GD 12 B (specific provisions dealing with non-market transactions in relation to films). (See Chapter 10 for details of sections GD 12 and GD 12B.)

## CHAPTER 6 – CLAWBACK OF DEDUCTIONS UNDER FILM REIMBURSEMENT SCHEMES: SECTIONS DS 3 AND DS 4

6.1 Deductions otherwise available under section DS 1 or DS 2 can be retrospectively clawed back if a person disposes of property under a “film reimbursement scheme” (as defined in section DS 4).

### Film reimbursement scheme – section DS 4

6.2 Section DS 4 defines “film reimbursement scheme”. For an arrangement to be a film reimbursement scheme, three requirements must be met:

- Deduction allowed: section DS 4(2)
- Disposal of property: section DS 4(3)
- Consideration not film income: section DS 4(4)

*Deduction allowed: section DS 4(2)*

6.3 The first requirement for a film reimbursement scheme is that **it is a scheme under which a person may incur expenditure for which they are allowed a deduction**, under—

- (a) section DS 1 or DS 2, or would be allowed a deduction if section DS 3 did not exist;
- (b) subpart DA (General rules), if the expenditure is for—
  - (i) a film right;
  - (ii) a right to an amount that is dependent on or calculated by reference to income from the rental, sale, use, or other exploitation of a film.

*Disposal of property: section DS 4(3)*

6.4 The second requirement for a film reimbursement scheme is that **there is a disposal of property under the scheme** of any of the kinds as follows:

- (a) the scheme enables the person or an associated person to dispose of property; or
- (b) the scheme gives a right to the person or an associated person to dispose of property; or
- (c) the scheme gives a right, the right creates an obligation for the person or an associated person, and the person or the associated person may meet the obligation by disposing of property.

6.5 For the purposes of section DS 4(3), a shareholder in a loss attributing qualifying company and the company are associated persons, in addition to the

associated persons described in section OD 7 (Defining when 2 persons are associated persons) or OD 8(3) (Further definitions of associated persons).

*Consideration not film income – section DS 4(4)*

- 6.6 The third requirement for a film reimbursement scheme is that **it is a scheme under which some or all of the consideration for the property would not be film income** (see Chapter 2 for income from films).

**Reduction of deductions**

- 6.7 The total deductions that have been allowed (or would be allowed) under section DS 1 or DS 2 must be reduced to an amount equal to the greater of zero and the amount calculated using the formula as follows (section DS 3(3)):

total deductions – total consideration

where—

**total deductions** is the total amount of deductions that—

- (i) the person has been allowed under section DS 1 or DS2; or
- (ii) the person would be allowed under section DS 1 or DS 2 if section DS 3 did not exist.

**total consideration** is the total amount of consideration for the disposal of the property that the person derives and that is not film income.

- 6.8 Deductions must be reduced in the same order as they have been allowed or would be allowed (section DS 3(2)).

**No time bar for amendment of assessment resulting from section DS 3**

- 6.9 Despite the time bar in section 108 of the Tax Administration Act 1994, the Commissioner may amend an assessment at any time in order to give effect to section DS 3 (section DS 3(6)).

**Special return – section 44A of the Tax Administration Act 1994**

- 6.10 If a taxpayer's deductions are reduced under section DS 3, that taxpayer and any other taxpayer who are affected by that reduction must file a special return. The special return is to be filed for the tax year in which the consideration is derived and by the date that the taxpayer's return of income for that tax year would be due (section 44A(2) of the Tax Administration Act 1994).

## **Exclusion – section DZ 11**

6.11 Section DS 3 does not apply to a deduction for expenditure excluded under section DZ 11, which covers the circumstances set out as follows (section DZ 11(1))—

- (a) the film reimbursement scheme is entered into on or before 30 June 2001; and
- (b) the film has, under section EJ 6 (Certification of New Zealand films),—
  - (i) a final certificate that it is a New Zealand film; or
  - (ii) a provisional certificate (not obtained by the provision of materially incorrect information to the New Zealand Film Commission) that it is a New Zealand film; and
- (c) the film had not been completed before 7 July 1999; and
- (d) before 7 July 1999,—
  - (i) 1 or more contracts had been entered into for the supply of goods or services in New Zealand in relation to the film; and
  - (ii) at least \$1,000,000 of expenditure had been incurred under the contract or contracts; and
- (e) on or before 1 November 1999, a person who entered into a contract referred to in paragraph (d)(i) gave notice to the Commissioner that the requirements in paragraphs (c) and (d) were met; and
- (f) the expenditure for which persons are allowed a deduction under section DS 1 (Acquiring film rights) or DS 2 (Film production expenditure) is no more than 140% of the physical cost of production of the film; and
- (g) without limiting the application of section BG 1 (Tax avoidance), on the date the film reimbursement scheme is entered into, there is an expectation based on reasonable commercial assumptions that the income to be derived by person A as a result of the expenditure will be at least equal to the sum of—
  - (i) all expenditure incurred by person A under the scheme; and
  - (ii) a return on each amount of expenditure that is equivalent to the return on 5 year government stock measured on the date that the scheme is entered into; and
- (h) if the expenditure is incurred on depreciable intangible property of a kind listed in schedule 17 (Depreciable intangible property), the expenditure is an amount paid to person B in the circumstances described in [section DZ 11(2)].

6.12 Section DZ 11(2) sets out the circumstances, for the purposes of section DZ 11(1)(h), as follows:

- (a) the amount paid is income of person B; or
- (b) at all times in the tax year in which the payment is made, person B—
  - (i) is resident of one of the grey-list countries (as specified in schedule 3, part A); and

(ii) is liable to income tax in that grey-list country or territory by reason by domicile, residence, place of incorporation, or place of management in that country; and

(iii) has calculated its income that is liable to income tax in that country or territory without applying a feature of the taxation law of the country or territory specified in schedule 3, part B.

6.13 It should be noted that the exclusion contained in section DZ 11 is of very limited application. In order for the exclusion to apply, a significant amount of expenditure must have been incurred for an incomplete film as at 7 July 1999. The film reimbursement scheme in question must also be entered into before 30 June 2001.

*Some definitions – section DZ 11(3)*

6.14 “Government stock”, for the purposes of section DZ 11(1)(g), means stock issued under Part 6 of the Public Finance Act 1989.

6.15 “Physical cost of production”, for the purposes of section DZ 11(1)(f), means the expenditure incurred in producing a film (whether incurred in New Zealand or elsewhere), other than expenditure incurred—

(a) in marketing or selling the film; and

(b) on depreciable intangible property of a kind listed in schedule 17 (Depreciable intangible property).

6.16 A diagram showing how section DS 3 operates is included in Appendix B.

## **PART IV. SPECIAL RULES DEFERRING DEDUCTIONS FOR EXPENDITURE IN RELATION TO FILMS**

### **CHAPTER 7 – DEFERRED DEDUCTION RULE: SECTIONS GC 29 – GC 31**

- 7.1 Deductions otherwise available under section DS 1 or DS 2 will be deferred by sections GC 29 - GC 31 (the deferred deduction rule (“DDR”)) if certain criteria are met. The general purpose of the DDR is to combat aggressive tax arrangements which provide taxpayers with excessive tax advantages in the form of large deductions, regardless of the success of the arrangement.
- 7.2 Broadly, sections GC 29 - GC 31 require a taxpayer who is a party to an arrangement based on a limited-recourse loan to defer the deductions in any of the first 3 years of the arrangement, when assessable income from the arrangement is less than the total deductions. The deferral mechanism operates by denying deductions that would otherwise be allowable to the extent that the limited-recourse loans are outstanding and the investor continues not to be at real risk of having to repay them. For arrangements which are commercially unsuccessful, such deferral can be permanent. Taxpayers involved in film investment arrangements are potentially subject to the DDR if the statutory criteria are met.
- 7.3 The Commissioner’s statement on the DDR under the Income Tax Act 1994 is set out in Tax Information Bulletin Vol. 16, No. 1 (February 2004), pages 58-66. It should be noted that the 2004 Act contains some changes to the DDR, although not major.

#### **Arrangements subject to the DDR – section GC 29(1)**

- 7.4 The statutory criteria contained in section GC 29(1) for the DDR to apply include:
- There is an arrangement under which a taxpayer (called a “participant”) is either a party to or is affected by that arrangement; **and**
  - After the arrangement commences, a person sells, issues or promotes the selling or issuing of the arrangement, whether or not for remuneration (section GC 29(1)(a)); **and**
  - As part of or for the purposes of the arrangement, the participant or an affected associate of the participant (as defined in section GC 30(1)) borrows a limited-recourse amount under a limited-recourse loan (section GC 29(1)(d)); **and**
  - The arrangement results in deductions for the participant and the participant’s affected associates (section GC 29 (1)(b)(i)); **and**

- The deductions are for the income year in which the participant or the participant and the associates acquired an interest in the arrangement, or that initial year and the next year, or that initial year and the next two income years (section GC 29(1)(c)); **and**
- Assessable income resulting from the arrangement (except assessable income arising under sections GC 29-GC 31) is less than the total amount of deductions of the participant and affected associates of the participant (section GC 29(1)(b)(ii)); **and**
- The total cost of property held by the participant and affected associates on the balance date for any of the first 3 years of the arrangement is:
  - (i) less than twice the total of the limited-recourse amounts borrowed (in other words, the limited-recourse loans are 50% or more of that total cost) (section GC 29(1)(e)(i)); **and**
  - (ii) more than 142.85% of the total cost of the part of that property is land, buildings, plant, machinery, certain listed company shares, employee share options and certain shares in a foreign company (in other words, the cost of land, buildings and other tangible property, expressed as a percentage of the total cost of all assets held, is 70% or less) (section GC 29(1)(e)(ii)).

*Consolidation of assessable income and deductions, and cost of property*

7.5 The assessable income and deductions resulting from an arrangement for each person in a group of persons (for the purposes of section GC 29(1)(b) and section GC 31), and the cost of property that is held by each person in the group as part of the arrangement (for the purposes of section GC 29(1)(e)) are consolidated to eliminate intra-group balances in accordance with generally accepted accounting practice (section GC 29(2)).

*Calculation of assessable income and deductions, and cost of property*

7.6 The assessable income, deductions and the cost of property held by individual members in a group of persons are calculated using the proportionate method in accordance with generally accepted accounting practice (section GC 29(3)). This method applies to members in partnerships or joint venture, and shareholders in loss attributing qualifying companies.

**Key definitions – section GC 30**

7.7 Section GC 30 further defines some terms for the purposes of the DDR.

*Limited-recourse loan – section GC 30(3)*

7.8 “Limited-recourse loan” is defined in section GC 30(3) and means a financial arrangement that—

- (a) is not an excepted financial arrangement; and
- (b) involves the provision of money by a person (“lender”) to another person (“borrower”); and
- (c) has an effect, or has an economic effect that is substantially similar to the effect, of—
  - (i) relieving the borrower under the financial arrangement from the obligation to repay all or some of the money, whether the relief is contingent or not;
  - (ii) requiring the borrower under the financial arrangement to make no repayment for a period of 10 or more years from the date on which the loan is made, other than repayments for the purpose of defeating the intent and application of sections GC 29-GC 31;
  - (iii) providing that the repayment of the money is in substance secured solely against assets that are employed in the arrangement; and
- (d) involves money that is [not provided to the borrower on arm’s-length terms].

7.9 Loan made by banks and financiers who are regular providers of money to persons on arm’s length terms **and** who are resident in New Zealand or carry on business in New Zealand through a fixed establishment in New Zealand are excluded from the definition of “limited-recourse loan” (section GC 30(3)(d)(i)).

7.10 If the lender and borrower are associated persons under either section OD 7 or section OD 8(3), there will be a limited-recourse loan if the lender obtains the loan funds on a limited-recourse basis as discussed above in paragraphs 7.8 (a)-(c).

7.11 Some examples of a limited-recourse loan are provided in Tax Information Bulletin Vol. 16, No. 1 (February 2004), page 64.

*Affected associate – section GC 30(1)*

7.12 For the purposes of sections GC 29-GC31, a person is an “affected associate”, for the arrangement, of another person if each person is a party to the arrangement or is affected by the arrangement and –

- (a) one person is a loss attributing qualifying company and the other person is a shareholder in that company;
- (b) the persons are associated under section OD 7 or section OD 8(3).

*Limited-recourse amount – section GC 30(2)*

7.13 For the purposes of sections GC 29-GC 31, the limited-recourse amount for a limited-recourse loan means the total for the limited-recourse loan of the amounts for which the obligations of a borrower (as defined in section GC 30(3)(b)) are affected in a way that is described in section GC 30(3)(c).

## **Deferral of surplus deductions from arrangement – section GC 31**

### *Application – section GC 31(1)*

7.14 Section GC 31 will apply to defer surplus deductions resulting from an arrangement to which the DDR applies, if—

- the participant (not being a loss attributing qualifying company), or the participant and the affected associates of the participant (not being a loss attributing qualifying company that has incurred a net loss from the arrangement for the income year), considered together, have from the arrangement assessable income that is less than deductions resulting from the arrangement (sections GC 31(1)(a) and (b)); and
- the arrangement involves a limited-recourse loan for which the participant or an affected associate of the participant is a borrower (section GC 31(1)(c)).

### *Formula – section GC 31(2)*

7.15 Broadly, a participant in an arrangement that is subject to the DDR is treated as deriving an amount of assessable income calculated under a formula provided for in section GC 31(2):

$$(a / b) \times c$$

where:

- a is the amount by which the deductions of the participant from the arrangement for the income year exceed the participant's assessable income from the arrangement;
- b is the total amount by which the deductions from the arrangement for the income year exceed the assessable income from the arrangement for that year of the group comprising the participant, and any affected associates, other than loss attributing qualifying companies, who each have total deductions exceeding assessable income from the arrangement;
- c is the lesser of:
  - the amount by which the total deductions for the income year from the arrangement exceed the assessable income from the arrangement for that year of the group comprising the participant and any affected associates (excluding any person which is a loss attributing qualifying company) who have incurred a net loss from the arrangement; and
  - the total limited-recourse amounts which, at the relevant balance date for the participant and affected associates,

those persons have undischarged obligations to repay as part of or for the purposes of the arrangement.

- 7.16 Such assessable income is, in turn, allowed as a deduction in the immediately following year (section GC 31(3)).

*Obligation to repay limited-recourse amount not discharged – section GC 31(4)*

- 7.17 For the purposes of section GC 31(1) and of paragraph (b) of the definition of item “c” in section GC 31(2), an obligation to repay a limited-recourse amount is not discharged by a transaction to the extent that the transaction—

- (a) involves the use, as part of the arrangement, of—
  - (i) a put or call option that is not a contract for the sale for future delivery of goods at market value;
  - (ii) a contract of insurance or guarantee; and
- (b) does not give rise to assessable income for the person who is the borrower of the limited-recourse amount under the limited-recourse loan.

- 7.18 An example of how the DDR under the Income Tax Act 1994 applies to defer deductions in an arrangement is provided in Tax Information Bulletin Vol. 16, No. 1 (February 2004), page 66. It should be noted that the 2004 Act contains some changes to the DDR, although not major.

## **PART V. OTHER SPECIFIC ANTI-AVOIDANCE PROVISIONS DEALING WITH FILMS**

### **CHAPTER 8 – INTRODUCTION**

- 8.1 Deductions otherwise allowed under section DS 1 or DS 2 will be reduced under certain circumstances by specific anti-avoidance provisions or provisions dealing with non-market transactions.
- 8.2 Depending on the nature of the film expenses, different provisions will apply:
- section GC 11A: Non-market transactions to acquire film rights
  - section GC 11B: Manipulation of arrangements to acquire film rights
  - section GD 12: Non-market transactions for incurring film production expenditure
  - section GD 12A: Film production expenditure if payments postponed or contingent
  - section GD 12B: Manipulation of arrangements to incur film production expenditure
- 8.3 Chapters 9 and 10 will discuss these provisions in detail.

## **CHAPTER 9 – SPECIFIC ANTI-AVOIDANCE PROVISIONS: SECTIONS GC 11A AND GC 11B**

9.1 Deductions otherwise allowed under section DS 1 for expenditure incurring in acquiring film rights will be reduced under the following circumstances:

- Non-market transactions to acquire film rights (section GC 11A)
- Manipulation of arrangements to acquire film rights (section GC 11B)

### **Section GC 11A: Non-market transactions to acquire film rights**

9.2 Section GC 11A will apply to reduce deductions otherwise allowed under section DS 1 for expenditure incurred in acquiring a film right, if (section GC 11A(1))—

- (a) the Commissioner considers that a person (person A) and another person (person B) from whom the film right was acquired were not dealing with each other at arm's length in relation to the acquisition; and
- (b) the amount of the expenditure incurred by person A in acquiring the film right is more than the market value of the film right at the time it was acquired by person A.

9.3 The deduction must then be reduced to an amount equal to the market value of the film right at the time it was acquired by person A (section GC 11A(2)).

9.4 If person A acquires only a share of a film right, section GC 11A applies only to the part of the total market value of the film right that is attributable to that share (section GC 11A(3)).

### **Section GC 11B: Manipulation of arrangements to acquire film rights**

9.5 If the Commissioner considers that two persons have made arrangements so that section DS 1, EJ 4 or EJ 5 applies more favourably in relation to a person in an income year than it would have applied without the arrangements, the deduction allowed to the person under section DS 1 must be reduced to the amount that the Commissioner considers would have been allowed if the arrangements had not been made (section GC 11B (a)).

9.6 In addition, the deduction allocated under section EJ 4 or EJ 5 must then be allocated to the income year to which the Commissioner considers it would have been allocated if the arrangements had not been made (section GC 11B(b)).

## **CHAPTER 10 – SPECIFIC PROVISIONS DEALING WITH NON-MARKET TRANSACTIONS IN RELATION TO FILMS**

10.1 Deductions allowed under section DS 2 for film production expenditure will be reduced under the following circumstances:

- Non-market transactions for incurring film production expenditure (section GD 12)
- Manipulation of arrangements to incur film production expenditure (section GD 12B)

### **Section GD 12: Non-market transactions for incurring film production expenditure**

10.2 Section GD 12 will apply to reduce the deduction otherwise allowable under section DS 2 for film production expenditure, if (section GD 12(1))—

- (a) the Commissioner considers that a person (person A) and another person (person B) who supplied goods or provided services to person A in relation to a film were not dealing with each other at arm's length in relation to the goods or services; and
- (b) person A incurred more film production expenditure than person A would have incurred if person A and person B had been dealing with each other at arm's length.

10.3 The deduction must be reduced to an amount equal to the film production expenditure that the Commissioner thinks person A would have incurred if person A and person B had been dealing with each other at arm's length (section GD 12(2)).

10.4 For the purposes of sections DS 2, EJ 7 and EJ 8, section GD 12A applies to treat certain film production expenditure as being incurred only at the time of payment where the payments for goods or services are deferred or contingent. (See paragraph 5.26 above for details of section GD 12A.)

### **Section GD 12B: Manipulation of arrangements to incur film production expenditure**

10.5 If the Commissioner considers that two persons have made arrangements so that section DS 2, EJ 7 or EJ 8 applies more favourably in relation to a person in an income year than it would have applied without those arrangements, the deduction that a person is allowed under section DS 2 must be reduced to the amount that the Commissioner considers would have been allowed if the arrangements had not been made (section GD 12B(a)).

10.6 In addition, the deduction allocated under section EJ 7 or EJ 8 must be allocated to the income year to which the Commissioner considers it would have been allocated if the arrangements had not been made (section GD 12B(b)).

## PART VI. LARGE BUDGET SCREEN PRODUCTION GRANTS

### CHAPTER 11 – THE LARGE BUDGET SCREEN PRODUCTION GRANT SCHEME

#### General Information

- 11.1 The Taxation (GST, Trans-Tasman Imputation and Miscellaneous Provisions) Act 2003 introduced tax provisions relating to the large budget screen production grant (“LBSPG”) scheme with application from 1 April 2003. Those provisions were first introduced by Supplementary Order Paper No. 170, dated 18 November 2003.
- 11.2 The LBSPG scheme, in essence, provides for a rebate of 12.5 per cent of the Qualifying New Zealand Production Expenditure (as defined for the purposes of the LBSPG scheme) to film and television production companies if certain requirements are satisfied. The purpose of the LBSPG scheme is to provide an additional financial incentive for the production of large budget film and television projects in New Zealand.
- 11.3 “Large budget screen production grant” is defined in section OB 1 and means a payment that:
- (a) is in the nature of a large budget screen production grant; and
  - (b) is made in relation to a film or television production; and
  - (c) is authorised by the New Zealand Film Commission in relation to a company that—
    - (i) is resident in New Zealand; or
    - (ii) has a permanent establishment in New Zealand.
- 11.4 The New Zealand Film Commission (“NZFC”) has the responsibility for administering the grant and, essentially, determining the entitlement of such grant to film or television production companies. The criteria developed by the NZFC are available on the NZFC’s website (<http://www.nzfilm.co.nz>). This paper will refer to these criteria as “the Guideline” in this chapter. The criteria described below were current as at August 2005, but reference should be made to the NZFC website to confirm that these have not been altered.
- 11.5 It should be noted that the Inland Revenue Department (“IRD”) **does not** administer the entitlement to grants or set the criteria for grants. The IRD does have a role in the validation of the information that is provided by screen production companies in support of their applications for grants. The contact person in the IRD for the LBSPG at the present time is Vince Costa, Screen Production Industry Desk leader in the Corporates segment of IRD. Vince can be contacted by telephone on (04) 802 7240 or by email: [vince.costa@ird.govt.nz](mailto:vince.costa@ird.govt.nz). All external inquiries in relation to the screen

production industry should be directed to the Screen Production Industry Desk at screen@ird.govt.nz or 0800 SCREEN (0800 727 336).

11.6 Appendix C includes a diagram showing how the LBSPG scheme works.

### **Some basic definitions**

11.7 The LBSPG scheme is based on the concepts of Qualifying New Zealand Production Expenditure (“QNZPE”) and Total Production Expenditure (“TPE”). The definitions of these terms are set out in the Guideline published by the NZFC.

#### *Qualifying New Zealand Production Expenditure*

11.8 QNZPE is generally defined as the production expenditure spent by the applicant on the screen production where that expenditure is incurred for, or is attributable to:

- goods and services provided in New Zealand;
- the use of land located in New Zealand; or
- the use of a good that is located in New Zealand at the time that the good is used in the making of the screen production.

11.9 The following New Zealand expenditure items are specifically **included** in QNZPE:

- **New Zealand development and pre-production expenditure**, which is defined as expenditure incurred in New Zealand on the development and pre-production stages of the screen production i.e. prior to the commencement of principal photography, including expenditure to cover:
  - location surveys and other activities undertaken to identify and assess locations for possible use in the production;
  - storyboarding and script writing;
  - research for the production;
  - casting actors;
  - developing a budget;
  - developing a shooting schedule for the production and
  - those legal costs relating to writers’ contracts or to copyright issues, including chain of title.

- **New Zealand copyright acquisition** (provided the cost is allowed as a deduction or depreciation is allowable under the 1994<sup>1</sup> Act);
- **New Zealand business overheads**, to the extent that the amount does not exceed the lesser of:
  - 2% of the total of the company's TPE on the screen production; or
  - NZ\$500,000
- **New Zealand copyrighted publicity and promotion expenditure**, if:
  - The expenditure was incurred by the applicant company before completion of the production; and
  - Copyright in the publicity material is held by a person the Income Tax Act 1994 treats as either being resident in New Zealand under section OE 1 or OE 2, or who carries on a business in New Zealand through a fixed establishment.
- **Travel to New Zealand**, where that travel relates to incoming journeys:
  - For non-cast personnel whose remuneration qualifies as QNZPE and who work on the screen production in New Zealand for a period totalling fourteen days or more; and
  - For cast personnel whose remuneration qualifies as QNZPE, regardless of the number of days spent working on the screen production in New Zealand.
- **Advances**, where they satisfy the criteria specified in the definition of QNZPE;
- **Production insurance and completion bonds** (with the exception of Errors and Omissions insurance);
- **Freight** (provided that it is paid in New Zealand).

11.10 The following expenditure items are specifically **excluded** from QNZPE:

- Financing expenditure
- Costs relating to Short-term Visits for Non-cast Personnel
- Costs of Services embodied in Goods (This is where the costs of certain services are embodied in the cost of a good that is delivered to

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<sup>1</sup> 2004 Act effective 1 April 2005

the applicant company, and those services were predominantly performed outside New Zealand.)

- Deferments, Profit Participation, Residuals
- Others (including Errors and Omissions insurance, cast perks, gifts, entertainment and gratuities).

#### *Total Production Expenditure*

11.11 TPE is defined as the production expenditure incurred in, or that is reasonably attributable to, actually making the screen production whether in New Zealand or elsewhere, to bring the production up to the state that the production is ready to be distributed, broadcast or exhibited to the general public.

11.12 TPE includes all expenditure items calculated as part of QNZPE.

11.13 TPE, however, does not include the following expenditure items:

- **Financing expenditure**, including returns payable on amounts invested in the screen production and expenditure connected with raising and servicing finance for the production, such as interest payments;
- **Development and pre-production expenditure** (except where it qualifies as QNZPE);
- **Copyright acquisition** (except where it qualifies as QNZPE);
- **General business overheads** (except where it qualifies as QNZPE);
- **Publicity and promotion expenditure** (except where it qualifies as QNZPE);
- **Deferments, profit participation, residuals**, including:
  - Payments deferred until the screen production provides financial returns through box office receipts, earnings, or profits (e.g. bonuses paid to directors);
  - Payment dependent on eventual profits made on the production; and
  - Amounts payable in relation to the residual rights of cast members concerning the commercial exploitation of the production through future exhibition and distribution.
- **Advances** (except where it qualifies as QNZPE and is non-recoverable);

- **Acquisition of depreciating asset** (except for copyright acquisition expenditure that qualifies as QNZPE);
- **Other exclusions**, including Errors and Omission insurance, cast perks, gifts, entertainment and gratuities.
- **Nominated exclusion** – remuneration, travel and associated costs of one individual to be disregarded.

### **Criteria for the LBSPG**

11.14 The eligibility criteria for the LBSPG include:

- Time of completion
- Expenditure thresholds
- Format
- Relevant entity
- Residency status

#### *Time of completion*

11.15 The LBSPG scheme applies to productions completed after 1 July 2003. Productions substantially completed before 1 July 2003 will not be eligible for the grants.

11.16 Where screen productions are completed after 1 July 2003, QNZPE incurred from 1 April 2003 will be eligible for the grant. Any expenditure on a screen production incurred before 1 April 2003 is excluded.

#### *Expenditure thresholds*

11.17 Access to the LBSPG requires a **minimum level of QNZPE of NZ\$15 million** on the production of a film or television project.

11.18 If the film or television project's QNZPE is between NZ\$15 million and NZ\$50 million, that QNZPE must be at least **70 per cent** of the film or television project's TPE.

11.19 If the film or television project's QNZPE is **NZ\$50 million or more, it will qualify for the grant**, regardless of the percentage ratio of QNZPE to the film or television project's TPE.

11.20 For television series, individual episodes which have completed principal photography within any 12 month period and with a minimum average spend

of \$500,000 per commercial hour may be bundled to achieve the total of NZ\$15 million.

### *Format*

11.21 Eligible screen production must be in one of the following formats:

- **a feature film** (including those shot direct-to-video) where the film is:
  - a film commonly screened as the main attraction in commercial cinemas;
  - no less than 60 minutes, or in the case of a large format (IMAX) film no less than 45 minutes; and
  - is shot and processed to commercial release standards for exhibition to the public in cinemas, by way of telecasting (including broadcasting by way of the delivery of a television programme by a broadcasting service), or for distribution to the public as a video recording (whether on video tapes, digital video disks or otherwise).
- **a television movie**, being a drama (i.e. a composition which tells a story through the development of theme and plot, by means of dialogue and action and the portrayal of characters, settings, and life situations) of a like nature to a feature film capable of exhibition on television where television movie is:
  - no less than one commercial television hour in length, or in the case of a programme predominantly utilising cell, stop motion and/or computer animation not less than one half commercial television hour; and
  - is shot and processed to commercial release standards, for cinema exhibition or telecast.
- **a television drama series or mini-series**, being an episodic television drama, including animation, which is either:
  - an extended but self-contained drama made for television wherein the key dramatic elements of character, theme, and plot are introduced, developed and concluded so as to form a narrative structure (similar to that of a novel) which features a major continuous plot enhanced by minor plots and there is the expectation of an ending that resolves the major tensions and is arranged into consecutive episodes for screening purposes; or
  - an anthology of drama works for television where the key dramatic elements of character, theme and plot are introduced, developed and concluded so as to form a narrative structure within each episode (similar to that of a novel or a short story) but there is no continuity of

plot between episodes (although there may be host elements common to each episode) and is made to be broadcast under one generic title; and

- is shot and processed to commercial release standards, for telecast.

11.22 It should be noted that the definition of “feature film” under the LBSPG scheme is different from that contained in section OB 1 of the 2004 Act. (See paragraph 4.5 above for the definition of “feature film” for income tax purposes.)

11.23 Screen productions that are specifically excluded from eligibility include:

- a documentary
- reality TV
- bundling of screen productions (other than television mini-series and series as outlined above)
- an advertising programme or commercial
- a discussion programme, current affairs, news, a panel programme, a variety programme, or a programme of a like nature
- a production of a public event, including a sports event
- a training programme

#### *Relevant Entity*

11.24 An applicant must be the entity responsible for all activities involved in making the production in New Zealand, and must have access to full financial information for the total production worldwide, which can be made available to the NZFC upon request.

11.25 Only one entity per screen production can be eligible for the LBSPG.

#### *Residency status*

11.26 A film or television production company is eligible to the LBSPG if it is a New Zealand resident company or a foreign corporation operating with a fixed establishment in New Zealand for the purposes of lodging an income tax return.

11.27 A company is a New Zealand resident company if:

- the company is incorporated in New Zealand; or

- although not incorporated in New Zealand, it carries on business in New Zealand and has either its central management or control in New Zealand, or its voting power is controlled by shareholders who are residents of New Zealand.

### **Income tax provisions relating to the LBSPG**

11.28 Income tax provisions in relation to the LBSPG in the 2004 Act include:

- **Section CW 30:** a large budget screen production grant is exempt income.
- **Section DF 1(6):** a recipient of a large budget screen production grant is not required to reduce claims for allowable deductions in respect of expenditure that is recouped by the grant. Nor will the depreciation value of any capital equipment acquired in the film production be lowered by the amount of the grant.
- **Section DS 2(3)(c):** the concessional deductions allowed under section DS 2 for film production expenditure are not available to a screen production for which a large budget screen production grant is claimed. (See paragraph 5.4 above.)

11.29 The Commissioner has a role in validating information provided in support of applications for the LBSPG. Section 85F(2) of the Tax Administration Act 1994 authorises the Commissioner (from 25 November 2003) to communicate information held by the IRD to the NZFC for the purposes of enabling the NZFC to determine the entitlement of a company to a LBSPG. Upon request from the chief executive of the NZFC, the Commissioner may provide to any authorised officer of the NZFC all of the following information that is held by the IRD:

- Particulars relating to the amount of expenditure incurred in relation to a film that is the subject of an application for a large budget screen production grant;
- Particulars relating to the amount of expenditure incurred in New Zealand in relation to a film that is the subject of an application for a large budget screen production grant;
- The Commissioner's opinion as to the accuracy of any information provided by an applicant in relation to the application for a large budget screen production grant.

11.30 If any of the information specified in section 85F(2) is not held by the IRD, the Commissioner may use any of the Commissioner's powers contained in Part 3 of the Tax Administration Act 1994 to obtain information.

## **Applications for the LBSPG**

11.31 An application for the grant can be made to the NZFC once:

- a screen production is completed or is regarded as having been completed when it is in a state where it could reasonably be considered ready for distribution, broadcast or exhibition to the general public; **or**
- the QNZPE has exceeded NZ \$50 million.<sup>2</sup>

11.32 Film or television companies need to apply for the grants within 3 months of completion of the screen productions. Each application must be made in the Application Form provided on the NZFC's website. This can be obtained from [http://www.nzfilm.co.nz/regulatory\\_approvals/large\\_budget\\_grant\\_scheme.aspx](http://www.nzfilm.co.nz/regulatory_approvals/large_budget_grant_scheme.aspx)

11.33 The following information must be included on each application (refer to paragraphs 71-77 of the Guideline for detailed analysis of each item):

- Audited Expenditure Statement
- Sample Footage
- Documentation Requested in Annex A
- Statutory Declaration
- Further Information as Requested

## **Payment of the LBSPG**

11.34 Payment of the final funding will be dependent on the IRD undertaking an audit and validation of the information provided to the NZFC and the decision of the NZFC.

11.35 Provided the application for a LBSPG is complete and has been validated, the NZFC will endeavour to approve payment within 3 months of application.

11.36 The Ministry of Economic Development will make payment of the grant upon advice from the NZFC.

## **Review of the LBSPG**

11.37 The LBSPG scheme will be subject to a review conducted by the Ministry of Economic Development in 2006.

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<sup>2</sup> For screen productions where the QNZPE exceeds NZ \$50 million, an application can essentially be made twice: once at any stage after QNZPE exceeds NZ\$ 50 million and secondly on completion of the production.

## **LIST OF REFERENCE MATERIAL**

### **Tax Information Bulletin**

Vol. 16, No. 1 (February 2004), pages 58-66 (Subpart ES: Deferred Deduction Rule)

Vol. 16, No. 1 (February 2004), page 69 (Large Budget Screen Production Grant)

Vol. 15, No. 5 (May 2003), page 75 (Section EO 4(2B): Interest Component of Reimbursement for Film Production Expenditure)

### **New Zealand Film Commission**

Website:

<http://www.nzfilm.co.nz/>

Certification as a New Zealand film

[http://www.nzfilm.co.nz/regulatory\\_approvals/nz\\_certifications.aspx](http://www.nzfilm.co.nz/regulatory_approvals/nz_certifications.aspx)

Application pack for Provisional Approval of Certification (pdf)

[http://www.nzfilm.co.nz/regulatory\\_approvals/nz\\_certifications.aspx](http://www.nzfilm.co.nz/regulatory_approvals/nz_certifications.aspx)

Application pack for Final Approval of Certification (pdf)

[http://www.nzfilm.co.nz/regulatory\\_approvals/nz\\_certifications.aspx](http://www.nzfilm.co.nz/regulatory_approvals/nz_certifications.aspx)

### **Large Budget Screen Production Grant**

Large Budget Screen Production Grant Criteria (pdf dated 17 December 2003):

[http://www.nzfilm.co.nz/regulatory\\_approvals/large\\_budget\\_grant\\_scheme.aspx](http://www.nzfilm.co.nz/regulatory_approvals/large_budget_grant_scheme.aspx)

Application Form (pdf dated September 2004):

[http://www.nzfilm.co.nz/regulatory\\_approvals/large\\_budget\\_grant\\_scheme.aspx](http://www.nzfilm.co.nz/regulatory_approvals/large_budget_grant_scheme.aspx)

### **IRD's Screen Production Desk**

Website:

<http://www.ird.govt.nz/industry-guidelines/screen-production/>

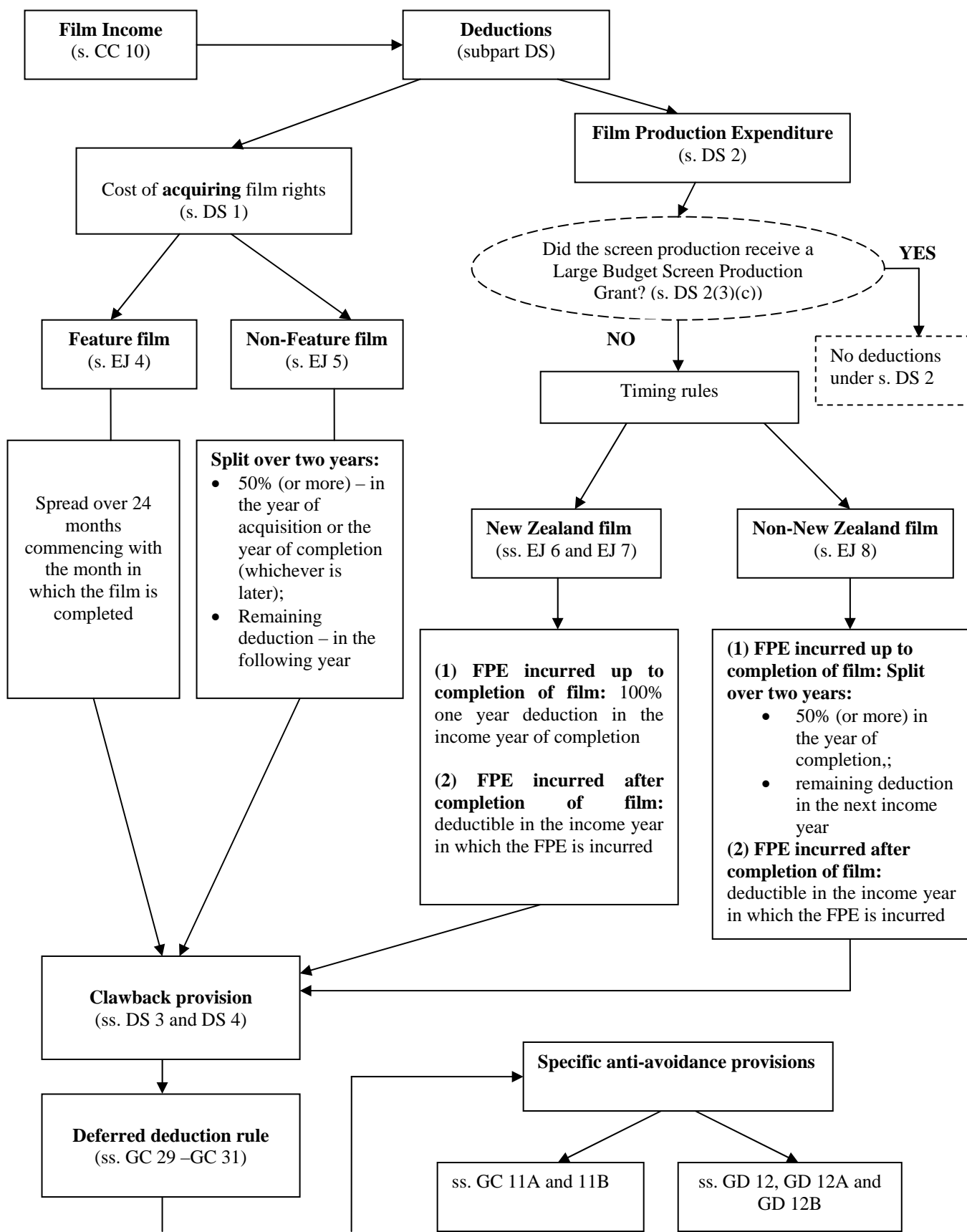
0800 phone number:

0800 SCREEN (0800 727 336)

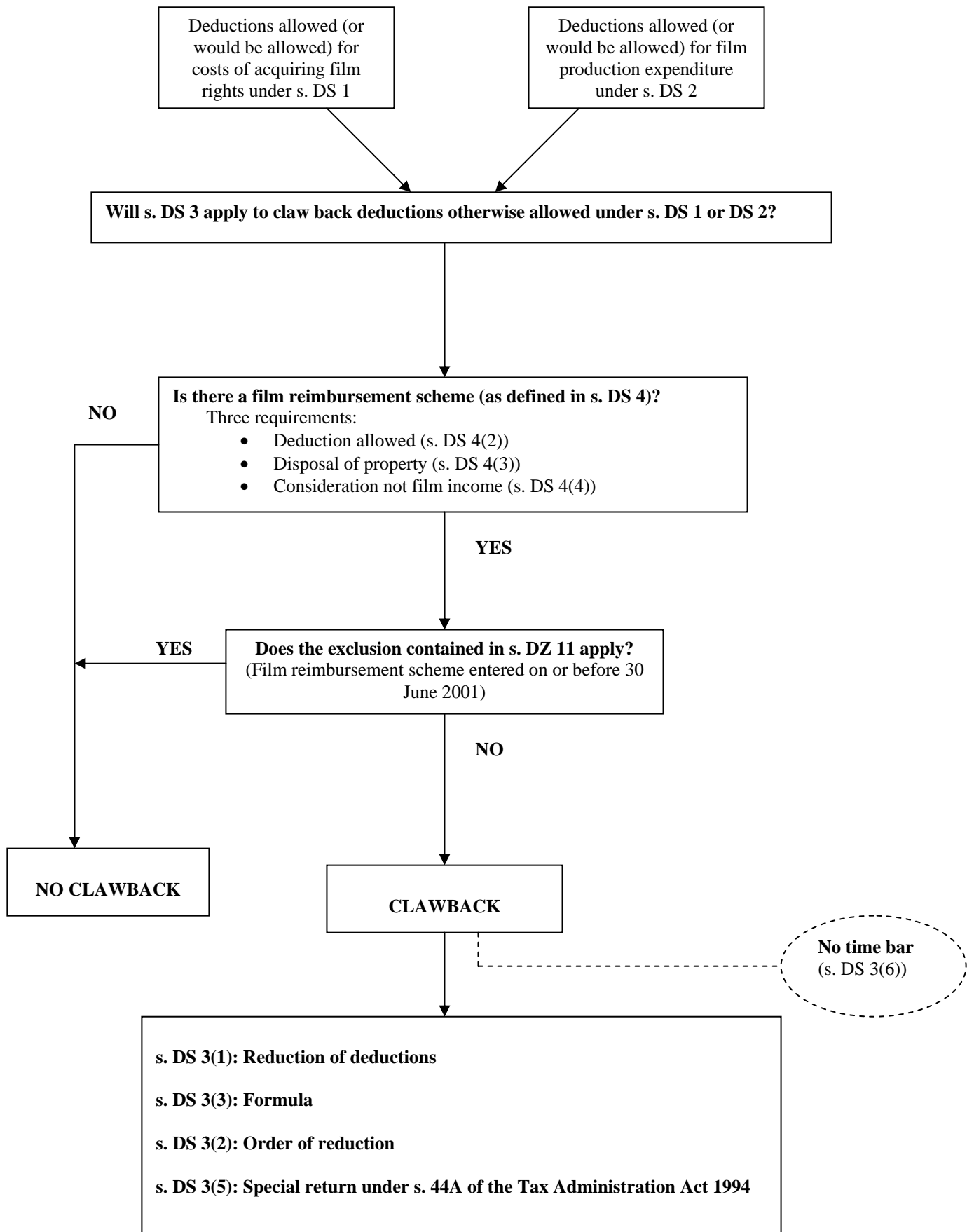
Email:

[screen@ird.govt.nz](mailto:screen@ird.govt.nz)

**APPENDIX A: INCOME TAX TREATMENT OF NEW ZEALAND SCREEN PRODUCTION INDUSTRY UNDER THE INCOME TAX ACT 2004**



**APPENDIX B: OPERATION OF SUBPART DS OF THE INCOME TAX ACT 2004**



**APPENDIX C: HOW THE LARGE BUDGET SCREEN PRODUCTION GRANT (LBSPG) SCHEME WORKS**

