



PR 1999/73 - Income tax: Group Colleges Australia Project

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Product Ruling

Income tax: Group Colleges Australia Project

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 98/1 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates. In this Ruling this arrangement is sometimes referred to as the Group Colleges Australia Project, or just simply as 'the Project', or the 'product'.

Tax law(s)

2. The tax law(s) dealt with in this Ruling are:
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 8-1 of the ITAA 1997;
 - sections 82KL and 82KZM of the *Income Tax Assessment Act 1936* (ITAA 1936); and
 - the relevant provisions of Part IVA of the ITAA 1936.

Class of persons

3. The class of persons to whom this Ruling applies is those who enter into the arrangement described below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant agreements until their term expires), and deriving assessable income

from this involvement as set out in the description of the arrangement. In this Ruling those persons are referred to as ‘Participants’.

4. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion, or who otherwise do not intend to derive assessable income from it.

Qualifications

5. The Ruling provides this specified class of persons with a binding ruling as to the tax consequences of this product. The Commissioner accepts no responsibility in relation to the commercial viability of this product, and gives no assurance the prices charged for the product are reasonable, appropriate, or represent industry norms. A financial (or other) adviser should be consulted for such information.

6. The Commissioner rules on the precise arrangement identified in the Ruling.

7. The class of persons defined in the Ruling may rely on its contents, provided the arrangement (described below at [paragraphs 12 to 33](#)) is carried out in accordance with details described in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out:

- the Ruling has no binding effect on the Commissioner, as the arrangement entered into is not the arrangement ruled upon; and
- the Ruling will be withdrawn or modified.

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Date of effect

9. This Ruling applies prospectively from 23 June 1999, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

10. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, the product ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

11. This Product Ruling is withdrawn and ceases to have effect after 30 June 2001. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, for arrangements entered into prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the persons' involvement in the arrangement.

Arrangement

12. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Prospectus dated 1 May 1999 prepared in respect of 'the Project';
- Management Agreement between Corporate Investment Australia Funds Management Limited (CIAFM), Group Colleges Australia Pty Ltd (GCA) and the 'Participants';
- Deed of Constitution establishing 'the Project';
- Compliance Plan lodged with the Australian Securities & Investment Commission (ASIC) by CIAFM;
- Draft Deed of Licence between the licensee GCA, and the licensor Desedi Pty Ltd (a company owned by a director and 50% shareholder of Group Colleges) granting to GCA a Licence to conduct the business of a college;

- Agreement for Sale of Business dated 4 May 1999 between Desedi Pty Ltd and the vendor to acquire an existing college;
- Letter from CIAFM dated 26th April 1999;
- Letter from CIAFM dated 11th May 1999;
- Certificate of Approval and Registration valid from 1 August 1997 to 31 July 2002 in respect of college acquired;
- Letter dated 14 August 1997 from NSW Vocational Educational & Training Accreditation Board (VETAB) in respect of courses accredited of college acquired;
- Commonwealth Register of Approved Courses Report dated 11 September 1997 in respect of college acquired;
- Loan Application form from nominated bank; and
- Copy of example of Personal Loan offer to be made by nominated bank to approved applicants.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

13. For the purposes of describing the arrangement to which this Ruling applies there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Participant, or any associate (within the meaning of section 318 of the ITAA 1936) will be a party to, except agreements relating to the provision of finance which come within paragraphs 30 to 33 below.

14. This arrangement is called the 'Group Colleges Australia Project' ('the Project'). Under the Prospectus the minimum number of Interests is 200 and the maximum number of Interests is 2000.

15. A Participant in this project may participate in the Project by applying under a Prospectus registered with the Australian Securities & Investment Commission (ASIC) to become a Participant. Participants apply for Interests with a \$10,000 payment as Initial Management Fees each and also purchase an educational module for a \$500 capital payment for interests applied for. The Participants will deposit by 30 June 1999 with the Responsible Entity an amount of \$10,500 representing this initial subscription amount.

16. Another payment of \$6000 for Initial Management Fees in the Second period (Year 1) per Interest is also payable by Participants prior to 1 July 2000.

17. The Project involves the marketing and delivery of a specific core of scholastic material through the ownership of an educational module consisting of approximately 12 to 15 hours of face to face teaching or the equivalent student contact hours via distance learning methods including the internet, satellite, and video. Distance learning students will be supported by tutors on the Internet addressing questions raised by students and interactive computer chat sessions between students and teaching support staff.

18. The educational modules will involve a course of study in subject areas of English as a second language, and Business areas of information technology, marketing or management. The modules when added to other relevant modules make the basis of educational training courses, which are part of or lead to qualifications such as certificates, diplomas and degrees. Each module will form part of approved educational courses and will be of a standard to be able to be accredited individually or as part of a course by the relevant local educational authority, by meeting the national accreditation standard of the Australian Qualifications Framework (AQF).

19. The investors are expected to claim a deduction in their income tax returns for the year ended 30 June 1999 in respect of the Management Fees of \$10,000 expended by way of contribution to the Project for each educational module purchased. This represents the fees for the initial period. and is comprised of:

- \$3,750 Marketing Fees;
- \$3,750 Business Management Fee; and
- \$2,500 Teaching Fees

There is also a Module Fee of \$500 which is a capital contribution and non deductible.

20. The investors are expected to claim a deduction in their income tax returns for the year ended 30 June 2000 in respect of the Management Fees of \$6,000 expended by way of contribution to the project for each educational module purchased. This represents the fees for the second period and is comprised of:

- \$2,500 Marketing Fees
- \$2,500 Business Management Fee; and
- \$1,000 Teaching Fees

21. The investors, in their income tax returns for subsequent years after the second period, are also expected to include as income, distributions received from the project. This income will be based on student fees paid for the delivery of their educational module. In subsequent years investors are also expected to claim as deductions, Continuing Management Fees and interest incurred in respect of loans

taken out for the purpose of investing in the project. The Continuing Management Fees comprise:

- Teaching Fee: 37% of Participant's Gross Business Income.
- Marketing Fee: 30% of Participant's Gross Business Income.
- Business Management Fee: 8% of Participant's Gross Business Income for the years ended 30 June 2003, 2004 and 2005 reducing to 5% for subsequent years until the Project concludes on 30 June 2011.
and
- Performance Fee: 40% of the net profits for any year where net profits are in excess of financial forecasts in the prospectus.

22. Participants enter into a Management Agreement with CIAFM, the Responsible Entity, to manage the business of the participant and to undertake the marketing and delivery of each educational module on behalf of the participant.

23. The Operational Manager, GCA, has also had drafted a Deed of Licence to obtain a licence to conduct the business of an existing college which has VETAB accredited courses.

24. The forecast for the Project returns in the Prospectus indicates that Participants should be in a net profit position (before interest expenses) in the year ending 30 June 2003, increasing each year until 30 June 2011.

25. The term of the project is until 30 June 2011, unless terminated earlier, under clause 11 of the Deed of Constitution, by a vote of Participants, or as determined by the Responsible Entity and 75% of the participants where there are insufficient Interests in the Project to make it viable.

Management Agreement

26. The Management Agreement will be between CIAFM (the 'Responsible Entity'), GCA (the 'Operational Manager') and the Participant. The Participants will engage in a business of marketing, delivery and ongoing management of educational modules for the provision of education services. CIAFM and GCA act on behalf of the Participants as their agent in accordance with the provisions of the Management Agreement. Participants have under Clause 6 of the Constitution, management agreement rights over a specific educational module per interest held.

27. Clause 7 of the Management Agreement sets out the services CIAFM and GCA will provide which, among other things, includes management of sales and marketing, delivery and ongoing management of educational modules, renting premises, planning lessons, and employing teachers, as part of a business of education.

28. Clause 8 of the Management Agreement allows CIAFM to delegate all or any of the functions to be performed (other than those requiring a securities dealers licence) and may also consult, appoint, employ or contract with any other person to assist in the provision of Management Services for remuneration without consulting the Participants. GCA has been engaged in this regard.

Finance

29. The Participants are at liberty to choose how best to fund their investment in the Project and may do so with their own cash, a combination of cash and finance, or 100% finance.

30. CIAFM has engaged a nominated bank as a financier not associated with CIAFM or any associates of CIAFM, to arrange loans to cover the fees payable to CIAFM. The nominated bank loans will be on normal commercial terms; they will be both in form and substance, full recourse, and borrowers will be obliged to make the regular repayments regardless of any income being derived from the Project. CIAFM will be put in funds directly as a result of these loans, on the Participant being accepted as a borrower. CIAFM will not be putting any of these funds on deposit either directly or indirectly with the nominated financier in question, or any associated persons, but will substantially use these funds in carrying out its obligations under the Management Agreement.

31. The Responsible Entity, CIAFM, has no association with any finance company and will not be using any associated finance companies to provide lending facilities to participants in the Project.

32. This Ruling also applies to other loans which exhibit the following features:

- all loan terms are of an arm's length nature;
- borrowers remain fully liable for the balance of the loan outstanding at any time and lenders will take legal action against defaulting borrowers;
- there is no right to assign;
- there are no 'round robin' characteristics;
- there are no split loan features of a type referred to in Taxation Ruling TR 98/22;

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- there are no indemnity arrangements or any other collateral agreements in relation to the loan;
- repayments of principal and payments of interest are not linked to derivation of income from the Project and are made regularly, starting shortly after the making of the loan.

Derivation of Income

33. Revenue derived by the Participants will consist of revenue from student fees for courses. Revenue generated is pooled and allocated to Participants proportionately based on the number of Interests held in the Project and is used to meet each Participants commitments in respect of the Teaching Fee, Marketing Fee and Business Management Fees payable after the Second Period.

Ruling

Year ended 30 June 1999

34. For participants entering the Project by 30 June 1999 and incurring the \$10,000 Management Fees set out in paragraph 19 above, a deduction will be allowable under **section 8-1** of the ITAA 1997 for these fees, in respect of the year ended 30 June 1999. Participants who incur interest under a financing arrangement described in paragraphs 29 to 32 above will be allowed a deduction under section 8-1 for that interest.

35. The \$500 Module fee incurred in the Initial period is expenditure of a capital nature and is not deductible under section 8-1 of the ITAA 1997.

Years ended 30 June 2000 to 2011

36. Fees derived by participants from the delivery of educational services will be assessable under **section 6-5** of the ITAA 1997 for the year of income in which recoverable debts for those fees arise.

37. For the year ended 30 June 2000, a deduction of \$6000 will be allowable under **section 8-1** of the ITAA 1997 to Participants who incur the Management Fees as set out in paragraph 20 above.

38. For the years subsequent to the year ended 30 June 2000, a deduction is available to the Participants under **section 8-1** of the ITAA 1997 for the Continuing Management Fees as set out in paragraph 21 above incurred by Participants and deducted from their Gross Business Income.

39. Interest incurred in respect of funds borrowed by the investors to make their contributions will be deductible to the Participants under section 8-1 of the ITAA 1997.

40. Deductions will only be allowed in respect of Ongoing Management Fees for the years ending 30th June 2011, in the year of income to the extent that such fees have actually been incurred by the participants or offset against income credited to their account.

Section 82KL and 82KZM

41. For Participants who enter into this Project the following provisions of the ITAA 1936 operate as follows:

- Section 82 KL does not apply to deny the deductions otherwise allowable; and
- The expenditure of participants does not fall within section 82KZM.

Part IVA

42. The relevant provisions of Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

Explanations

Section 6-5

43. Student Fees derived by participants from the delivery of educational services will be assessable under section 6-5 of the ITAA 1997 for the year of income in which recoverable debts for those fees arise. This will depend on the specific contracts entered into.

Section 8-1

44. Consideration of whether the Management Fees are deductible under section 8-1, begins on the following basis:

- the outgoings in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under paragraph 8-1(1)(b) if they are incurred before the business has commenced; and
- where all that happens in a year of income is a taxpayer contractually commits itself to a venture that may not

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turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether deductions are allowable under paragraph 8-1(1)(b). However, that does not preclude the application of paragraph 8-1(1)(a) in determining whether the outgoings in question have a sufficient connection with the activities to produce assessable income.

45. The commercial marketing, management, sale and delivery of education modules as part of approved educational courses and the provision of associated educational services can constitute the carrying on of a business of education. Where there is a business, or a future business, the gross sale proceeds from the delivery of educational modules and services will constitute assessable income. The generation of 'business income' from such a business, or future business, provides the backdrop against which to judge whether the outgoings in question have the requisite connection with the operations that more directly gain or produce this income. These operations will include the marketing, management, sale and delivery of education modules and associated educational services.

46. A Participant will be carrying on a business of delivering education modules and providing associated educational services where:

- the Participant has an identifiable interest in the Project giving them access to the educational modules and associated educational services which are necessary for the conduct of the business;
- the marketing, management, sale and delivery activities are carried out on the Participant's behalf by the Manager; and
- the weight and influence of the general indicators of a business as used by the Courts, point to the carrying on of a business.

47. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the arrangement's description for all the indicators discussed in that Ruling. The Educational Consultant's marketing and technical reports indicate that the Project is realistic and commercially viable.

48. Participants appoint the Manager to perform the services specified in the Management Agreement. The Participant's degree of control over the Manager, as evidenced by the Management Agreement and supplemented by the Corporations Law, is sufficient. Participants are able to terminate arrangements with the Manager in

certain instances, such as where the Manager fails to perform its services in a proper or efficient manner. The Manager's activities described in the Management Agreement are carried out on the Participants' behalf.

49. Participants to whom this Ruling applies intend to derive assessable income from the Project. This intention is related to projections contained in the Prospectus that suggest the Project should return a 'before-tax' profit to the Participants, ie., a 'profit' in cash terms that does not depend in its calculation, on the fees in question being allowed as a deduction.

50. The professional services are provided by a Manager with appropriate credentials and relevant experience in business management and marketing and will conduct the business in a manner that would be recognised as appropriate in the industry.

51. The marketing, management, sale and distribution activities undertaken by the Manager on behalf of the Participants are consistent with an intention to carry on regular activities that have an 'air of permanence' about them. The Participants will be 'sufficiently committed' to the business. The Participants will be fully subjecting themselves to the risks of the business as all funding will be on a fully recourse basis. The Participants' involvement in the activities will constitute the carrying on of a business.

52. The Fees associated with the educational activities will relate to the gaining of income from this business, and hence have a sufficient connection to the operations by which assessable income, is to be gained from this business. They will thus be deductible under section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. No capital component is identifiable, other than the \$500 module fee identified in paragraph 19 above, in respect of deductions allowable under section 8-1. The tests of deductibility under section 8-1 are met. The exclusions in subsection 8-1(2) do not apply, subject to the exception of the \$500 module fee noted above.

53. The Initial Management Fees of \$10,000 per Interest for the Initial Period will be prepaid upon execution of the Management Agreement. The Fees will be incurred in the year the New Management Agreement is entered into. The Initial Management Fees of \$6000 per Interest for the Second Period (Year 1) are payable prior to 1 July 2000 in the Initial Period and are for services provided within 13 months of the date from which the relevant outgoings are incurred. Taxation Ruling TR 94/25 states that the facts in *Coles Myer Finance Ltd v. FC of T* (1993) 176 CLR 640; 93 ATC 4214; (1993) 25 ATR 95 were fundamentally different from those of a prepayment and that the decision did not affect the deductibility of prepaid expenses..

Section 82KL

54. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

55. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit received that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

56. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefit(s)'. Insufficient 'additional benefits' will be provided to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

Section 82KZM

57. Section 82KZM operates to spread over more than one income year a deduction for prepaid expenditure that would otherwise be immediately deductible, in full, under section 8-1. The section applies if certain expenditure incurred under an agreement is in return for the doing of a thing under the agreement that is not wholly done within 13 months after the day on which the expenditure is incurred.

58. The initial management fee is charged for providing services to a Participant only for the period of 12 months from the execution of the Management Agreement. There is nothing in the facts of the arrangement that would indicate the management fees have been inflated to result in reduced fees being payable for subsequent years. Having regard to the terms of the contracts and projected expenditure budgets provided by the Manager, and as the expenditure will not relate to a period greater than 12 months, it will not need to be apportioned in accordance with section 82KZM.

59. The ongoing management fees are payable on the day after the Initial Period for the period to 30 June 2000 and then quarterly in advance. For the purposes of this Ruling, it is accepted that no part of the management fees is for CIAFM or the Operational Manager, GCA, to do 'things' that are not to be wholly done within 13 months of the fee being incurred. On this basis, the basic precondition for the operation of section 82KZM is not satisfied and it will not apply to the expenditure.

Part IVA

60. For Part IVA of ITAA 1936 to apply there must be a ‘scheme’ (section 177A); a ‘tax benefit’ (section 177C); and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D). The Project will be a ‘scheme’ commencing when the Prospectus is issued. The Participants will obtain an initial ‘tax benefit’ from entering into the scheme, in the form of the deductions for the Initial Management Fees payable to CIAFM, and the Interest on any Loan, that would not have been obtained but for the scheme. However, it is not possible to conclude that the scheme will be entered into or carried out with the dominant purpose of obtaining these tax benefits.

61. Participants to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from delivery of educational services. Further, the independent expert’s opinion in the market and technical report in the Prospectus indicates that there is a sizeable market for the Project as outlined and believes the estimated student numbers to be attainable. There appears to be no specific indication of features of the Project, that might suggest the Project was so ‘tax driven’, and so designed to produce a tax deduction of a certain magnitude that would attract the operation of Part IVA.

Detailed contents list

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Commissioner of Taxation23 June 1999

Previous draft:

No draft issued

- tax benefits under tax avoidance schemes
- tax shelters
- tax shelters project

*Related Rulings/Determinations:*PR 98/1; TR 92/1; TR 94/25;
TR 97/11; TR 97/16; TD 93/34*Legislative references:*

- ITAA1936 82KH(1)
- ITAA1936 82KH(1F)(b)
- ITAA1936 82KL
- ITAA1936 82KL(1)
- ITAA1936 82KZM
- ITAA1936 Pt IVA
- ITAA1936 177A
- ITAA1936 177C
- ITAA1936 177D
- ITAA1997 6-5
- ITAA1997 8-1

Subject references:

- carrying on a business
- commencement of business
- fee expenses
- interest expenses
- management fees expenses
- primary production
- primary production expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance

Case references:

- Coles Myer Finance v. FC of T
(1993) 25 ATR 95; 93 ATC 4214

ATO references:

NO 99/2966-5

BO

FOI index detail: I 1020123

ISSN: 1039-0731

Price: \$1.40