

Application Policy

NUMBER: FAS 2009-01

DATE: March 31, 2009

SUBJECT: Reasonableness of Producer Fees

Reference: i) Definition of "Labour Expenditure" and "Canadian Labour Expenditure" in subsections 125.4(1) and 125.5(1) of the Act,
ii) Definition of "qualified labour expenditure" in subsection 125.4(1) of the Act, and
iii) Similar provincial legislative provisions.

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Application

These guidelines replace and cancel the document entitled "Draft guidelines for determining the reasonableness of producer fees for the purposes of the provincial and federal film, video and television tax credits co-administered by the CRA" dated June 16, 2008.

Purpose

These guidelines discuss the approach used by the Canada Revenue Agency (CRA) to review the producer fees claimed for the purposes of the Canadian Film or Video Production Tax Credit (CPTC), the Film or Video Production Services Tax Credit (PSTC) and similar provincial tax credits co-administered by the CRA to ensure they are "reasonably attributable" to the production and/or "reasonable in the circumstances". The guidelines were developed in an effort to be transparent, to provide claimants with guidance and certainty, and to improve overall efficiencies in the CRA's risk assessment and audit functions.

Summary

Producer fees paid to certain incumbents of producer positions (i.e., those not dealing at arm's length or those with an ownership interest in the production or the production corporation, or the financiers of the production or their nominees) are generally considered reasonable in the circumstances when they are within the reference threshold of 10% of the total actual costs in parts B and C of the standardized production budget. The reference threshold is not intended as a "cap" or "maximum allowable". When justified and supported by the facts of the particular case, amounts greater than the reference threshold may be considered reasonable.

Producer fees paid to other incumbents of producer positions (i.e., those dealing at arm's length, or those who have no ownership interest in the production or the production corporation, or those who are not financiers of the production or their nominees) are generally considered reasonable in the circumstances when they are incurred and paid pursuant to a valid contractual obligation for services.

Discussion and Guidelines

General

1. The refundable CPTC and PSTC are based on a percentage of certain eligible labour expenditures. The requirements to qualify as an eligible labour expenditure for the purposes of these tax credits are specified in sections 125.4 and 125.5 of the *Income Tax Act* (the Act).
2. The definition of "**labour expenditure**" for the purposes of the CPTC in subsection 125.4(1) the Act and "**Canadian labour expenditure**" for the purposes of the PSTC in subsection 125.5(1) of the Act state that the labour expenditure must be "**reasonable in the circumstances**". This expression is also used in the statutes that provide for the provincial tax credits to which these guidelines apply.
3. The amount of labour expenditure for purposes of the CPTC is capped by a production cost limit equal to 60% of the "**cost or capital cost of the production**"¹ (the "production cost"). Some provincial tax credits, such as the British Columbia Film and Television Tax Credit, may also apply a similar cap on labour expenditures.

The term "production cost" is not defined in the Act. In the absence of a legislated definition, Paragraph 8 of Interpretation Bulletin IT-285R2, [Capital Cost Allowance - General Comments](#) is used to establish the capital cost of a property (in this case, a film, television or video production). It reads:

8. "The term "capital cost of property" generally means the full cost to the taxpayer of acquiring the property and includes:
 - (a) legal, accounting, engineering or other fees incurred to acquire the property; and
 - (b) in the case of a property a taxpayer manufactures for the taxpayer's own use, it includes material, labour and overhead costs **reasonably attributable** to the property, but nothing for any profit which might have been earned had the asset been sold."

Reasonableness

4. The expressions "reasonable in the circumstances" and "reasonably attributable" or the word "reasonable" are not defined in the Act. However, the Black's Law Dictionary defines the word "reasonable" as "*Fair, proper, or moderate under the circumstances. According to reason.*" The Concise Oxford Dictionary defines "reasonable" as "*within the limits of reason; not greatly less or more than might be expected*" and "*tolerable, fair*".

¹ In accordance with subsection (b)(i) of the definition of "*qualified labour expenditure*" in subsection 125.4(1) of the Act.

5. In any particular case, the issue of whether certain expenditures are considered “reasonable” is a question of fact. In order for these expenditures to be eligible for the purposes of the film tax credits, they must meet certain other conditions set out in the Act, in addition to being “reasonable in the circumstances” and/or “reasonably attributable”. For example, an expense that is incurred and supported with a cancelled cheque or voucher may not necessarily be considered “reasonable”.

6. Perhaps one of the best commentaries related to reasonableness arises from the Federal Court of Appeal in *Mohammad v MNR* (97 DTC 5503)². While this case dealt with reasonable expectation of profit, the judge provided some valuable commentary on the interpretation of what is “reasonable”:

“When evaluating the reasonableness of an expense, one is measuring its reasonableness in terms of its magnitude or quantum. Although such a determination may involve an element of subjective appreciation on the part of the trier of fact, there should always be a search for an objective component.”

In determining the reasonableness of producer fees included in a tax credit claim, the CRA is guided by this objective component principle. The CRA has established that an appropriate objective component for this purpose is 10% of the total actual costs in parts B and C of the standardized production budget, otherwise known as the “10% x (B+C)” formula³. The amount calculated by this formula is considered a reference threshold for establishing the reasonableness of producer fees under certain circumstances. It is not intended as a “cap” or “maximum allowable”. When justified to CRA’s satisfaction, greater amounts may be considered reasonable.

7. The amount corresponding to the reference threshold is calculated on the basis of the actual production and post-production costs (B+C), as opposed to the budgeted costs.

8. **Part A** of the production budget is comprised of above-the-line costs, including development costs and fees such as director and producer fees, **part B** is for production costs, **part C** represents post-production costs, and **part D** includes publicity, general expenses and indirect costs like corporate overhead and interim financing.

Producer Fees

9. Producer fees are typically included in the labour expenditure and/or the cost or capital cost of the production that are the basis for the tax credits. They are considered above-the-line costs and usually included in category 4 of a standard budget. The fees are paid to incumbents of the following producer positions: producer, co-producer, line producer, executive producer and associate producer. This is consistent with the [breakdown of production costs](#) that is used by the Canadian Audio-Visual Certification Office (CAVCO) of the Department of Canadian Heritage for the purposes of the CPTC, as well as other production costs templates.

10. In the event an amount has been included in producer fees and the claimant can clearly demonstrate that this was in fact for other functions (e.g., cameraman, film editor, etc.), the particular amount will be reclassified in the appropriate budget account for the purpose of reviewing the tax credit claim(s). Similarly, amounts that were paid for above-the-line producer functions and not included as producer fees (i.e., category 4) will be reclassified accordingly for the purpose of reviewing the tax credit claim(s), and subjected to the guidelines.

² 1997/07/28 — (FCA) *Mohammad v The Queen*; 97 DTC 5503; [1998] 1 FC 165; [1997] F.C.J. No. 1020; [1997] 3 CTC 321.

³ The “10% x (B+C)” formula is used by other film and television funding agencies to quantify producer fees.

11. Subsection 1106(1) of the Income Tax Regulations defines the term “producer” only for the purposes of applying section 1106 of the Regulations.⁴ For example, the definition is used to identify the producer that must be Canadian at all times during the production (i.e., this is a requirement to qualify for the CPTC). The purpose of this definition is not to exclude the fees paid to other incumbents of producer functions from the application of these guidelines.

Guidelines

12. The total of producer fees paid directly or indirectly to:

- producers or any persons or partnerships who are not dealing at arm’s length with the production corporation, either in law or in fact (see Interpretation Bulletin [IT-419R2, Meaning of arm's length](#)); and
- producers or any persons or partnerships who have an ownership interest in the production or the production corporation; and
- financiers who have decision-making authority for, or meaningful influence on, any significant matters of the production company (including but not limited to broadcasters and distributors), or the financiers' employees, agents and nominees, or any persons or partnerships who are not dealing at arm’s length with the financiers

is generally considered reasonable in the circumstances if it is within the reference threshold of “10% of the actual B + C costs” (15% for low-budget productions totalling \$500,000 or less).

13. Producer fees paid to other incumbents of producer positions (i.e., those dealing at arm’s length, or those who have no ownership interest in the production or the production corporation, or those who are not financiers of the production or their nominees) are generally considered reasonable in the circumstances when they are pursuant to a valid contractual obligation for services.

14. “Ownership interest” means a direct or indirect ownership interest in the production company itself, or in any entity with a direct or indirect ownership interest in the production company, including affiliates, subsidiaries and parent entities, granting the holder decision-making authority for, or meaningful influence on, any significant matters of the production company.

Co-Productions

15. For treaty and inter-provincial co-productions, the reference threshold is applied on the production costs and labour expenditures of the Canadian co-producer, or co-producer who is claiming a provincial tax credit that is subject to these guidelines. Amounts one co-producer pays to the other co-producer for producer services, including amounts paid directly to individuals performing producer tasks for the co-producer, are not eligible production costs or labour expenditures for the tax credits, as each co-producer is responsible for its own expenses.

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⁴ The preamble to subsection 1106(1) reads: “The following definitions apply in this Division and in paragraph (x) of Class 10 in Schedule II.” The Division in question is Division VII of the Regulations entitled “Certificates issued by the Minister of Canadian Heritage”.