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Mass-marketed Tax Schemes  
The General Manager  
Policy Advice Division  
Inland Revenue Department  
PO Box 2198  
**Wellington**

22 February 2002

Dear Sir/Madam

### **Mass marketed Tax Schemes**

This letter sets out SPADA's submissions in relation to the Mass-marketed Tax Schemes Issues Paper published by Inland Revenue's Policy Advice Division and Treasury in January 2002 ("Issues Paper"). We appreciate the opportunity to comment.

1. We acknowledge that there may be schemes in use which provide significant tax benefits to certain investors. However any proposed solution to this specific issue should be considered in the context of the effect on the relevant industries and the New Zealand economy as a whole. A balance needs to be struck between recognising the value of new economic activity and enterprise in New Zealand and preserving the tax base.
2. If the proposals set out in the Issues Paper were introduced, there could be a significant impact on the level of investment in films in New Zealand. The proposals are likely to create greater uncertainty for investors in New Zealand films and we understand that a number of film projects are already in jeopardy due to the uncertainty created. Therefore, SPADA considers that a cautious approach should be taken and that the issues should be carefully considered from a number of angles to ensure that any amendments do not prejudice either existing film projects or genuine new activity.
3. Our submissions on the Issues Paper cover the following two broad areas of concern for the New Zealand screen production industry:

- (a) the degree to which the proposals will conflict with and/or reduce the benefit of the existing specific tax regime for film investments and the tax preferences contained in the Income Tax Act 1994 for those activities; and
- (b) the related but more general issue of the overall economic impact of the proposed changes.

### **Impact on existing concessionary regime**

#### *Summary of Submission*

- 4. We submit that further consideration should be given to the extent to which:
  - (a) the Issues Paper will prevent taxpayers from utilising the existing regime for film expenditure; and
  - (b) the general and specific anti-avoidance provisions in the Act could be used to combat abuse of the existing regime.
- 5. If, for policy reasons, it is considered that such a concessionary regime is not warranted, this should be addressed explicitly and subject to wide consultation.

#### *Discussion*

- 6. The Issues Paper states that it is not intended to prevent taxpayers from taking advantage of existing provisions which allow deductions to be taken for expenditure in advance of the income associated with that expenditure. It goes on to say that it is aimed at schemes that seem to “overstate the investors’ deductions”.
- 7. This aim is reflected in the acknowledgement (at paragraph 3.1 of the Issues Paper) that the key concern in relation to such schemes is the inflated valuation of assets. It is difficult not to agree with this view. However, in the case of films, while valuations can only be an estimate and are clearly subjective to some extent, such estimates are made on the basis of past experience and all information available at the time. From time to time those estimates are, with hindsight, seen to be conservative. The Issues Paper does not provide any evidence that valuations in relation to film investments have been significantly manipulated to increase tax benefits.
- 8. The Issues Paper focuses on whether the investors’ funds are “at-risk” and states that this approach is preferable to targeting valuation because “the forecasts of income that underpin valuations of the assets involved are inherently difficult to determine and are very subjective”. It therefore proposes the introduction of a deferred deduction rule and registration of tax schemes. SPADA would be concerned if this option has been taken purely because addressing the real issue, inflated valuations, is too difficult.
- 9. Specific concessionary regimes dealing with the taxation of film investments have been included in the applicable tax legislation in one form or another since 1982. They were enacted because of the particular risk profile of the film industry, which generally involves a large outlay of expenditure with a low prospect of significant commercial return for any particular project. The film provisions were tightened in 1999 and contain a number of rules intended to prevent abuse of the concessionary regime (for example, by disallowing deductions for film expenditure if that expenditure is “effectively

reimbursed” to the investor). These amendments have already reduced investor interest in film projects by removing some of the tax benefits of those investments.

10. The Issues Paper refers to Canadian and US legislation which deals with investments where funds are not “at risk”. A brief review of these provisions indicates that they are similar to the proposals in the Issues Paper. We note that the Canadian “at-risk” rules appear to apply only to transactions between related parties, whereas the New Zealand proposals would also apply to arms-length transactions. We submit that this aspect should be reconsidered. It is important that any amendments are made after consideration of the particular context of the New Zealand film industry and economy generally.
11. The application of the proposed changes is broadened further by the IRD’s intention that the deferred deduction rule:
  - will not be subject to any statutory time-bar and therefore investors will be at risk of reassessment indefinitely; and
  - will apply retroactively to future deductions of existing schemes.
12. New Zealand tax legislation already contains a detailed regime in relation to film expenditure and range of specific anti-avoidance provisions which deal with related party film transactions (as well as the general anti-avoidance provisions). The need for further changes as proposed in the Issues Paper (to the extent they apply to film expenditure) is not clear. There is a very real risk that the broad application of the proposals (in addition to the amendments made in 1999) will be a deterrent to potential investors in New Zealand films. We are already aware of one major production which is struggling to find investors as a result of the uncertainty as to the tax treatment and the effective removal of incentives.
13. SPADA is concerned that the effect of the proposals in the Issues Paper may be to prevent taxpayers from legitimately utilising the specific statutory provisions for deductibility of film expenditure. It appears that the IRD may be of the view that the existing concessionary regime is open to abuse. We would like to see further explanation as to why the existing anti-avoidance provisions are not sufficient to deal with this issue.
14. The proposals in the Issues Paper could stigmatise all investors in film as a threat to the revenue base, even if they are simply applying the rules set out in the legislation. They are therefore likely to have a serious adverse impact on investment in this area generally.

## **Overall economic impact**

### *Summary of Submission*

15. We submit that further analysis is required in respect of the overall economic context to balance the benefits of new economic activity against any threat to the revenue base before proceeding with the proposals.

### *Discussion*

16. SPADA is concerned about the lack of analysis as to the overall economic impact of the proposed changes. The Issues Paper refers to a figure of \$436 million in tax credits that have been claimed

in relation to schemes that the Inland Revenue is aware of by the end of the 2000 income year. No information is provided as to how this figure was reached and it is therefore impossible for us to evaluate it.

17. More importantly, these figures are not balanced by any estimate of the economic benefits of the relevant investments. It is entirely possible that, should the proposals be enacted, potential investors will not invest in the New Zealand film industry (or even in New Zealand at all). We consider that a global economic analysis of investment in films in New Zealand should be undertaken before the proposals in the Issues Paper are progressed. The Prime Minister, in her Statement to Parliament last week, identified creative industries as one of the key areas in which government resources will be focused in the future. In this context it would not be desirable to introduce tax changes that may have the effect of undermining those very industries, including the film industry, without a detailed strategic analysis of the industry, its potential for growth and how this can be assisted through supportive government policies.
18. From our perspective, industry growth will be leveraged from domestic private investment and foreign direct investment in specific screen production projects or production slates. This is because public funding overall will remain relatively static or possibly even decline when the television industry in particular - the engine of the screen production industry - is considered. Securing debt financing, a key part of most film packages, also relies on a measure of private investment as the gap financing component. Private and foreign investment relies on a consistent and clear regulatory regime and the Issues Paper is not assisting this. We cannot stress enough that it is unlikely the industry will maintain or reach even its current level of activity without active, bold support and that surety of public policy is critical.
19. We consider that the following questions would be a useful starting point for discussion:
  - What is the purpose of providing tax relief?
  - If it is accepted that there may be positive purposes (for example, job creation, skills training, capital/infrastructure investment, encouragement of entrepreneurs), which activities are currently deemed as legitimate for tax relief?
  - Who should be involved in determining this and what are the criteria? In this regard, we suggest that the long delays between incurring expenditure and deriving income which are characteristic of industries such as film, forestry and mining provide a justification for special treatment in these areas.
  - We consider that the criteria should also include consideration of flow-on tax takes such as GST and PAYE, which would not be collected if the activity did not take place.
20. We would be happy to participate in discussions in relation to how the concerns raised in the Issues Paper may be addressed without adversely impacting on industries that have been identified as key for the development of the New Zealand economy.

Yours sincerely

**Jane Wrightson**  
**Chief Executive**  
*[sent unsigned by email]*