IT 2646 - Income tax: television program licences

TAXATION RULING IT 2646

NO Ref.: 91/432-1 Date of effect: Immediate

BO Ref.: Date original memo issued:

EDR Ref.: 38

FOI INDEX DETAIL

Reference no.:	Subject refs:	Legislative refs:
I 1012761	**PROGRAM LICENCES** **- DEDUCTIBILITY** **- WHEN INCURRED**	**51** **82KZL(2)(b)** **82KZM(b)(i)** **124K(1)** **124L(1)(b)** **DIVISION 10B**

OTHER RULINGS ON THIS TOPIC:

INCOME TAX: TELEVISION PROGRAM LICENCES

TE: . Income Tax Rulings do not have the force of law.

. Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant Ruling.

PREAMBLE

The purpose of this Ruling is to clarify this Office's views on the deductibility for income tax purposes of the costs incurred by television stations in acquiring licences to televise programs ("program licences"). The following two aspects of acquiring program licences will be covered:

a. Is the expenditure on program licences revenue or capital in nature? and

b. When is the expenditure incurred?

2. In general, Australian television stations get their program licences from the major Australian networks (who get Australia-wide licences both locally and overseas, and who also produce their own programs) or from a local production company in the case of locally made films or series. The period of those licences vary but, in general, they can be classified as follows:

Up to 1 year - Series (occasionally 2 years)
- Series reports
- Documentaries
- Specials
- News

Up to 3 years - Mini-series

Up to 7 years - Feature movies
- Telemovies

3. Most acquisitions of program licences will involve the television station (and/or network company) entering into a television film licence agreement, television program licence agreement or similar agreement. These agreements will usually grant a licence to show a program for a particular number of years and for a particular number of runs within those years. As far as payment is concerned, most written agreements provide either for payment in full on signing (or within 30 days) or for payment by way of regular and pre-agreed instalments. Where there is no written agreement, payment is usually on demand by invoice.

RULING

Subsection 51(1) - Expenditure of a Revenue Nature

4. Expenditure incurred to acquire program licences is considered to be revenue in nature. This expenditure forms an essential part of the cost of the business operations of a television station and has the character of a working expense of a television station's business. It is considered to be deductible under subsection 51(1) of the Income Tax Assessment Act 1936 ("the Act").

5. Expenditure on acquiring program licences is not "once and for all" expenditure because it is the necessary in a television station's business that they be acquired on a frequent and continuous basis. See the test enunciated in:

a. Vallambrosa Rubber Co. Ltd v. Farmer (1910) 5 TC 529 at page 536; and

b. Ounsworth v. Vickers Ltd (1915) 6 TC 671 at page 675.

6. Moreover, expenditure on program licences is an outlay on the process by which an organisation operates to obtain its income rather than an outlay on the organisation itself. In essence, a television station incurs outlays on program licences in the course of its business operations to obtain advertising revenue. See Sun Newspapers Ltd & Associated Newspapers Ltd v. F.C. of T. (1938) 61 CLR 337 at pp. 362-363.

Division 10B

7. Division 10B does not apply to expenditure on television program licences as this expenditure is of a revenue nature. That Division applies only to capital expenditure.

Subsection 51(1) - When Incurred

8. Having determined that expenditure to acquire program licences is deductible under section 51, the question that then arises is when is the expense incurred for the purposes of that section.

9. Expenditure to acquire program licences will only qualify as an allowable deduction in the year of income in which it is incurred for the purposes of subsection 51(1) of the Act. The meaning of the word "incurred" was discussed by the High Court of Australia in Nilsen Development Laboratories Pty Ltd & Ors v. F.C. of T. 81 ATC 4031, 11 ATR 505. Barwick CJ stated, at ATC 4034-35, ATR 509:

"...there can be no warrant for treating a liability which has not 'come home' in the year of income, in the sense of a pecuniary obligation which has become due, as having been incurred in that year. ...the word 'incurred' in sec. 51(1) 'does not include a loss or expenditure which is no more than pending, threatened or expected': and I would for myself add 'no matter how certain it is in the year of income that that loss or expenditure will occur in the future'."

10. A liability will be a loss or outgoing "incurred" within the meaning of subsection 51(1), even though it remains unpaid, if the taxpayer is definitively committed or has completely subjected itself to the liability (see F.C. of T. v. James Flood Pty. Ltd. (1953) 88 C.L.R. 492 at 506). Section 51 covers outgoings to which the taxpayer is "definitively committed" in the year of income in the sense that he or she is then under a presently existing liability on that account (Beaumont J in F.C. of T. v. Lau 84 ATC 4929 at 4940; (1984) 16 ATR 55 at 68).

11. The question is, therefore, at what point of time in acquiring program licences is the television station definitively committed to the liability. This can only be determined by reference to the particular facts of each case, especially to the terms of the agreement entered into.

12. Agreements to acquire program licences come in many different forms. Some are in writing, some are not. Even where the agreement is in writing, programs are commonly substituted, cancelled or withdrawn (with corresponding adjustments to the agreement prices). Some agreements, as sometimes happens for Australian network-produced programs, are open ended in that they provide cancellation clauses in the event of poor ratings. As mentioned in paragraph 3, payment terms also come in different forms.

13. Having regard to the principles referred to in the decided cases, expenditure to acquire program licences is considered to be incurred for the purposes of section 51 as follows (the agreements mentioned below are indicative of the types of agreements that

exist but are not intended to be an exhaustive list of such agreements):

. Where the agreement provides that the full amount of the expenditure on the program licence is due and payable in full on entering into the agreement, it is considered that the liability for the total expenditure is incurred at the time the agreement was entered into.

Where the agreement provides that the full amount of the expenditure on the program licence is due on entering into the agreement but may be paid by way of instalments, it is considered that the liability for the total cost is incurred at the time the agreement was entered into. The subsequent payments are considered to be payments in settlement of a debt. Whether the agreement is in fact of this type or one which makes each individual payment due at the time of each individual instalment will depend on the proper construction of the particular contract.

Where the agreement provides that the expenditure on the program licence is due and payable on the receipt of an invoice, as may happen with informal or unwritten agreements, it is considered that the liability for the total expenditure is incurred at the time the invoice was received. A deduction would be available in such circumstances even where the invoice had not actually been paid because the taxpayer was, at that stage, definitively committed to incur the expenditure in the sense that a presently existing liability existed.

14. Expenditure incurred to acquire program licences is not expenditure "incurred in return for the doing of a thing...that is not to be wholly done within 13 months" in terms of subparagraph 82KZM(b)(i)). Because the "thing" to be done is the granting of the right to use the program and this "thing" is done only once (usually at the commencement of the agreement), expenditure incurred to acquire program licences would not, of itself, fall within section 82KZM. If, however, the expenditure fell within the expression "payments of a similar kind" in paragraph 82KZL(2)(b), the "thing" to be done would be taken to be done over the period of the agreement. Where that agreement was for a period in excess of 13 months, section 82KZM would apply. The expression "payments of a similar kind" in paragraph 82KZL(2)(b) is considered to refer to payments:

a. the nature of which is similar to the nature of rent and lease payments; and

b. the object or benefit sought by the payments is similar to the object or benefit sought by a payment of rent or a lease payment.

The intention of the legislation is to create a symmetry between advance expenditure and either the service to be provided or the income to flow. Bearing in mind this intention and the above construction of the expression "payments of a similar kind", expenditure to acquire program licences is considered to not be a payment of a similar kind to a payment of rent or a lease payment in terms of paragraph 82KZL(2)(b). Accordingly, the advance expenditure provisions (Subdivision H of Division 3 of Part III of the Act) do not apply to change the timing of deductions for expenditure on program licences.

Transitional Arrangements

15. Because different tax treatments have previously been accepted or approved by this Office, this Ruling will be applied only to program licences agreements entered into after the date of this Ruling.

16. Deductions arising from a program licence agreement which was entered into before this Ruling will continue to be accepted on the method currently being claimed and accepted by this Office unless the taxpayer asks that the Ruling apply. If the taxpayer requests to have this Ruling apply to the agreement, previous returns of income may be amended to the extent permitted by the Act.

COMMISSIONER OF TAXATION
11 July 1991

ISSN 0813 - 3662 Price $0.50