



## PRIMARY SECURITIES LTD

Our Ref: PrimRE/Admin/Corr/General

6 August 2006

**Mr Peter Young**  
**General Manager**  
**Film and Digital Content**

Department of Communications, Information Technology and the Arts  
GPO Box 2154  
CANBERRA ACT 2601

**BY EMAIL: [filmreview2006@dcita.gov.au](mailto:filmreview2006@dcita.gov.au)**

Dear Sir

### **Review of Australian Government Film Funding Support**

In this letter, I will refer to Division 10B and Division 10BA simply as 10B and 10BA.

Primary Securities Ltd is a responsible entity for operating managed investment schemes, holding Australian Financial Services Licence 224107. Primary is one of the only companies in Australia that has been licensed by ASIC to offer film investments to retail investors. Primary Securities Ltd is, insofar as we are aware, the only contract responsible entity available in Australia for 10B and 10BA retail offers.

Our last film offer to retail investors was for the producers of the proposed feature film *Clancy of the Overflow* (a company controlled by Michael Edgley Productions). In 2004, they asked Primary Securities Ltd to act as the responsible entity for their \$30m capital raising, which was held up for 2 years until close to June 2004 by ATO meanness and quibbling over 10BA details and then, when eventually issued to the public, was spectacularly unsuccessful because it failed to gain the support of clients of financial planners.

The managing director of Primary Securities Ltd has degrees in law, commerce and financial planning and also practises as a solicitor. More notes on the managing director and Primary Securities Ltd are contained in the attached Submission on 10B and 10BA dated 28 October 2005 prepared by the Managing Director (under the name of his law practice Garton Smith & Co).

### **WILL INVESTORS EVER RETURN TO 10BA?**

No, for a number of reasons. 10BA is unsuitable for encouraging non-government investment in film. Only the generous and foolish are making 10BA investments today. And it is inappropriate to try and build an industry on assistance from the generous and foolish.

**ABN 96 089 812 635**

**AFSL No. 224107**

**13 Nairn Street [PO Box 732] Fremantle WA 6959**

**Tel: 08 9430 5262 Fax: 08 9430 5552 Email: [admin@primarysecurities.com.au](mailto:admin@primarysecurities.com.au)**



## PRIMARY SECURITIES LTD

2

When first introduced, 10BA deals were simply money deals in which tax was deferred for 12 months or longer by the investor. They worked because on paper, investors were going to receive a good tax deduction as well as tax exempt income.

The much maligned section 51(1) schemes of Kamisha Corporation Ltd which the writer was involved in devising were also money deals. It is naïve to think that investors went into these arrangements because they wanted to support the film industry or particular films.

### **10BA is not market driven**

The writer has already spent some time making observations on 10B and 10BA for your department. Refer to the attached Submission on 10B and 10BA dated 28 October 2005. I will now restate some of the material in that paper regarding the uncommercial nature of 10BA because I think it needs to be emphasised.

The core problem with 10BA is that it is not market driven. It serves two purposes, cultural and economic. The cultural aspect requires "significant Australian content". After 25 years of 10BA, rich investors and their advisers are now fully aware that 10BA films with significant Australian content are unlikely to appeal to international distributors and networks, let alone Village Roadshow or Hoyts or Channels 7, 9 and 10, and are unlikely to be in profit, let alone recover their costs of production. 10BA productions are art house movies or documentaries suitable only for SBS and the ABC.

Unless appealing to international mainstream markets and media and strongly commercial, 10BA films have no blue sky, that is, they do not promise super-profits, to justify the enormous and expected risk of loss of the capital invested or a good proportion of it.

Hence, any investor proposing to invest in a 10BA film today will be doing so for other reasons:

- a warm feeling from being generous to all those involved in the production,
- excitement at being involved in the film industry,
- the warm feeling from being involved in a production which says something meaningful,
- the thrill of taking a risk ("risk for risk's sake"),
- nostalgia for the heady 80s when everyone invested in films,
- stupidity.

### **Investment advisers have got more professional**

There has been a revolution in the financial planning industry in the last few years. It is no longer possible to marshal armies of unprofessional salespersons or film producers themselves to push managed investments of risk so that investors can claim a tax deduction.

Since the Financial Services Reform provisions were introduced to the Corporations Act, financial planners and their authorised representatives must be suitably experienced and qualified in financial planning. They must be "Policy Statement 146 compliant". For example, the writer took appropriate qualifications and now holds a Graduate Diploma of Financial Planning. No-one outside such qualified persons may advise retail investors. Care must also be taken with wholesale clients, but the controls are not as onerous.



## PRIMARY SECURITIES LTD

3

### **Risks must be spread**

A client's overall circumstances must be taken into account and only a very small proportion of a client's funds can be appropriated to high risk investments. Hence, even wholesale investors cannot be expected to place more than a small amount relative to their overall assets into any venture which involves substantial risk.

### **Commissions have to be paid**

Like it or not, the financial planners expect a 10% commission for placing investment in anything that is tax effective. 10% is what is paid by the majors (Great Southern, Gunns, ITC, Timbercorp) and so new entrants to the market probably have to pay an even higher commission or no money is raised. Planners are besieged with companies wanting access to their high net worth clients. The film industry cannot expect to walk in the door and receive money, there is a long line of people standing there ahead. Hence, even higher commissions than 10% are probably required.

### **Risk**

Expecting investors to be at risk for any percentage of their money (even 20%) is sufficient to put financial planners on edge. There is far less risk with forestry and other agricultural investments even though the projects are often very long term and subject to the vicissitudes of nature.

Financial planners must be conscious of the risk profile and tolerance of the client. In other words, a serious attempt must be made to ascertain whether or not the client has a tolerance for risk, that is, whether the investor has a clearly enunciated wish for risk taking with a view to high returns, and appreciates the risk of capital loss (see ASIC Policy Statement 175). Only a very small proportion of all clients will be in this category.

A planner will only be able to recommend riskier investments for clients with risk tolerance if the anticipated returns are great enough to justify the risk. Risk without high returns ("risk for risk's sake") is not justified, in other words, a financial planner would be negligent for permitting a client to enter into a high risk investment that did not have the possibility of high returns. If a film investment is not expected to have blue sky, extraordinary returns if it is well received by audiences, then the planner would be negligent for recommending it.

The writer concludes that because of the changes to the financial services industry, which are in the interest of investors and designed to protect capital, financial planners are no longer able to recommend that investors invest in a 10BA film, unless the film is mainstream and very commercial with a real prospect of **substantial** returns and super profits.

### **And there is a new and major risk, unreasonable interpretations from the ATO**

In the last few years, the ATO has earned a reputation for stifling film investment because of its very restrictive interpretations of 10BA. Some examples are:

- the one year delay while the ATO held up **all** product rulings and quibbled about whether or not 10BA had to be reduced to the extent that foreign income was anticipated



## PRIMARY SECURITIES LTD

4

- the removal of the producer backed distribution guarantee as a method of risk reduction for investors (reversing on an interpretation agreed with the film industry in 1981). Hence, one flaw in the proposal by the AFC to use the offset to provide a distribution guarantee to 10BA investors is that this conflicts with the ATO's new interpretation which prevents such guarantees. The ATO will simply say investors are not at risk and reduce the deduction accordingly. Refer to the attached Submission on 10B and 10BA dated 28 October 2005 in which I dealt with this in more detail.
- The removal or reading down of the rule in *Fayman's Case* to the effect that 10BA investment could be used to repay loans to the producer made for the purpose of paying for production expenses.

Consider how the ATO treated investors in the Barron Entertainment Ltd (WA produced) \$10m television series *Kings in Grass Castles* which was produced in 1998. Five years later, the ATO disallowed the bulk of the tax deductions claimed by investors on three grounds:

- (a) the budget was inflated (an utterly unsubstantiated assertion which the ATO subsequently reversed);
- (b) there was a producer backed distribution guarantee (a "security") paid for by the producer out of the investment (untrue, there was a producer backed guarantee funded by the AFC); and
- (c) the investment was used to pay back a loan and to the extent to which this loan was used for financing and other costs was not available as production expenditure (a distortion of what in fact took place - there was more production expenditure than the amount funded by investors under 10BA).

Each of these grounds was incorrect and the executive producer (Paul Barron) was unable to do anything because his company had gone into liquidation and all records were with the liquidators and receivers and there were no funds or infrastructure available for an appeal. The ATO took the outrageous position: "in the event that additional information supported by appropriate documentation does become available our treatment of the Division 10BA deductions will be reviewed".

The budget for the series was just under \$10m, and actual production expenditure was slightly in excess of this figure. The writer was lead counsel for this project. This project was very complex in structure and involved AFC funding, as well as 10BA and 10B investors and was also an international co-production.

The retrospective attack by the ATO on investors in this major award winning project five years after they invested, whose budget had been approved by government agencies in two countries and was fully spent and audited, which involved teams of accountants and lawyers and in which everything had been done carefully and correctly and in accordance with 10BA as understood in ATO policy and in case law, was a gross abuse of the intention of 10BA and an injustice to the investors and all professionals involved.

Investors in a project of this size came from planners and accountants all over Australia, and hence the impact just from the disallowance of deductions for just one project is substantial. There are other examples, and planners do not think there is any distinction between the now disgraced section 51 schemes and 10BA.



## PRIMARY SECURITIES LTD

5

10BA was designed to assist the film industry and should be interpreted liberally. The ATO's unreasonable interpretations have substantially contributed to the destruction of the film industry.

I will go further and say that the "Film Industry Partnership" is a public relations exercise designed to hide the fact that at the same time as seeking to cooperate with the film industry, the ATO is using every means at its disposal to limit 10BA investment because of its open ended nature. I suspect that they have been instructed to do so by Treasury in order to confine the deductions to the minimum possible. Every possible method that can be perceived to frustrate and delay 10BA promotions is used.

### **So where does that leave 10BA?**

In the context of the above, the following steps need to be taken if investors and their advisers are to use 10BA:

- 10BA must be altered to be entirely commercial and market driven
- 10BA should be permitted to specifically allow distribution guarantees including producer backed distribution guarantees
- 10BA needs to be expanded to permit expenditure on finance costs and commissions and all other current non-deductibles
- interest and other borrowing expenses need to be fully deductible
- any other interpretation problems of 10BA need to be clarified to prevent the ATO from adopting unreasonable and stifling interpretations

For matters of detail, I refer to the attached Submission on 10B and 10BA dated 28 October 2005.

Yours faithfully

**PRIMARY SECURITIES LTD**

Robert Garton Smith  
Managing Director