



## Public Notice CAVCO 2006-02

Ottawa, 8 June 2006

### Canadian Film or Video Production Tax Credit (CPTC) – Revision and implementation of CAVCO program guidelines

In this public notice, the Department of Canadian Heritage seeks comments in addition to those received following its release of Public Notice CAVCO 2005-01.

#### Background

1. The Government of Canada introduced the Canadian Film or Video Production Tax Credit (CPTC) in its 1995 budget, at a rate equal to 25% of the eligible labour costs of a Canadian-controlled production corporation, to a maximum of 48% of the total cost of a production, for films with high Canadian content as evidenced by the presence of Canadians in key creative positions according to the “point” system administered by the Canadian Audio-visual Certification Office (CAVCO) of the Department of Canadian Heritage.
2. In 1997, the Government of Canada introduced the Film or Video Production Services Tax Credit (PSTC), at a rate equal to 11% (raised in 2003 to 16%) of the salary and wages paid to Canadians working on productions that do not seek certification as Canadian, and meet certain other conditions. The PSTC is the Government’s mechanism for providing industrial support to the production sector through its recognition of the value of service productions and co-ventures.
3. In the February 2000 budget, the Government indicated that the rules and administration of the CPTC would be simplified, and the departments of Finance and Canadian Heritage undertook consultations with the industry to this end. In November 2003, the Government announced changes to the CPTC intended to increase the base of qualifying labour expenditures from 48% to 60%; remove certain fiscal impediments to investments; and simplify the tax credit mechanism and ensure that tax assistance is appropriately targeted.
4. In Public Notice CAVCO 2005-01, the Department of Canadian Heritage sought comments on potential changes to CAVCO Guidelines for the CPTC, further to the announcement of the draft modifications to the *Income Tax Act*. Of particular importance to the Department of Canadian Heritage are modifications that affect the financial and creative controls that CPTC beneficiaries must demonstrate over their productions. The Public Notice put forward a number of proposals with respect to (i) copyright ownership of certified productions, (ii) acceptable revenues from the exploitation of the production in non-Canadian markets,

- (iii) control of the initial licensing of the commercial exploitation of the production, and (iv) CAVCO's producer control guidelines.
5. Over the spring and summer of 2005, the Department received a range of valuable comments from producers, broadcasters, funding agencies and creators' associations in two stages, both as initial interventions, and as comments on the interventions of others, which allowed the Department to gain a better understanding of some of the current challenges facing Canadian film and television producers. Subsequently, a working group comprised of industry representatives (producer and creator associations) was formed to provide feedback to the Department in its revision of CPTC guidelines that ensure that the program achieves its intended objectives.
  6. In November 2005, the Auditor General completed its audit of the Government's management practices for cultural industries, including the CPTC. The key risk the Report identified with respect to the CPTC was "that they [CAVCO and the Canada Revenue Agency] might issue tax credits to non-Canadian productions or to productions with significant foreign investment that are not under the effective control of Canadians" (paragraph 5.71). The revised CPTC guidelines are intended to respond to these concerns.
  7. The revised guidelines elaborate but do not change the basic conditions on which certification is based, which are found in section 125.4 of the *Income Tax Act*, and section 1106 of the Regulations. Specifically, they elaborate on the "point" system; the definition of an "excluded production," which incorporates requirements of copyright ownership, initial licensing of commercial exploitation, and retention of a share of revenues; the definition of "producer," which requires that that person control the production from development through exploitation; and the minimum Canadian expenditures.
  8. It should also be noted that the guidelines are superseded by the applicable treaty terms in official co-productions.

### **Review of comments received in response to Public Notice 2005-01**

9. In Public Notice 2005-01, comments were sought on the following matters:
  - (i) Should Canadian broadcasters continue to be "prescribed" persons and thus continue to participate in Canadian content productions in the form of equity participation and copyright ownership? The majority of respondents agreed that broadcasters should retain their "prescribed" status.
  - (ii) Should the current 25-year copyright ownership requirement be maintained? Opinions were divided on the requisite length of copyright

ownership, some arguing for the removal of the 25-year requirement, some asking that it be maintained and others arguing for a reduced term.

(iii) What should be the policy with respect to the requirement for producers to demonstrate an “acceptable share of revenues from the exploitation of the production in non-Canadian markets”? Most respondents asked that CAVCO’s current definition of “acceptable revenues” be maintained, that is, that producers “retain an effective share of net proceeds equivalent to at least 25% of the value worldwide excluding Canada.”

(iv) Should the 25-year Canadian copyright ownership requirement be adapted to take advantage of foreign tax-based incentives? Creators’ associations were not in favor while producers felt that this approach would be useful to access foreign financing opportunities.

(v) Should CAVCO adopt different guidelines for theatrical and television productions? Only four respondents addressed the need for different rules for theatrical and television productions, their comments pointing out basically that there are no showrunners on theatrical productions and that executive producer roles are different on each type of production.

(vi) What should be the mandate and composition of a CAVCO Advisory Committee? While the majority of respondents agreed that CAVCO should create an Advisory Committee, there was no clear consensus on its mandate or composition.

(vii) Should productions based on acquired “formats” be allowed? Most respondents agreed that “format” shows should be allowed.

(viii) Would CAVCO’s proposed “two simple rules” for ensuring Canadian control — (1) to recognize only those productions whose development originates under the control of Canadians, and (2) to disallow non-Canadian underlying rights owners from securing foreign exploitation rights once the production is completed — be a workable test of control from development to exploitation? Producers disagreed and creators agreed.

(ix) Do CAVCO’s current producer control guidelines including rules governing non-Canadian screen credits function appropriately? The Canadian Film and Television Production Association proposed a series of indicia of control that could replace the current guidelines. These were found to be very helpful and they will be discussed in depth later in this notice.

(x) What stance should CAVCO take with respect to non-Canadian “showrunners”? The question of non-Canadian showrunners generated a number of comments that highlight the opposing views of producers and creators, the former taking the position that non-Canadians in these roles are often essential to

generate foreign financing, the latter insisting that only having Canadians fill that role can guarantee Canadian control of the production. There was no universal agreement regarding the meaning of the term “showrunner” and the functions performed by an individual with that title.

### **Examination of the issues**

10. The Department of Canadian Heritage appreciates the comments submitted during the initial consultation phase and by the participants in the working group. The submissions have been helpful in refining the Department’s proposals set out in Public Notice 2005-01. In the following sections, the Department sets out its analysis and determination on the issues highlighted below:

#### ***Issues concerning ownership***

11. Throughout the initial consultation phase and during working group discussions, it was deemed necessary to clarify the intent and wording of the draft November 2003 legislation with respect to “ownership” of the production. The announcement accompanying the draft legislation said that “...*the holding of an interest in a film or video production by a person other than the production corporation will no longer disqualify the production from eligibility for a tax credit, unless the production or one of its investors is associated with a tax shelter.*” The announcement specified that, however, “...*it remains a requirement under the Income Tax Regulations that the production company have ownership of copyright.*”
12. While the intention of the draft legislation was to permit third parties to participate in the exploitation of the production and actually invest in the production, short of creating tax shelter vehicles, interveners frequently raised the point that the Canada Revenue Agency may view such exploitation rights and the right to benefit from the revenues of exploitation as a form of “beneficial ownership” of a share of the copyright, a position that currently could affect eligibility for the CPTC, and creates great uncertainty for purposes of claiming Capital Cost Allowance.
13. The Department of Finance is presently considering a proposal from the Department of Canadian Heritage to clarify, in the Income Tax Regulations, that copyright ownership has not been transferred unless there is a written assignment to that effect. Reference would be made to the *Copyright Act* to define what copyright is, and ensure that a partial assignment of rights, such as distribution rights, as well as the inclusion of certain other investors’ rights to equity participation in the production, would not render the production ineligible to the CPTC.

***Canadian broadcasters as prescribed entities***

14. It has been determined that Canadian broadcasters should retain their prescribed person status.

***25-year copyright ownership requirement***

15. To satisfy the need to ensure that the company has effective control of the production, the Department considers that it should continue to be a requirement that 100% of the copyright in the production must remain in Canadian hands for a minimum period. However, given that the most productive revenue period for the majority of productions is typically the first ten (10) years, it is proposed that the term of copyright ownership be reduced to ten (10) years from the current 25-year requirement. This shortened period should have the effect of greatly facilitating the winding up of the affairs of a production company or the decision of a producer to leave the business, which was mentioned by several interveners as a matter that the new Guidelines should address. Of course, the change in this requirement in no way alters the ability of the production company to retain copyright as long as the *Copyright Act* allows.

***Acceptable share of revenues***

16. It has been determined that the term “acceptable share of revenues” should be interpreted to mean that producers must retain an effective share of net proceeds equivalent to at least 25% of the value worldwide excluding Canada.

***Waiving copyright ownership requirements for foreign tax-based incentives***

17. Some interveners asked whether the Canadian copyright requirement could be waived by CAVCO to allow access to certain foreign investment opportunities where a temporary transfer of copyright was a requirement. Further to discussions with the Department of Finance, it was determined that an open-ended authority for the Department of Canadian Heritage to exercise its discretion to waive the Canadian copyright ownership requirement for funds of this nature would be impracticable due to the uncertainty created by the prospect of judicial review. A specific regulatory amendment for each new fund could be considered, but would inevitably be a slow process. Therefore, access to foreign tax-based funds that require copyright ownership in foreign hands will continue to render productions ineligible for Canadian certification, unless and until specific regulatory exceptions are made.

***Different approaches for theatrical and television productions***

18. Despite the obvious differences between theatrical and television productions, it was determined that the actual and proposed program guidelines can reasonably apply to both types of production.

***CAVCO Advisory Committee***

19. Most interveners were in favour of creating a CAVCO Advisory Committee and asked to be represented on it. It was determined that the development of such a

committee should be discussed properly in the context of the current Departmental project to centralize Canadian content certification at CAVCO.

***Non-Canadian showrunners***

20. Opinions were divided between producers' and creators' groups regarding the exact definition of the term "showrunner." A number of different interpretations were proposed, ranging from simple liaison functions to something equivalent to an executive producer. In the Department's view, it is not necessary to settle on a definition to reiterate its position that the Canadian producer must control the production as more fully outlined in the following paragraph 22 of this notice, and any non-Canadian performing functions that derogate from that control will render the project ineligible.

***Format shows***

21. It has been determined that "format" shows should be eligible to the CPTC under the condition that the Canadian producer must clearly demonstrate effective control over the foreign exploitation of the production.

***Producer control***

22. The term "producer" is used to refer either to the eligible individual, or to the production corporation, or both. As stated in the CAVCO Guidelines, an individual producer must be Canadian and the production company must be an eligible corporation as defined under the *Income Tax Act*. The definition of "producer" is as follows:

The producer controls and is the central decision maker of the production from beginning to end. The producer is involved in and ultimately responsible for: the acquisition and/or meaningful development of the story; the commissioning of the writing of the screenplay/series bible; the selection, hiring and firing of key artists and creative personnel; the preparation, revision and final approval of the budget; all overages; the binding of the production company to talent and crew contracts; the arranging of the production financing; the supervision of the filming/taping and post-production; final creative control (as per contract), production expenditures (as per contract), production bank accounts (sole and unfettered cheque signing authority); and the arranging of the commercial exploitation of the production.

***Producer control guidelines***

23. The Canadian Film and Television Production Association has proposed to replace CAVCO's current Producer Control Guidelines with "Commercially Relevant Indicia of Control," providing a new tool for the analysis of Canadian control of the production. The Department thanks the CFTPA for its diligent and proactive efforts in this regard. This proposal is reproduced below, for consultation purposes, albeit with a number of modifications that, in our view, do not detract from the initial recommendations from the CFTPA.

24. Under the proposed indicia of control, the Canadian producer:

- 1) Must have and maintain full control over the development of the project from the time at which the producer has secured underlying rights;
- 2) Must have and maintain full responsibility and control over all aspects (creative and financial) of the production of the project;
- 3) Must have and maintain full responsibility and control over all aspects of production financing;
- 4) Must have and maintain full responsibility and control over the negotiation of initial exploitation agreements; and,
- 5) Is entitled to a demonstrable monetary participation in terms of budgeted fees and overhead, and participation in revenues of exploitation.

25. Please see **ADDENDUM** for more detailed criteria of the indicia of producer control.

***Production-related screen credits for non-Canadians***

26. In line with its initial proposal, the Department will allow as many non-Canadians as there are Canadians represented in production-related roles in the screen credits, as long as prominence is assured for Canadians and the non-Canadian credits are in the nature of “vanity” credits. However, as is currently the case, non-Canadians cannot receive a “producer” credit.

**Call for comments**

27. Comments may be filed with CAVCO on any matter within the scope of PUBLIC NOTICE CAVCO 2006-02. CAVCO will not formally acknowledge individual comments; however, it will consider all comments and they will form part of the public record.

**Procedure**

28. Comments must be received by CAVCO by July 21, 2006.

29. Please number each paragraph of your submission. In addition, please enter the line \*\*\*End of document\*\*\* following the last paragraph. This will help CAVCO verify that the document has not been damaged during transmission.

**Publishing of comments**

30. All information submitted, including your name, e-mail address, and any other information not submitted under a claim for confidentiality, will be posted on CAVCO's Web site. Documents received in electronic format will be posted on the Web site exactly as you send them, and in the official language and format in which they are received. Documents not received electronically will not be published.

**Contacts**

31. All electronic submissions should be sent to CAVCO's e-mail address at [bcpac\\_cavco@pch.gc.ca](mailto:bcpac_cavco@pch.gc.ca) with PUBLIC NOTICE CAVCO 2006-02 written in the subject.

32. Written submissions should be sent to:

Robert Soucy  
Director  
Canadian Audio-Visual Certification Office  
4th Floor, 100 Sparks Street  
Ottawa, Ontario, K1A 0M5

## **ADDENDUM**

### **Producer definition**

The producer controls and is the central decision maker of the production from beginning to end. The producer is involved in and ultimately responsible for: the acquisition and/or meaningful development of the story; the commissioning of the writing of the screenplay/series bible; the selection, hiring and firing of key artists and creative personnel; the preparation, revision and final approval of the budget; all overages; the binding of the production company to talent and crew contracts; the arranging of the production financing; the supervision of the filming/taping and post-production; final creative control (as per contract), production expenditures (as per contract), production bank accounts (sole and unfettered cheque signing authority); and the arranging of the commercial exploitation of the production.

Under the proposed revised indicia of Canadian control, the Canadian producer:

- i. Must have and maintain full control over the development of the project from the time at which the producer has secured underlying rights;
- ii. Must have and maintain full responsibility and control over all aspects (creative and financial) of the production of the project;
- iii. Must have and maintain full responsibility and control over all aspects of production financing;
- iv. Must have and maintain full responsibility and control over the negotiation of initial exploitation agreements; and,
- v. Is entitled to a demonstrable monetary participation in terms of budgeted fees and overhead, and participation in revenues of exploitation.

Below are the guidelines for applying the indicia:

**GUIDELINE 1: DEVELOPMENT**

The Canadian producer must have and maintain full control over the development of the project from the time at which the producer has secured underlying rights.

**Indicator 1(a):**

*The producer must demonstrate full responsibility for the development of underlying rights from the date upon which the producer has secured the underlying rights.*

## Comment:

- i. CAVCO will review the chain-of-title documentation to confirm that the producer is responsible for the development of the project. \*
- ii. CAVCO will assess chain-of-title documentation against all relevant documents concerning creative decision-making and the engagement of creative talent (writer, director, consultants, script editors, etc.).
- iii. The producer must affirm that all documentation affecting his/her decision-making authority has been disclosed and submitted to CAVCO as part of the application.

\* Provision to be made for industry-standard third-party approval rights (distributors, financiers, completion bonders, etc.).

**Indicator 1(b):**

*Ongoing involvement of prior rights-owners in development, production or exploitation of the project subsequent to the producer securing the underlying rights will be presumed to indicate that such party retains a degree of responsibility and control.*

## Comment:

- i. The producer will have the onus of establishing, to the satisfaction of CAVCO, that ongoing involvement did not interfere with the producer's rights and responsibilities in the producer definition.

**Indicator 1(c):**

*Prior development of the project by non-Canadians is permitted, subject to satisfaction of the Guideline (and its indicators set out above).*

## Comment:

- i. CAVCO will consider the degree of prior development of the project by non-Canadians. The producer must demonstrate *bona fide* development of the project. If development of the project has been materially completed by or with the involvement of non-Canadians, the producer will have the onus of establishing, to the satisfaction of CAVCO, that the situation did not interfere with the producer's rights and responsibilities in the producer definition.
- ii. Non-Canadian prior rights holders may have ongoing involvement in the production in terms of consultation rights only, provided that such involvement does not otherwise encroach on any of the rights and responsibilities of the producer as outlined in the producer definition.

**GUIDELINE 2: PRODUCTION**

The Canadian producer must have and maintain full responsibility and control over all aspects (creative and financial) of the production of the project.

**Indicator 2(a):**

*Documentation must demonstrate that with the exception of standard approval rights from broadcasters, distributors, financiers and completion-bonders, the producer has exercised full control (direct or indirect) and holds final decision-making authority over creative and financial aspects of the production, including:*

- *the project's budget;*
- *the production schedule;*
- *the selection and engagement of above and below-the-line cast and production personnel and the negotiation of the terms thereof;*
- *the selection and contracting for production services (camera package, sound package, post-production facilities, etc.) and the negotiation of terms thereof;*

- *the negotiation of agreements with unions and guilds;*
- *the post-production elements.*

Comment:

- i. Where a non-Canadian has the right to overrule any decision by the producer, the producer will have the onus of establishing, to the satisfaction of CAVCO, that the situation did not interfere with the producer's rights and responsibilities in the producer definition.

### ***GUIDELINE 3: FINANCING***

The Canadian producer must have and maintain full responsibility and control over all aspects of production financing.

#### **Indicator 3(a):**

*Documentation must demonstrate that the producer has exercised full control (direct or indirect) and holds final decision-making authority over:*

- *the project's financing plan;*
- *the securing of all third-party financing including, without limitation, domestic and foreign equity, domestic and foreign subsidies, domestic and foreign pre-sales and the negotiation of the terms thereof;*
- *the securing of interim financing (i.e. production financing) and the negotiation of the terms thereof;*
- *the project's cash-flow schedule;*
- *the management of the project's banking and sole and unfettered control over the project's bank account(s) and cheque signing authority.*

Comment:

- i. Where a non-Canadian has the right to overrule any decision by the producer, the producer will have the onus of establishing, to the satisfaction of CAVCO, that the situation did not interfere with the producer's rights and responsibilities in the producer definition.

- ii. Delegation of banking authority by the producer to a person(s) over whom the producer exercises final authority shall not be deemed to constitute a contravention of this indicator.

**Indicator 3(b):**

*Documentation must demonstrate that the producer has assumed and retained the commercial risks associated with the financing and production of the project.*

Comment:

- i. Where the majority of production financing is provided by a single non-Canadian party (or multiple parties with common ownership and/or control), the producer will have the onus of establishing, to the satisfaction of CAVCO, that the situation does not interfere with the producer's rights and responsibilities in the producer definition.
- ii. Where a single non-Canadian party (or multiple parties with common ownership and/or control) has acquired exploitation rights to all territories (with the exception of Canada), the producer will have the onus of establishing, to the satisfaction of CAVCO, that the situation does not interfere with the producer's rights and responsibilities in the producer definition.
- iii. Where a non-Canadian party has agreed to reimburse or indemnify the producer e.g. with respect to budget overages, the producer will have the onus of establishing, to the satisfaction of CAVCO, that the situation does not interfere with the producer's rights and responsibilities in the producer definition.\*

\*Provision to be made for industry-standard completion guarantees.

**GUIDELINE 4: EXPLOITATION**

<p>The Canadian producer must have and maintain full responsibility and control over the negotiation of initial exploitation agreements.</p>
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**Indicator 4(a):**

*Documentation must demonstrate that the producer has exercised full control (direct or indirect) and holds final decision-making authority over the terms pursuant to which any party acquires any right to exploit the project, regardless of territory, media and term.*

**Comment:**

- i. Where arrangements between third parties with respect to the exploitation of the project were made prior to the acquisition of rights to the project by the producer, the producer will have the onus of establishing, to the satisfaction of CAVCO, that the situation did not interfere with the producer's rights and responsibilities in the producer definition.

**GUIDELINE 5: PRODUCER REMUNERATION**

The Canadian producer is entitled to a demonstrable monetary participation in terms of budgeted fees and overhead, and participation in revenues of exploitation.

**Indicator 5(a):**

*The producer must demonstrate an equity ownership in the project by retaining an effective share of net proceeds equivalent to at least 25% of the value worldwide excluding Canada.*

**Indicator 5(b)**

*Where, in addition to acquiring broadcast rights in the production, an entity acquires either distribution rights or has an equity interest in the production, the producer must demonstrate that the non-recoupable licence fee provided for broadcast rights is allocated properly at fair market value.*

\*\*\*END OF DOCUMENT\*\*\*