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Ministry for Culture & Heritage
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SPADA'S SUBMISSION: SCREEN PRODUCTION INCENTIVE FUND (SPIF)

SPADA would like to congratulate the Ministry for Culture and Heritage and the Government for its foresight and commitment to introducing this production incentive scheme.

SPADA views this as a positive and encouraging government initiative which empowers and incentivises entrepreneurial screen production practitioners, giving a maturing industry more ability to determine and control its own future.

SPADA appreciates the Ministry's open and frank discussion and the opportunity for direct dialogue with the Ministry by industry members. SPADA acknowledges the time constraints the Ministry is under to ensure the scheme is operational by 1 July 2008; to this end, SPADA's role in ensuring its members had input into this process was via liaison with the Ministry in supplying names and contacts of key practitioners to invite to the consultation meetings led by the Ministry; and distribution of draft documentation via its email distribution list to all members.

In writing this submission SPADA has drawn on members' feedback to the Ministry, from the Auckland (4th of June) and Wellington (3rd of June) workshops and meetings; and from other correspondence received from the feedback. In the light of the above, SPADA presents the following points for consideration:

SIGNIFICANT NEW ZEALAND CONTENT TEST

1. SPADA would like to stress the importance of ensuring the process for assessing Significant New Zealand Content is as **transparent** and **non-subjective** as possible. In order to secure production finance producers and their investors will require absolute certainty at the outset that they will qualify under the Significant New Zealand Content Test. There is therefore some evident concern about the subjectivity of “Contribution to New Zealand Culture or History” and “Any Other Relevant Matters”. There is also some concern about “Lead Characters” and the potential for this content area to limit the ability of New Zealand filmmakers to make genre (particularly for example Sci-Fi) films.

A number of practitioners have suggested that the minimum be lowered to 3 out of 12 in this section; as opposed to the current 4 out of 12 points.

SPADA recommends further consideration is given to criteria for assessing these content areas to ensure that the assessment is clear cut and not subject to interpretation by the panel.

2. SPADA believes “Ownership of Copyright” should be given greater prominence. Copyright ownership is significant economic driver and New Zealand companies need to be incentivised and encouraged to retain copyright wherever possible. Retention of copyright should in some cases outweigh the benefits of utilising other New Zealand elements.

SPADA recommends Ownership of Copyright be given up to 2 points – 1 point when 50% of the copyright in the production is owned by New Zealanders or New Zealand-resident companies and 2 points when 100% of the copyright in the production is owned by New Zealanders or New Zealand-resident companies.

3. It is important that once the assessment panel has provided an initial assessment on the Significant New Zealand Content Test that this cannot be revisited at a later stage. If the current subjective content areas are to be retained – for example “Contribution to New Zealand Culture/History” – and if these points have been granted for these areas in the initial assessment process they should not be able to be rescinded because of a different interpretation by the final certification panel.
4. In some cases individual SPADA members have diverging views on the Significant New Zealand Content Test, most especially in respect of the screen format threshold.

Therefore beyond the comments above SPADA has not commented on the Test and has instead encouraged members to make individual submissions.

SCREEN PRODUCTION INCENTIVE FUND DRAFT CRITERIA

(Please Note: headings are as per the Draft Criteria unless otherwise specified)

Section I – Introduction

1. Clause 7 – completion. To future proof this definition, and to avoid confusion, SPADA recommends the following wording be adopted:

A screen production is completed when it is first in a state where it could reasonably be regarded as ready to be distributed, broadcast or exhibited to the general public, specifically in the case of:

- (i) feature film – when it is completed to answer print stage or digital equivalent;
- (ii) individual television episode – when it finished to master video tape stage or digital equivalent with credits ready for broadcast;
- (iii) series – when it finished to master video tape stage or digital equivalent with credits ready for broadcast; and
- (iv) season of a series - when it finished to master video tape stage or digital equivalent with credits ready for broadcast, completed within one defined time period or “season” of a series.

Expenditure Thresholds

Film

2. SPADA acknowledges the Government’s rationale for the \$5 million threshold for feature films, however, if the Government is seeking parity with Australia, and seeks to stem potential flow of production to Australia it needs to acknowledge the different economic environments; and lower the threshold to \$3 million for feature film. The gap between \$1 million in Australia and \$5 million in New Zealand is too high. \$5 million is also too high for QNZPE as it is likely that total budgets will need to be in excess of \$6 million in order to qualify and this is in realm of higher rather than medium budget domestic New Zealand films. Therefore in order to support increased production of medium scale New Zealand films, a key aim of SPIF, the threshold needs to be \$3 million QNZPE for feature films.

Television

3. Similarly, SPADA believes that the minimum QNZPE thresholds for television are too high. New Zealand television budgets are often less than a third of Australian

budgets (broadcaster licence fees being very low in New Zealand – see paragraph 16) and in copying Australian expenditure thresholds that are unattainable by New Zealand producers SPIF will not achieve the aim of stopping productions moving to Australia or elsewhere. While MCH acknowledges that TV programmes will require a strong international focus in their financing and content, the government's aim is surely not to enable SPIF to be used only by international productions shooting in New Zealand if they can meet the content test. This will not result in a boost for domestic television production companies. SPADA believes the minimum QNZPE threshold for documentaries should be reduced to \$200,000 or lower. The current minimum threshold for QNZPE of \$250,000 reflects the Australian environment but will not be met in the New Zealand environment; as documentaries do not command budgets at these levels and as stated licence fees are much lower in New Zealand than Australia.

Format

4. The definition of the genres “documentary” and “reality” could be problematic, and therefore need to be clarified.
5. The “Reality genre” has little or no meaning in the current screen production market; as it is a broad term that encompasses a multitude of genres and sub-genres. In its broadest sense – under the context of this Draft Criteria - a documentary could be thought of as Reality (e.g. does reality include factual?).
6. SPADA recommends a definition such as Scripted Factual (as opposed to non-scripted competition factual). SPADA would argue that non-scripted competition factual (e.g. Survivor/Treasure Island) should be excluded.
7. SPADA notes the FFC’s definition for the other formats has effectively already been adopted.
8. A strong argument for the inclusion of one-off variety programmes has also been made when the concept or format is of New Zealand origin. It is SPADA’s belief that this would contribute to the objectives of the scheme.

Cinematic Distribution

9. For the purpose of clarity and transparency SPADA believes a more detailed definition of “commercial cinematic distribution” needs to be incorporated within the Criteria. The definition in the FFC Producer Offset Guidelines is a useful guide in the first instance, as follows:

“...evidence of a commercial agreement for distribution via exhibition in commercial cinemas in Australia, where an admission fee is charged. This should be a bona fide release (e.g. six screens in aggregate in three capitol cities), not a contrived arrangement for release on one or a very small number of screens. It excludes test screenings, free or charitable screenings, and the film festival screenings (as such terms are commonly understood in the Australian film and television industry).”

Relevant Entity

10. Whilst SPADA acknowledges broadcasters may in some rare instances be the entity responsible for making the production, it needs to be clear that when the production is made by an independent producer/production company the producer is eligible for the SPIF, rather than the broadcaster. The broadcaster should only be eligible when the broadcaster is the genuine producer of the programme.

Access to Other Incentives

Film

11. SPADA perceives a problem with the \$2 million allocated to the NZFC for co-investment in SPIF projects. If this arrangement is maintained it will grossly hamper the NZFC's ability to co-invest in SPIF film projects, and in turn, will limit the number of medium to large budget films able to be made in New Zealand.
12. It would seem as currently structured the NZFC can only access the \$2 million per annum co-investment funds at the point in which they will be invested in a project. However this is entirely inconsistent with the way in which the NZFC makes funding decisions and inconsistent with standard film industry practice. Normally the NZFC would make a commitment to a project but this funding would not be drawn down until completion of all financing documentation and the start of pre-production or principal photography. It is unusual for this to occur within the same financial year. In some cases there can a significant time-frame between the initial commitment and actual draw-down. *River Queen* for example received a commitment from the NZ Film Fund in December 2001 but did not draw production funding until May 2004. Similarly *Under the Mountain* received a commitment in August 2007, but has yet to draw production funding and will not until the NZFC's next financial year.
13. Therefore the distinct possibility exists whereby in 2008 the NZFC commits \$2 million towards productions but because these productions do not go into production in 2008, it forfeits the 2008 funding and is unable to make any further of funding commitments until these commitments are honoured, potentially rolling over several years. Using the *River Queen* timeframe as an example the NZFC would only be

able to utilise \$2 million of the \$8 million available to it. This would seriously undermine the intent of the SPIF and New Zealand filmmakers' ability to make medium to large budget films.

14. It is essential the NZFC remains free to make such commitments and that filmmakers have absolute certainty the full \$8 million of funding over four years will be available.
15. SPADA recommends the best way forward is to provide the \$2 million per annum direct to the NZFC. In order to facilitate rolling commitments, the NZFC should be able to retain and roll over these funds, and still be eligible to receive a further \$2 million per annum of co-investment funding so as to be able to make future commitments. However this must come with the caveat that these funds can only be explicitly utilised for investment in SPIF projects (i.e. not used for other NZFC activities and nor towards administration costs associated with managing the co-investment in SPIF projects) and that any interest accrued will also only be utilised for SPIF co-investment purposes.
16. This process could also stem the concerns that NZFC holds regarding a reduction to its production funding. SPADA is concerned about the NZFC's perceived pressures on its funding as a result of SPIF. In particular SPADA is concerned that any retrenchment by the NZFC or significant changes or any cut backs in its current funding strategies could have a significant impact on the industry and be detrimental to the aims of the SPIF.

Television

17. SPADA believes the current 20% threshold for television will result in a minimal uptake for international service production in New Zealand; and next to no uptake for domestic production - as producers will struggle to secure the 80% plus of private and/or offshore finance required with the requirement for 14 cultural/location specific points under the Significant New Zealand Content Test.
18. Further whilst the criteria currently allows for development funding from all government funding agencies for projects accessing the SPIF scheme it is highly unlikely any development funding will flow for television projects. The Government agencies are unlikely to expend development funding on projects when they cannot subsequently invest in the production of these projects. The net result being that no domestically driven and owned television projects that could utilise the SPIF will be delivered.

19. Under the Australian Producer Offset television producers may also secure funding from the FFC and other state agencies. In addition Australasian broadcaster licence fees are proportionally significantly higher than those in New Zealand. New Zealand licence fees are effectively artificially suppressed (relative to other markets) due to the role of NZ On Air and Te Māngai Pāho.
20. The existence of NZ On Air and Te Māngai Pāho on the domestic screen production sector needs to be acknowledged. Therefore, to ensure parity with Australia is maintained, SPADA supports the view that co-investment from NZ On Air and Te Māngai Pāho (or feasibly the NZFC as it has invested in television in the past) should be allowed up to a maximum of 40% of the total screen production budget. This would also ensure television is on a par with film. The alternative would be to raise the television grant to 40%, which has much greater budgetary implications.
21. SPADA believes, based on minimal uptake, it will be inevitable that the television threshold will need to be amended post the 2010 review of the SPIF. SPADA therefore maintains that co-investment of up to 40% should adopted immediately to ensure the incentive is as effective as possible from the outset.

Tax Treatment

(Clause 24)

22. SPADA is particularly concerned by the proposal that *'Productions receiving a SPIF grant will not be eligible for immediate write off tax incentive under sub-part EJ of the Income Tax Act 2007'*. SPADA is aware some of its members have already commented on this issue and it fully endorses and supports their comments. We reiterate their concerns.
23. If productions receiving a SPIF grant are ineligible for immediate tax write off under sub-part EJ of the Income Tax Act 2007 this directly conflicts with all three of SPIF objectives as set out in the MCH paper and will act as a major deterrent to New Zealand private investment. SPADA therefore recommends that this provision be removed from the Criteria.
24. Consistency and continuity are imperative for both the tax payer and the Inland Revenue to ensure the effectiveness and integrity of tax legislation. The proposed provision undermines both these principals.
25. From the Inland Revenue's perspective whether there is a one or two year deduction makes no difference – there is still a 'nil' balance at the end of the project. However

from a producer's perspective there are very significant cash flow (and hence interest) and administration implications. The mismatch of timing of expenditure and deductibility will put significant pressure on cash flows with the tax liability from year one needing to be cash flowed in addition to the SPIF grant. Using hypothetical \$10 million film and television projects as examples the cash flow and cost implications are very material :

Film - \$10,000,000

- \$4,000,000 grant paid at end of the production
- Spend (\$10,000,000 - \$4,000,000) = \$6,000,000 in Year 1 (but can only deduct \$3,000,000)

Resultant cash flow implication & additional interest costs

- Cash flow required = Grant - \$4,000,000 + Income Tax - \$900,000
(\$3,000,000 x 30%) = \$4,900,000
- Additional interest cost on Income Tax circa \$130,000 (@ 14.5%)

Television - \$10,000,000

- \$2,000,000 grant paid at end of the production
- Spend (\$10,000,000 - \$2,000,000) = \$8,000,000 in Year 1 (but can only deduct \$4,000,000)

Resultant cash flow implication & additional interest costs

- Cash flow required = Grant - \$2,000,000 + Income Tax - \$1,200,000
(\$4,000,000 x 30%) = \$3,200,000
- Additional interest cost on Income Tax circa \$175,000 (@ 14.5%)

26. This additional burden is an absolute disincentive and adds only to administration costs. The interest costs reduce the amount of QNZPE funding available to the project which contradicts all three of its objectives. It does not benefit the Inland Revenue but it certainly penalizes the producer, the production and the investors – particularly as it will necessitate that the investors increase their contribution to cover the lost interest costs. This will undoubtedly put greater pressure on NZFC's funding and production budgets.
27. Further, given that an aim of the SPIF is to "*incentivise the New Zealand screen production industry to develop closer market connections and private finance for larger screen productions*" SPADA views the removal of the one year deduction as anomalous to this. Whilst private investment is increasingly difficult to attract in New Zealand the ability to do so will have a direct bearing on the success of the SPIF. It

therefore seems contrary to the best interests of the incentive to impose additional obstacles.

28. Given the importance of this issue and considerable financial implications, SPADA believes it needs to be examined fully and robustly. SPADA therefore recommends that a small working group comprising: a MCH representative, an Inland representative, a SPADA representative (a working producer) and a tax specialist (SPADA nominates Greg Thompson – Tax Partner at Grant Thornton) be immediately formed to discuss and reach a definitive position on this issue.

Definition of Qualifying New Zealand Production Expenditure (QNZPE)

29. For the sake of clarity SPADA would like to see the inclusion of a definition of a project's 'production expenditure'. SPADA proposes:

“A project's 'production expenditure' is defined as the expenditure incurred in, or that is reasonably attributable to, the making of the production.

The making of a production means the doing of the things necessary for the production of the first copy of the production.

This includes development activities, pre-production activities, production activities, post production activities and any other activities undertaken in or outside New Zealand that are necessary to bring a production up to the state that it is ready to be distributed, broadcast or exhibited to the general public.”

30. It is recommended that this be inserted between the current clauses 30 and 31.
31. In respect of clause 31 SPADA recommends the inclusion of the following New Zealand incurred production expenditure:
- Legal Fees
 - Financing Costs
 - Audit Fees
 - Errors and Omissions Insurance
32. This expenditure should be eligible if incurred, *“by a person the Income Tax Act 2007 treats as either resident in New Zealand, or who carries on a business in New Zealand through a fixed establishment” or “the purchase of goods and services from a New Zealand resident company”.*

33. SPADA believes that this expenditure is a legitimate production related expenditure - without the involvement of lawyers, financiers, financial advisors, insurance etc, the high risk business which is screen production could and would not take place:
34. SPADA believes this expenditure aligns with the New Zealand Government rationale for introducing SPIF: to support the retention of New Zealand screen talent, stories and **infrastructure** by maintaining New Zealand's international competitiveness. By including this expenditure as QNZPE it will encourage the use of New Zealand persons or entities and result in:
- Enhancing and building infrastructure in key and under-developed areas; and
 - Additional tax benefits from as a result of directing as much business as possible to the domestic market.
35. Further and specifically:
- a. Legal Fees: All legal expenses incurred in respect of services performed by a law firm in New Zealand during the making of the production should be eligible as QNZPE. With the growing complexity of production's financing arrangements (and this will certainly apply to projects accessing the SPIF) lawyers are becoming increasingly integral. New Zealand currently has a limited pool of experienced and specialised entertainment lawyers – for example in respect of domestic film productions there are essentially only two fulltime specialists. This base needs to be further expanded and developed.
- b. Financing Costs: All financing costs incurred in respect of services performed by a financing firm in New Zealand during the making of the production should be eligible as QNZPE. The ability to cash flow the grant is going to be pivotal to its success. Australia and the UK experienced some difficulty in attracting financiers to cash flow their respective incentives. By including financing costs the Government is stimulating and providing a clear incentive to New Zealand investors to support cash flowing of projects. It will be a huge asset to the New Zealand screen production sector if for the first time it can genuinely build an investor base. The SPIF presents a real opportunity which needs to be maximised.

There may be some concern that this will encourage inflated finance costs within budgets. However SPADA does not believe this is of major concern as it is in the applicants' interest to minimise finance costs so as to maximise the

expenditure that can be directed on screen. Further the SPIF would in effect only cover between a maximum of 20% to 40% of the finance costs so the producer will still need to find the balance of 60% to 80%.

- c. Audit Fees: SPADA assumes that as per the Australian Producer Offset and the LBSPG that audit fees will qualify as QNZPE. However this should be made explicit. Similarly specialist financial advice (i.e. professional advice in preparing a SPIF application) should also be eligible.
 - d. Errors and Omission Insurance: SPADA does not understand the distinction between production insurance and Errors and Omissions (E&O) insurance. E&O like production insurance is generally required from the first day of principal photography. Similarly like production insurance whilst other parties (financiers, the completion bond, distributors, etc) may be listed as additional insured the insured entity is only the production company. The primary purpose of the insurance is to protect the production and the production company. On this basis it is a legitimate cost of production and should be eligible as QNZPE.
36. SPADA also maintains that the following expenditure should also be eligible as QNZPE regardless of whether the service is provided by a non resident company:
- Financing Costs
 - Completion Bond Fee
37. Given the Australian Producer Offset is already functioning it is probable that offshore (likely Australian) financiers will cash flow the grant for first SPIF projects. This will in turn give New Zealand financiers the comfort to follow. Further as there is not yet a developed investor base in New Zealand producers will have to look offshore in order to find the balance of the finance for their projects. In order to bridge this transition and ensure that the SPIF can function and be cash flowed from the outset it is important to encourage financiers irrespective of where they are domiciled.
38. Completion bond fees have already been accepted as QNZPE. However no completion bond companies are New Zealand based (two are based in Australia) and given the highly specialised nature of the services and the significant retraction in the re-insurance market this is unlikely to change. In the case of all independent films and often higher budget television a completion bond is mandatory. Given these factors there is justification to allow a non resident company's completion bond fees qualify as QNZPE.

39. In addition, as per clause 37, SPADA believes that a maximum of 5% qualifying expenditure on **overheads** may be too low. While it may work for drama and features it is unlikely to work for other genres.

Above the Line Costs

40. As currently drafted there is the possibility for confusion about the amount of Above the Line Costs eligible. Some producers have incorrectly surmised that in the case of a film the Above the Line Costs are only eligible for a maximum 20% grant. Perhaps it could be re-worded as follows:

“Above the Line’ expenditure up to a maximum of 20% of the screen production’s total expenditure may be claimed as QNZPE. Any “Above the Line” expenditure over 20% of the screen production’s total expenditure will be ineligible as QNZPE.”

41. It is imperative that the ‘Above the Line’ 20% cap remain based, as it is in Australia, on the total production expenditure. It would be totally unrealistic to expect a production to limit its ‘Above the Line’ expenditure to 20% of QNZPE (on which basis film ‘Above the Line’ expenditure could not exceed 8% of the total budget and television could not exceed 4% of the total budget). This figure would be artificially low and unnecessarily penalise television. Whilst it is acknowledged some applicants may be unwilling to provide a breakdown of the total expenditure this could be circumvented by the auditor providing a statement confirming the total production expenditure figure.

Basis of Expenditure

42. The wording of clause 65 is currently very problematic and likely to minimise the effectiveness of the SPIF. Government agency funders, broadcasters and most private or offshore financiers all require payments to be withheld until delivery or in some cases broadcast, which may be some time after completion. Further in Australia the entity’s cash-flowing the offset have only been prepared to cash flow up to 85% of the offset. The same situation will occur in New Zealand. Therefore, any expenditure incurred – but not paid out at the time of making the application – would be ineligible. This could be sizeable – at 15% of up to a \$6 million grant plus any investor payment hold backs.

43. SPADA therefore suggests that the same provisions as in Australia be adopted (as per the FFC Producer Offset Guidelines):

“Accrual basis of expenditure

For the purposes of the Producer Offset, expenditure will count as QAPE as long as it has been incurred by the applicant company. The company does not have to actually discharge its liability to pay, thereby allowing expenditure to count on an accrual basis as is consistent with normal commercial practice in the film industry.

For example, a company may be making a Film on a cost-plus basis and hold significant expenditures unpaid until funds are available via payments made from a commissioning entity. Some of these expenditures, and some part of the payments by the commissioning entity, could be unpaid at the time of completion of the Film and at the time the Producer Offset is claimed.

Note however that despite the above, most deferrals and residuals are explicitly excluded from QAPE, unless paid out by the applicant company before production is completed.”

Assessment Panel (clauses 71 & 86)

44. At present the draft Criteria only outlines that *“Applications for the grant will be assessed by a panel established by the NZFC made up from industry practitioners and relevant government agencies.”* And that, *“..the NZFC panel may seek the advice of one or more independent consultants”*. In the interests of transparency SPADA would like to *composition* of the NZFC Panel to be stipulated - for example CEO of the NZFC, Head of Business Affairs of the NZFC, representative from the IRD and two industry practitioners. Whilst the individuals may change this arrangement will provide continuity and integrity. Further SPADA would also like to see an annual list published of the potential industry practitioners and independent consultant.

Applications

45. SPADA does not perceive the need for deadline for the final SPIF application. Like Australia there should be *“no specific closing date for applications”*. Given that New Zealand producers will in almost all cases being having the grant cash flowed there already exists significant motivation for the producer to make a timely application. Removing the deadline also removes the potential for protracted and complicated disputes over when a production was actually “completed”.

Payment of Grant

46. There needs to be provision for the grant to be paid to a nominated bank account other than that of the applicant. In most cases it is likely that the grant will be cash flowed by a third party entity – i.e. a bank. In this case that party will therefore require that the grant is paid directly to them. Much like the NZFC (as an investor in a film) requiring a film’s gross receipts to be paid into a collection account versus direct to the producer or the sales agents.

Other

47. Disputes Resolution Mechanism: SPADA would like to see the inclusion of a dispute mechanism arrangement. There is the potential for conflict of interest issues over the selection of industry practitioners or independent consultants to the Assessment Panel. Similarly there needs to a mechanism to resolve any potential disagreement or uncertainty regarding interpretation of the Significant New Zealand Cultural Test or the SPIF criteria.
48. Other Criteria Being Considered: SPADA does not believe provisions around a minimum proportion of New Zealand expenditure or a maximum proportion of total government funding allowable are necessary. These additional provisions reduce the SPIF’s purity and integrity. The Significant New Zealand Content Test already adequately provides sufficient protection and is a less intrusive and blunt instrument.



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