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Manager
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The Treasury
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Dear Sir/Madam

University Sector - Submission on the exposure draft legislation:

Tax Laws Amendment (2012 Measures No.4) Bill 2012: tax exempt body “in Australia” requirements

“Restating and standardising the special conditions for tax concession entities” 17 April 2012

Thank you for the opportunity to provide Moore Stephen’s views on behalf of the University Sector regarding the reforms proposed in the exposure draft legislation Tax Laws Amendment (2012 Measures No.4) Bill 2012: tax exempt body “in Australia” requirements (“the ED legislation”) and the accompanying explanatory memorandum (“the EDEM”) released on 17 April 2012 .

1 About Moore Stephens

We are writing on behalf of the Moore Stephens Australia network of eight independent firms of accountants and advisors. Moore Stephens have a real understanding of the environment in which the University sector operates. We currently service universities across Australia and specialise in providing assurance, accounting, tax and advisory services to our university clients.

These clients include;

University of Melbourne	University of Ballarat	James Cook University
Monash University	University of Tasmania	Flinders university
Deakin University	Australian National University	University of Western Australia
RMIT	University of Canberra	Edith Cowen University
Latrobe University	University of Sydney	Murdoch University
Swinburne University	University of NSW	Curtin University
Victoria University	Griffith University	Macquarie University

We have had a long standing commitment and involvement for the past 15 years in this sector. We have been active in recent years in providing submissions to the Government’s various committees and consultations to support the sector through this reform phase.

2 General comments

We refer to our previous submission dated 12 August 2011 responding to the Consultation Paper – “In Australia’ special conditions for tax concession entities” and are pleased that the Government has taken into consideration some of our comments and have largely addressed 2 of the 3 main concerns that we raised in this submission. However, we believe that some fine tuning is still required to be made to the ED legislation to ensure that onerous administration is removed from the process.

The University Sector is one of Australia’s largest export industries and is a major employer. It operates in a very competitive environment and equivalent Universities around the world are not subject to similar taxing provisions.

Universities are increasingly under pressure to commercialise intellectual property and find alternative funding sources.

Most Australian Universities are considering expanding overseas as it is important for the Australian Universities to have significant overseas presence to attract international students.

We are aware that most Australia universities have expanded their overseas footprint. In particular they are operating in developing countries such as India, Vietnam, Chian and Africa. Any changes to the existing legislation will impact of the University’s ability to raise donations from the public for activities that are conducted solely in Australia.

We have included a typical University example as Appendix A for your consideration.

It is therefore important that this legislation is drafted correctly the first time and that there are no mistakes or unintended consequences.

3 Main concerns

Our main concerns are:

3.1. Restriction on distributions to NFP entities that do not have similar purposes

The ED legislation now allows Universities to transfer profits or assets to another University entity with a “similar purpose” even if the other University entity is an owner or member. We commend the Government for clarifying this issue.

However, we do not see why there is any need to restrict the transfer of profits to assets to another University subsidiary entity with a “similar purpose”. A University should be able to transfer profits or assets to any University subsidiary. This “similar purpose” restriction will create added complexity when trying to determine whether University’s subsidiary entities have a “similar purpose”.

In particular subsidiaries of Universities are generally set up for specific purposes and therefore never have identical purposes to their parents. The current legislation is not clear on what is considered to be a “similar purpose”. As a minimum, we request an example in the EM to show that a subsidiary of a University would by definition be considered to have similar objectives.

We have included an example at Appendix B that highlights typical objectives of a University and a University subsidiary. Whilst we would hope that these objectives would be considered to be similar purpose this is not clear.

3.2. Clarification of phrases 'genuine compensation' and 'reasonable expenses' and burden of proof

We note that paragraph (b) of the proposed definition of a 'not-for-profit entity' refers to 'genuine compensation for services provided to, or reasonable expenses incurred on behalf of, the entity' (sub-paragraph (ii)) as a type of distribution that would be excluded from the general prohibition on distributions of profits or assets to owners and members. We request clarification firstly for the phrases 'genuine compensation' and 'reasonable expenses' and secondly the extent to which a 'not-for-profit entity' would be required to substantiate such a requirement.

3.3. Sole purpose test for use of assets by tax exempt entities

The proposed section 50-1 still imposes a strict requirement for the tax exempt entity to:

"use its income and assets solely to pursue the purposes for which it was established"

We believe that the ED legislation should provide some leeway for minor or insignificant breaches.

3.4. Clarification of increased tracing burden requirements

The proposed Section 50-50-(4) imposes a significant tracing burden on tax exempt entities, it states:

*"If an entity gives money or property to another entity that is not an *exempt entity, the use of the money by the recipient (or any other entity) must be taken into account when determining whether the first mentioned entity satisfies the requirements in paragraph (2)(a) and (b)."*

This will require the University to take into account the use of the funds generated to determine whether the funds have been spent on activities that operate principally in Australia.

We seek clarification that the tracing of funds only relates to those generated for DGR activities and not in respect of other funding that may be generated by the University.

We require further guidance on the extent of investigation/tracing required. For example:

- Does it only apply to funds generated using the University's DGR status (e.g deductible donations which are held by a University is a separate fund)
- What is meant by "the use of the money"

We have provided an example of the type of tracing difficulties that Universities will have to consider at Appendix C.

3.5. Strict 'In Australia' test for DGRs

The introduction of the proposed 'in Australia' special conditions has the potential to deny most Australian universities DGR status as this status is currently provided on an 'entity' basis. This would have significant impact on Australian Universities ability to attract scholarships within Australia, fund research within Australia, and would limit resources and grants otherwise made available to students such as library resources and disabled equipment grants.

Section 30-18(1)(b) will require most DGRs to operate and pursue their purposes "solely" in Australia (subject to a few exceptions including the carve out contained in section 30-18(2) for activities that are "merely incidental" or "minor in extent and importance").

In addition section 30-18(3) states “*if a DGR gives money or property to another entity that is not a DGR, take into account the use of the money or property by that other entity (or any other entity) into account when determining whether the deductible gift recipient satisfies the requirements in paragraphs (1)(b) and (c).*”

In other words it will have to look through any entity that it provides money to determine the final use of the money under the sole purpose test. This will place a greater burden on Universities to trace the use of funds that they provide to non-tax exempt entities, than is currently the case.

Our main concerns are the extra burden required to determine what is considered to be:

- merely incidental to its activities in Australia; or
- minor in extent and importance when considered with reference to its activities in Australia.

We have provided examples at Appendix D that highlight some of the difficulties that can arise when determining what is merely incidental or minor.

Certainty is an important factor for Universities. We would recommend greater clarity in these definitions to address the questions raised in our Appendix D.

4 Possible remedies for strict “in Australia” conditions for DGRS

We have highlighted some of the problems with the strict in Australia special conditions for DGRs.

Possible remedies for Universities are:

- 4.1. Insert a specific provision to exempt ‘Table A’ higher education providers from the operation of these special conditions.**
- 4.2. Alternatively, insert a new provision that excludes from the operation of the special conditions all international activities that have a purpose of bringing funds into Australia (either directly or indirectly) or otherwise generating a benefit for Australia (directly or indirectly).**
- 4.3. Alternatively, adjust the current ED provisions to ensure that an entity may retain DGR status where it is able to establish that no DGR funds are expended in undertaking activities outside of Australia (excluding minor or incidental expenditure).**

5 Conclusion

In formulating our response to the ED legislation we have actively sought feedback from a range of Universities. Our submission incorporates a number of the issues and concerns which have been identified in these discussions.

We request that the Government does not rush through this legislation without ensuring that the unintended consequences are thoroughly considered and mitigated.

If you require further information or have any queries with regard to our submission please contact Steven Allan or Stephen O'Flynn on (03) 8635 1800.

Yours faithfully



Steven Allan
MOORE STEPHENS
MELBOURNE PTY LTD

Appendix A

We outline how a typical University currently manages its DGR status.

Typical University

- Established under a State Government Act
- Funded by Federal Government, State Government, Student Fees **and Donations**
- Turnover of \$1 Billion
- Assets of \$500 Million
- **Donations received via DGR status of \$5 Million p.a (1% of revenue)**
- Overseas activities operate within University or via Subsidiary Entities / Joint Ventures of varying sizes between \$10 Million and \$100 Million in revenue

DGR Funds

The funds that are generated via the DGR (being \$5 Million) are currently all spent on Australian activities such as:

- Student scholarships;
- Prizes;
- Awards;
- Travel and equipment grants (including specialist equipment for disabled students);
- Improving and updating critical resources such as libraries;
- Fields of research (via a Universities research institute or centre) or specific research projects;
- Buildings, laboratories or much needed equipment; and
- Support for specific academic positions, such as a Professorships or Chair in a particular field of study.

These gifts, donations and bequests are utilised for the benefit of Australia, by directly providing educational outcomes to students studying in Australia, by supporting research occurring within Australia. These funds are directed to national priority areas and individuals most at need of educational support, including rural, indigenous and low SES students, as well as scholarships and prizes to encourage studies in disciplines currently in critical national need (for example nursing).

You will note that in all cases the purposes to which these donated funds **are directed for the benefit of parties located in Australia.**

Importantly Universities do not expended funds that have been donated via the DGR status on overseas activities or projects nor are they used to invest in entities owned by the University that undertake these overseas activities.

There are cases which may be some interest where an Australian student has been provided a travel grant, to assist in studying abroad and immersion in other cultures. The benefits of travelling and studying abroad are significant to both the student, and for Australia as a whole in the creation and strengthening of ties between Australia and its neighbours¹. Further, there may be limited occasions where a student who is not an Australian citizen may be entitled to a prize, grant, award or scholarship

In this case we would argue that firstly the individual is an Australian resident and secondly the amount spent is outside of Australia would be regarded as minor or incidental.

The ability to offer a deductible gift receipt and enable the numerous generous donors to claim a tax deduction for this benefaction is critical to maintain this level of funding.

Relevance of Universities international activities

Universities have a necessary global focus, and a documented strategy for undertaking targeted international activities. These activities are many and varied, including:

- Undertaking specific research projects overseas, on either a grant or commercial contract basis;
- Research partnerships and collaborations with international education institutions and technology-based industries;
- Partnering with international education institutions to provide in-country education, involving the provision of University courses directly to students located overseas delivered by Australian lecturers travelling to the country, or by international lecturers trained to deliver on our behalf and moderated by Universities; and
- Assisting students to undertake research and study abroad.

Universities based in Australia will not alter their overseas expansions as a result of this change to DGR.

Conclusion

The University clearly understands that DGR funds raised from the public must be used exclusively in Australia and the accounting systems can track these funds to ensure that this occurs.

It appears that the ED legislation will remove the DGR status of the Universities as they conduct activities overseas, unless they are:

- merely incidental to its activities in Australia; or
- minor in extent and importance when considered with reference to its activities in Australia.

In the event that the University loses its DGR status then it would be anticipated that donations would dry up completely. Ancillary Funds and Trust Funds (that are endorsed as DGRs pursuant to Item 2 in the table in section 30-15 of *ITAA 1997*) would not be able to donate to Universities and the general public would also not be inclined to donate to Universities. This would impact on scholarships, research etc. that is provided to benefit Australia.

The University sector requires absolute clarity as to whether a University would lose its DGR status based upon the above indicative facts.

We would like to thank Kristian Thoroughgood from the University of SA for his contribution to this Appendix.

Appendix B

Restriction on distributions to NFP entities that do not have similar purposes

Example A - University “operates solely in Australia” test

Facts A:

A University’s objectives are:

- (a) to provide education at university standard; and
- (b) to provide facilities for study and research generally; and
- (c) to encourage study and research generally; and
- (d) to provide courses of study or instruction (at the levels of achievement the council considers appropriate) to meet the needs of the community; and
- (e) to confer higher education awards; and
- (f) to disseminate knowledge and promote scholarship; and
- (g) to provide facilities and resources for the wellbeing of the university’s staff, students and other persons undertaking courses at the university; and
- (h) to exploit commercially, for the university’s benefit, a facility or resource of the university, including, for example, study, research or knowledge, or the practical application of study, research or knowledge, belonging to the university, whether alone or with someone else; and
- (i) to perform other functions given to the university under this or another Act.

A University subsidiary’s objectives are:

- (a) to act as the commercial investment arm for the University; and
- (b) to exploit the intellectual property of the University; and
- (c) to support the University in the execution of its functions, including through the provision of financial support and accommodation; and
- (d) any other object or purpose not inconsistent with the objects specified in this Constitution, which is consistent with the provisions of the University Act and which the Directors in consultation with the Council

Question A

Would the University’s objectives and University subsidiary’s objectives be considered to be similar purpose?

Appendix C

Example B.1 - Use of money

Facts B.1:

University A has a \$200m operation in Australia.

It provides \$1m seed capital for a 50% interest in a start up IT business in India ("India Co.") that supports public health initiatives which align with the objectives of the University.

India Co. is extremely successful and 5 years later it is a \$50m self funding operation.

The University Australian operations have not expanded.

Question B.1

What amount would you need to take into account when determining whether Entity A satisfies the "operating and pursuing purposes" in Australia requirement in:

- Year 1- the \$1m?
- Year 5 – nil (as no expenditure incurred by A), \$1m (the initial investment), **or consider** \$25m (50% of the turnover in India Co.) **or consider** 50% of the market value of India Co.?

Example B.2 Increased tracing burden for tax exempts

Facts B.2:

In 2011 Entity X paid \$1m to Entity Y.

Entity Y carried on its operations entirely in Australia in 2011.

In 2012 Entity X again paid \$1m to Entity Y.

In 2012 as Y had shown specialist skills they also received a \$5m donation from overseas to expand their charitable activities into Indonesia. As a result of the \$5m donation Entity Y no longer would be considered to be NFP in Australia for the 2012 year. This change occurred after Entity X made their payment and was outside the control of Entity X.

Question B.2:

Does this mean that Entity X no longer satisfies the "In Australia" requirements for a NFP for the 2012 year?

Appendix D

Example C - DGR "operates solely in Australia" test

Facts C.1:

- City University is an income tax exempt entity and has deductible gift recipient status
- Apart from its Australian activities, City University has entered into numerous joint ventures in overseas countries to provide degree courses in these overseas countries.
- City University is required to provide course materials and course assessors.
- City University's course assessors are required to fly overseas to attend examinations and to review the exam papers.
- Their joint venture partners are responsible for providing academic teaching staff, facilities and administration support.
- The revenue returned to the University from the overseas joint ventures is less than 15% of the University's total revenue.

Question C.1:

- Would providing degree courses , course materials and assessors be considered to be:
 - Merely incidental to its activities in Australia? or
 - Minor in extent and importance when considered with reference to its activities in Australia?
- Would they still be considered to be minor if the revenue was less than 15%or 20% of the University's total revenue?
- As the activities are Education course related would they be considered incidental no matter what quantum of revenue is derived by the University
- What about if the revenue is not repatriated to Australia but retained in a non-resident company?

Appendix D (Continued)

Example C - DGR “operates solely in Australia” test

Facts C.2:

- Country University is an income tax exempt entity and has deductible gift recipient status
- Country University has a wholly owned Australian subsidiary (Company A) which holds a 49% interest in Company B.
- Country University paid \$200m as initial capital to Company A. Company A in turn invested \$200m as initial capital for its 49% interest in Company B.
- Company A's directors are all Australian residents and Company B has 4 directors one being an Australian resident and one a non-Australian resident who was nominated by the University;
- Company B operates a University overseas. It has operated for 3 years but has never made a profit and has never returned any surpluses to Country University.
- Country University is required to provide course materials and course assessors to company B.
- Country University's course assessors are required to fly overseas to attend examinations and to review the exam papers.
- The \$200m investment is 20% of the Universities Net Assets.
- Company B also has \$200m revenue which approximates 20% of the revenue of Country University;

Question C.2:

- Will Company A be able to obtain tax exempt status under the ED legislation?
(Our view: As Company A has no income only investment overseas. Hard to argue that it “pursues its purposes principally in Australia”)
- Will company A be able to obtain DGR status?
(Our view: Unlikely as it does not have any Australian activities)
- Will Country University be able to retain its DGR status in the year of the investment?
(Our view: Do you have to look at the size of the initial investment or any expenditure?)
- In future years Company B does not require any additional cash injections.
(Our view: Are we correct to assume that Country University would retain its DGR status in future years?)