



**APPLICATION POLICY**

**NUMBER: FIS 2006-01**

**SUBJECT: Application of the phrase “directly attributable” that is found in the definition of “labour expenditure” in subsection 125.4(1) of the *Income Tax Act* and in the definition of “Canadian labour expenditure” in subsection 125.5(1) of the Act**

**DATE: January 10, 2006**

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**Purpose**

The purpose of these guidelines is to present the Film Industry Services’ position with respect to the term “directly attributable”, as it is used in subsection 125.4(1) of the *Income Tax Act* (“the Act”) for the Canadian Film or Video Production Tax Credit (FTC), and in subsection 125.5(1) of the Act for the Film or Video Production Services Tax Credit (PSTC).

The term “directly attributable”<sup>1</sup> is used to identify the salary or wages, and other remuneration considered to be a “labour expenditure” (LE) in calculating the FTC, and a “Canadian labour expenditure” (CLE) in calculating the PSTC.

**Essential Factors**

Before we discuss the term directly attributable in more detail, we will review some of the conditions that must be met for expenditures to qualify as an LE or CLE. These conditions are set out in the Act and summarized below.

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<sup>1</sup> This term is also used in the definition of “production commencement time” in subsection 125.4(1) of the Act in reference to salary or wages and other remuneration paid for the development of script material for the production.

The expenditure must be:

- an amount paid for services rendered by an individual for the production, or an amount that would have qualified as an LE or CLE that is reimbursed to a parent corporation;
- directly attributable to the production of a film or video;
- reasonable in the circumstances; and
- paid in the year, or no later than 60 days after the end of the year (other than amounts incurred in the preceding taxation year that are paid within 60 days after the end of that preceding taxation year).

To qualify as an LE, the expenditure must also be:

- included in the cost or capital cost of the production to the production corporation or any other person or partnership, except for another qualified corporation<sup>2</sup>; and
- incurred for the stages of production from the production commencement time to the end of the post-production stage.

To qualify as a CLE, the expenditures must also be:

- incurred for the stages of production from the final script stage to the end of the post-production stage.

Additional conditions that must be satisfied are outlined in the section *Restrictions on the LE and CLE* on page 6.

### **Directly Attributable – Definitions**

The term “directly attributable” is **not defined** in the Act. The common meaning of this term must, therefore, be used and the context in which it is used taken into account. The Collins English Dictionary defines “directly” as “in a direct manner”, “direct” as “without intervening persons or agencies, immediate”, and “attributable” as “resulting from”. Conversely “indirectly” is defined as “not coming as a direct effect or consequence” and “indirect labour” as “work done in administration or sales rather than in the manufacturing of a product”. According to the Webster’s Dictionary, the adverb “directly” means “in a direct manner” and “direct” means “marked by the absence of an intervening agency, instrumentality, or influence.”

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<sup>2</sup> In the case of productions for which development starts on or after November 14, 2003. If the development starts earlier, the expenditure must be included in the cost or capital cost of the production corporation.

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### **Guidelines to assist when applying the term “directly attributable”**

In order for salary or wages and other remuneration to be considered directly attributable, there must be a link between the expenditures for salaries or wages or other remuneration, and specific work on the production of the film or video.

The activities of persons engaged in support of a film production may be considered to be directly attributable to the production, depending on the particular facts of each situation. This may include an allocation of administration, or managerial and staff expenditures that were incurred in support of a production. Administrative labour may be included where it is linked to the production of a film or video. To make this determination, it may be necessary to examine the functions and duties performed by the worker. There should be a link between the activities of the particular person and the creation of the film or video production.

### **Application**

In any particular case, the issue of whether certain expenditures are directly attributable to the production of a film or video is **a question of fact**. The onus is on the producers of the film or video production to determine whether salary or wages and other remuneration are directly attributable to the production of a film or video for the purpose of the calculation of an FTC and a PSTC. Where it is not clear, the functions and duties for which the expenditures are incurred should be analyzed to determine if there is a link to the production.

In order for these expenditures to be allowed as an LE or CLE, they must meet certain other conditions set out in the Act, in addition to being “directly attributable to the production of the film or video”, and may be limited by certain restrictions in the Act. These conditions and restrictions are summarized in the sections *Essential Factors* and *Restrictions on the LE and CLE*, on pages 1 and 6 respectively.

Below, for your reference, you will find: examples of types of expenditures that are/are not considered to be an LE and CLE, indicators that an expenditure is directly attributable to the production of a film or video and examples of tasks where expenditures for salary or wages and other remuneration may or may not be directly attributable to the production of a film or video.

When questions arise about the determination of whether salary or wages and other remuneration are directly attributable to the production of a film or video, clients can contact their Film Services Unit at the CRA for assistance.

### **Types of expenditures that are/are not considered to be an LE and CLE**

Expenditures that may be considered to be an LE or CLE include:

- vacation pay, statutory holiday pay, sick leave pay; and
- benefits that are taxable in the hands of an employee (corporation's contribution to the employees' RRSP, group insurance plan, meals, etc.);

that are paid to, or for, individuals whose salary, wages, or remuneration are directly attributable to the production of a film or video.

Expenditures that will not be considered an LE or CLE include:

- stock options or amounts determined with reference to profits or revenues;
- employer's contribution to the Canada Pension Plan, the Employment Insurance, the Workers Compensation Board or the Commission de la santé et de la sécurité du travail du Québec, or any approved employee pension plan, dental care plan, or medical care or optical care plan for the worker;
- per diems, travel and living expenses, car rentals, etc., unless they have been included in the income of the recipient as a taxable benefit;
- amounts paid to non-taxable Canadian corporations, including some broadcasters, even if the amounts are included in the production cost;
- amounts paid to foreign corporations for services; and
- costs that are not considered to be labour-related, such as costs incurred for the supply of materials, the rental of equipment, travel and living expenses, or the profit element related to these costs.

### **Indicators that an expenditure is “directly attributable” to the production of a film or video**

Although they are not essential to this determination, the following indicators suggest that the expenditure may be directly attributable to the production of a film or video:

- the work is performed on the set and is an integral part of the production of the film or video; and
- the salaries and wages are correctly included in “production costs” for accounting or CCA purposes.

**Examples of tasks where expenditures for salary or wages and other remuneration may be directly attributable to the production of a film or video**

The following tasks **may** be directly attributable to the production of a film or video:

- set construction and design;
- services of messengers, police officers, security, cleaners, maintenance, medical and ambulance staff, and safety personnel on the film set. For example, ambulance services may be required to be on stand-by at the set for the filming of stunt scenes, etc.;
- on-location services for the installation, set up, or maintenance of equipment, apparatus, or machinery that is done on-site;
- services of a chef to prepare meals for staff that are involved in the production of a film or video. If, for example, the chef provides services on a film set so that the film crews and actors are readily available throughout the working day, the chef's wages may be considered to be directly attributable to the production of the film or video;
- services for recruiting, evaluating, and hiring production personnel;
- administrative work (staff who have non-specific film or video production background). The functions and duties should be analyzed to determine if there is a linkage to the production. The expenditures for the production must be clearly discernible from other expenditures for other productions;
- clerical work for tasks related to payroll and purchasing that are linked to the production;
- review, monitoring, and approval of film and video production budgets, cost reports; and
- bookkeeping, accounting, taxation, and legal services specific to the film or video production. For instance, the functions of an agent/or accountant who prepares the tax return that is solely for the taxation concerning the film or video production, including the tax credit application, may be considered directly attributable to the production of a film or video. Producers must establish that the activities directly result from the production of the film or video.

As mentioned earlier, expenditures for salary or wages, and other remuneration that are included in an LE or CLE must first meet certain conditions in the Act, and may be limited by certain restrictions in the Act. For instance, labour expenditures that are directly attributable to the production, such as those listed above, would not be included in determining the LE or CLE if they were incurred after the post-production stage.

**Examples of tasks where expenditures for salary or wages and other remuneration may not be directly attributable to the production of a film or video**

The following tasks **may not** be directly attributable to the production of a film or video:

- management or supervision activities that are not associated with the activities of the production of a film or video;
- employee relations, management of benefit programs, and other human resource functions, unless the tasks performed can be linked specifically to a production;
- purchasing of goods not related to the production;
- corporate secretarial functions, general corporate functions, such as the reporting of financial results to shareholders;
- corporate legal services that are incurred for another film or video production, or for the sale, distribution, or other activities that are not related to the production of the film or video;
- advertising functions including securing product placement advertising or selling advertising space or time;
- off-location services that may be associated with equipment, machinery, or goods used for the production. For instance, where a supplier restocks his inventory for reshipment to the production corporation, the labour for this restocking of inventory would not be considered directly attributable to the production of a film or video;
- maintenance of off-location equipment;
- studies and research leading to potential collaborations or potential co-productions;
- activities of a bank for the set up of a loan or credit facility; and
- the labour portion of a goods contract. For instance a film production corporation enters into a contract with a supplier of set components. The labour portion of the contract for the supplier's construction of the set components should not be included in the production corporation's labour costs because the contract is for the purchase of set components and not for construction services. The cost of the contract can, however, be included in the production costs of the film or video for which, and to the extent that, the set components were required.

**Restrictions on the LE and CLE**

Subsections 125.4(2) and 125.5(2) of the Act contain restrictions governing the LE and CLE of a corporation. The LE and CLE do not include remuneration determined by reference to profits or revenue. In addition, the definitions of LE and CLE do not apply to an amount for which a deduction for Scientific Research and Experimental Development in Canada has been claimed under section 37 of the Act.

Sections 125.4 and 125.5 of the Act also specify residency requirements for the “salary or wages” and remuneration, for purpose of determining the LE and CLE respectively. The LE does not include remuneration for services rendered by a non-resident unless that person is a Canadian citizen. The CLE is restricted to amounts paid for services rendered in Canada by Canadian residents.

Where a film is produced jointly between two or more qualified corporations, the LE for one qualified corporation does not include an expenditure for services rendered by the other qualified corporation or on behalf of the other qualified corporation. Therefore, only one qualified corporation may claim an FTC for any particular expenditure.

The Act provides a specific rule, at paragraphs 125.4(2)(b) and 125.5(2)(b), for labour expenditures of a corporation incurred during the post-production stage. When remuneration is paid to an individual who is not an employee of the corporation, or to another business for services rendered at the post-production stage, the amounts paid must be for services rendered at that stage by a person who performs the duties of animation cameraman, assistant colourist, assistant mixer, assistant sound-effects technician, boom operator, colourist, computer graphics designer, cutter, developing technician, director of post production, dubbing technician, encoding technician, inspection technician-clean up, mixer, optical effects technician, picture editor, printing technician, projectionist, recording technician, senior editor, sound editor, sound-effects technician, special effects editor, subtitle technician, timer, video-film recorder operator, video tape operator, or by a person who performs a prescribed duty. Production corporations should work with their service providers to ensure that this breakdown is shown on the invoice.

When the postproduction is done in-house and payments are made in the form of salary and wages, the above rule does not apply.

The Act also restricts the CLE by not including in production costs amounts that are for advertising, marketing, promotion, market research, or an amount related in any way to another film or video production.

### **The look-through approach**

When payments are made to a self-employed individual, a taxable Canadian corporation, or a partnership carrying on a business in Canada for the services of their employee, the look-through approach may be used to determine the reasonableness of the LE and CLE. This approach limits the amount of remuneration that may qualify as an LE or CLE to the amount that would have been incurred by the production corporation had it directly employed the individuals.

In applying this approach:

- the production corporation must obtain from the service provider the amount of salary or wages paid to the individual. This amount should qualify as a LE or CLE directly attributable to the production;

or

- if the production corporation is unable to obtain the labour-related information from a service provider, we will accept 65 percent of the labour portion of an invoice amount as a reasonable estimate of the LE or CLE directly attributable to the production. The remaining 35 percent represents overhead and the profit of the service provider.

In cases where non-labour amounts (such as rental fees, goods provided by the service provider, and travel and living expenses) are included in a payment to a service provider, but no breakdown is provided on the invoice, it will be necessary to estimate the labour component of the invoice before applying the 65 percent rate.

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