



University of
South Australia

**University of South Australia (UniSA) Submission
to the Treasury Regarding Changes to the 'In Australia' Special Conditions
for Deductible Gift Recipients (DGR)**

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1. Executive Summary

1.1. Concerns

The University's concerns are:

1. The current drafting of the 'in Australia' special conditions prohibit DGRs from undertaking activities outside Australia. There is no specific exemption or allowance within the Exposure Draft of legislation (the ED¹) for Australian universities, which are by nature required to have a global focus and undertake international activities.
2. The exclusions from these special conditions for 'minor' or 'incidental' activities are exceptionally narrow, and Australian universities are unlikely to be able to satisfy these exclusions given their global focus.
3. There appears to be an intent expressed within the Exposure Draft Explanatory Memorandum (the EM²) not to apply the 'in Australia' special conditions where an entity does not use 'DGR funds' for its activities overseas - overseas activities in these cases would be funded from non-DGR sources. This intent is not effectively reflected in the current drafting for Australian public universities. While Australian universities are currently endorsed as DGRs on an 'entity basis' under the *Income Tax Assessment Act 1997* (ITAA 97), there is no provision in the ED for separating universities into 'DGR' and 'non-DGR' portions.

The University considers the current drafting of the rules threatens the ability for Australian public universities to maintain their entity-based DGR status, requiring expensive and complex restructuring of philanthropic activities and legal structures.

1.2. Summary of recommendations

To remove uncertainty surrounding the DGR status of Australian universities it is recommended that:

1. A specific provision is inserted to exempt 'Table A' higher education providers³ from the operation of these special conditions.
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).
3. Alternatively, the current ED provisions are adjusted to ensure that an entity may retain DGR status where it is able to establish that no more than minor or incidental DGR funds are expended in undertaking activities outside of Australia.
4. Alternatively, if Treasury determines that no amendment to this proposed provision is required on the basis that the activities undertaken by public universities will be either minor or incidental; UniSA requests the inclusion of a single specific example encompassing the *entire inclusive range* of offshore activities commonly undertaken by universities.

¹http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/In%20Australia%20Special%20Conditions%20for%20Tax%20Concession%20Entities/Key%20Documents/Exposure_Draft.ashx

²http://www.treasury.gov.au/~media/Treasury/Consultations%20and%20Reviews/2012/In%20Australia%20Special%20Conditions%20for%20Tax%20Concession%20Entities/Key%20Documents/Explanatory_materials.ashx

³http://www.austlii.edu.au/au/legis/cth/consol_act/hesa2003271/s16.15.html

2. Introduction

2.1. Background

On 17 April 2012 the Treasury released the revised ED and EM that purports to restate the 'in Australia' special conditions for tax concession entities as it applies to DGR status⁴. These special conditions have been drafted to indicate that an entity must operate solely within Australia (with allowance for very minor/incidental activities) to maintain DGR status.

The University of South Australia (UniSA) is a public university, established by the South Australian Government in 1991 by the *University of South Australia Act 1990*, and is a listed 'Table A' higher education provider under the *Higher Education Support Act 2003* (HESA 2003).

Like most public universities, UniSA is endorsed as a DGR under Item 1 of the table in section 30-15 of the *Income Tax Assessment Act 1997* (ITAA 97), which refers to item 2.1.1 of section 30-25 of the ITAA 97. This endorsement extends to 'public universities' and is provided on an 'entity' basis, not on a 'fund' basis. This is an important distinction – the Australian Taxation Office confirms on its website:

*“Donations made to an organisation that **is endorsed as a whole may be tax deductible** whereas donations made to an organisation that is endorsed for a fund, authority or institution it operates are only tax deductible if they are made to that particular part of the organisation⁵.”(emphasis added).*

UniSA is very concerned with the proposed drafting of the 'in Australia' special conditions, as (like most Australian universities):

- UniSA relies on gifts to support many activities in Australia that would otherwise be unfunded (including scholarships, academic research activities and provision of critical resources etc); and
- The global nature of higher education requires UniSA to undertake a range of activities *outside of Australia* in order to further *within Australia* educational, academic and research goals, as well as continue to develop international student markets.

The current drafting of the 'in Australia' special conditions has the potential to deny UniSA (and arguably all other Australian universities) DGR status as this status is currently provided on an 'entity' basis. This would have significant impact on UniSA's ability to attract scholarships within Australia, fund research within Australia, and would limit resources and grants otherwise made available to Australian students.

The University considers it is possible to satisfy the policy objectives stated within the EM without denying UniSA and other universities DGR status and disadvantaging Australian students.

⁴ This submission does not address the test for income tax exemption, it focuses only on the proposed special conditions that DGRs must be operated solely in Australia.

⁵ <http://www.ato.gov.au/nonprofit/content.aspx?doc=/content/8568.htm>

3. Activities of the University of South Australia

Understanding the activities of UniSA (and other Australian Universities), particularly in respect of both its DGR status and its operations internationally, is critical to understanding the conflict and uncertainty to donors that the current drafting of the 'in Australia' special conditions has the potential to create.

3.1. Significance of UniSA's DGR status

In each of the last few years UniSA has received in excess of \$1 million by way of donations, revenue from fundraising activities, and bequests. These gifts and donations support important activities within Australia that may otherwise be unfunded, including:

- Student scholarships;
- Prizes;
- Awards;
- Travel and equipment grants (including specialist equipment for disabled students);
- Improving and updating critical resources such as libraries;
- Academic and industry supported research (via a UniSA research institute or centre) or specific research projects;
- Buildings, laboratories or specialised research equipment; and
- Support for specific academic positions, such as a Professorships or Chairs in a particular discipline.

These gifts, donations and bequests are utilised for the benefit of Australia, by direct provision to students studying in Australia and by supporting research conducted by Australian universities. 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 the vast majority of purposes to which these donated funds are directed for the benefit of students and academics located in Australia. It is recognised that on very limited occasions DGR funds may be expended overseas, such as where an Australian student has been provided a travel grant to assist in studying or researching abroad for a given period of time. 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 other countries⁶. 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. UniSA confers these awards and scholarship based on meritorious performance or greatest need. Recognition of high performers when they are undergraduates has an additional benefit of potentially leading to higher degree studies being undertaken, providing the University with status, as well as additional revenue. The recognition of UniSA's highest achievers and support of those most in need is regarded as highly important regardless of the residence of the recipient. It is considered that the amounts that may be spent outside of Australia would be regarded as minor or incidental.

The ability to offer a deductible gift receipt and enable donors to claim a tax deduction for this benefaction is critical to maintain this level of funding. For your information, please visit <http://www.unisa.edu.au/Business-community/Give-to-UniSA/Gifts-in-action/> to see a current sample of the important benefits UniSA is providing to its Australian students as a direct consequence of receiving these important gifts and donations.

⁶ As support for this statement, please refer to the Endeavour Awards, a series of scholarships/grants are offered by the Australian Commonwealth Government (through DEEWR) to both Australian and non-resident students for the same reasons: <http://www.deewr.gov.au/International/EndeavourAwards/Pages/Home.aspx>.

3.2. Significance of UniSA's international activities

UniSA has 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 UniSA 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 UniSA; and
- Assisting students to undertake research and study abroad.

UniSA does not at this stage:

- Own or operate a physical campus in any international location;
- Licence educational Intellectual Property (IP) for international institutions to use as a basis for the development their own courses; or
- Offer jointly conferred degrees with international education institutions.

But these are considered options available to UniSA to explore in the future, and note that other Australian universities may well be currently undertaking these activities.

By building UniSA's global brand, the benefits of these overseas programs and activities to the University are manifold. The direct benefits of these international collaborations, contracts and ventures include:

- Improved global profile and research reputation of UniSA, which directly translates to improving its international university rankings;
- Increases in the number and quality of co-authored papers and research publications;
- Access to international expertise;
- Access to information and data from overseas, samples of materials for testing, equipment, technology and infrastructure;
- Improved international relationships,
- Ability to contribute to research on global issues (health/medical matters, environmental and sustainability issues, green energy solutions etc.);
- Ability to attract top research talent who, in turn, assist to attract grants and produce patentable intellectual property for the benefit of Australia; and
- Access to international research funding.

In addition to these already significant benefits, these activities and the profile they generate provide UniSA access to international student markets. UniSA, like all Australian universities, relies on international student enrolments on our campuses for revenue. For UniSA, full fee paying international students account for approximately 16 % of total revenue contributing to improved student facilities and support of research activities. The importance of international students in subsidising higher education costs for Australian students well established. Please refer page 2 of the COAG report *International Students Strategy for Australia: 2010 – 2014*, http://www.coag.gov.au/reports/docs/aus_international_students_strategy.pdf which indicates education is Australia's third largest source of export income.

UniSA therefore considers both its DGR status and its international activities to be of significant importance to providing benefits to Australian students and the wider economy.

4. Current drafting of the ‘in Australia’ special conditions within the ED

The special conditions are expressed in the ED as follows (emphasis added):

“30-18 Fund, authority or institution must operate in Australia etc.

- (1) *A fund, authority or institution satisfies the conditions in this section if:*
- (a) it is established in Australia; and*
 - (b) it **operates solely in Australia**; and*
 - (c) it pursues its purposes solely in Australia.*
- (2) *Despite subsection (1), a fund, authority or institution that operates or pursues purposes outside Australia does not fail the conditions in paragraphs (1)(b) and (c) if:*
- (a) its activities outside Australia are **merely incidental** to its activities in Australia; or*
 - (b) its activities outside Australia are **minor in extent and importance when considered with reference to its activities in Australia.**”*

The EM provides additional discussion on these proposed provisions:

*“1.107 ‘Solely in Australia’ is to be interpreted as requiring deductible gift recipients to be established and operated only in Australia (including control, **activities and assets**) and must have their purpose and beneficiaries only in Australia.*

1.108 A deductible gift recipient does not fail the ‘operating solely in Australia’ and ‘pursuing purposes solely in Australia’ if the overseas activities are merely incidental to the Australian activities of the entity, and⁷ the overseas activities are minor in extent and importance when considered with reference to the Australian activities.”

4.1. UniSA Interpretation

It is apparent from the drafting of the special conditions in the ED and the discussion in the EM that the ‘solely in Australia’ is a very strict test. UniSA also considers that it will not satisfy the current drafting of proposed subsection 30-18(1) as it undertakes a range of activities outside of Australia, thereby failing the ‘solely’ test.

Furthermore it is not certain that the ‘minor’ or ‘incidental’ activity exclusions in proposed subsections 30-18(2)(a) and (b) will apply to all of the activities undertaken by UniSA given the examples provided in the EM.

⁷ Paragraph 1.108 of the EM, discussion on proposed subsection 30-18(2) the EM indicates that to satisfy the exemption, the activities must be both minor *and* incidental and the relevant examples contained in the EM (examples 1.12 to 1.18) make no distinction between the two tests. We note that under the current drafting of this proposed subsection, it is clear that this is an *or* test – that is, activities will satisfy the exemption if they are *either* minor *or* incidental.

Examining the first exclusion under proposed subsection 30-18(2)(a), we note that each example in the EM purports to discuss ‘incidental’ activities. We request your consideration of Example 1.18:

“Example 1.18: Incidental activities

An orchestra which has a deductible gift recipient fund tours around Australia, and wishes to purchase an instrument.

The orchestra receives an opportunity to do a tour overseas for one week, and they choose to take the instrument on the tour.

Deductible gift recipient funds could be used to purchase the instrument, as the instrument will be used mainly in Australia, and its use overseas is incidental to this.

However, deductible gift recipient funds will not be able to be used to cover the flights of the orchestra members, and other tour costs incurred while the orchestra is touring overseas, as these costs are not considered incidental to the orchestra’s activities in Australia.⁸”

From this example, it is clear that the threshold for ‘incidental’ activities is exceptionally low – a one week activity overseas (from the example we must presume that this is one week out of the entire year) is enough to be considered ‘not incidental’ to their activities in Australia. In UniSA’s context, international research collaborations can extend for months or years. Further, the commitment for teaching UniSA courses in another country is at a minimum the length of a degree course (commonly three years), and at termination there is a requirement to ‘teach-out’ any current on-going students, which extends UniSA’s involvement for another two to three years.

Turning to the exclusion proposed subsection 30-18(2)(b), we note that this purports to exclude “***minor in extent and importance when considered with reference to its activities in Australia***”. UniSA would consider that all of the activities it conducts overseas would satisfy this exclusion, when the size, scale and cost of these international activities are not significant compared with UniSA’s Australian operations. However, there is little practical guidance in the EM on what activities will be considered minor. We note Examples 1.15 and 1.17 advise that the ‘temporary tour of an artwork collection’ is minor, as is ‘the minor activity of bringing a small number of children into Australia for medical treatment’. Again, these examples are limited to very temporary, short-term, occasional or one-off activities. The activities undertaken by UniSA tend to be longer term, on-going and regularly occurring.

It is therefore UniSA’s view that it may not be able to rely on these exclusions, with the result that continuing UniSA’s international activities would result in the loss of its DGR status.

4.2. Special conditions only apply to “the portion of the entity that is a DGR”

We note that the EM provides in paragraph 1.118:

*1.118 However, these conditions only apply to **the portion of the entity or public fund that is endorsed as a deductible gift recipient**. Similarly, the part of the entity that is a deductible gift recipient is disregarded when applying the income tax exemption special conditions.*

It is important to note that as UniSA is endorsed for DGR status on an entity basis, it is not possible to separate a 'DGR portion' from a 'non-DGR portion'. Whilst the University's DGR funds are not expended overseas to any significant extent, there does not appear to be any basis for this approach (as it applies to DGR entities) under existing legislation or under the proposed Exposure Draft. It fails to consider that as DGR status is provided to the University on an 'entity' basis it is not required to separately operate a DGR gift fund.

We return to Example 1.18 (the touring orchestra) of the EM which implies that DGR status may be retained if the orchestra spends funds that are not from the DGR fund operated by the orchestra. This is a logical outcome where there is a separation between the legal entity undertaking the activity and the DGR gift fund whose use is in question. However, UniSA is endorsed as a DGR on an 'entity' basis, and there is no current rule (in legislation or practice) for UniSA to maintain a gift fund.

We note the following guidance from the ATO fact sheet '*Gift Fund Requirements*⁹:

"Who is required to maintain a gift fund?"

Organisations that are endorsed, or seeking to be endorsed, by the Tax Office as a DGR for the operation of a fund, authority or institution must maintain a gift fund.

An exception is where an organisation is seeking DGR endorsement for a fund, authority or institution that it operates and the organisation is already endorsed as a DGR as a whole.

In this situation, the organisation does not need to maintain a gift fund.

Example

*A public university is endorsed as a DGR as a whole. The university is seeking endorsement for the operation of a library on its grounds, which is open to the public. **The university does not need to operate a gift fund for its library, as the university itself is endorsed as a DGR as a whole.**" (emphasis added)*

Accordingly UniSA considers that if the intent is to apply the 'in Australia' special conditions in the manner outlined, that is effectively restricted to a test of the *actual use of DGR funds*, and not a test of *the activities of the DGR*, then the current drafting does not represent this intent, nor does it have this effect.

It is our understanding that it is not the intent of the Treasury to remove the ability of public universities to be endorsed as DGRs. This is evidenced by the fact that the ED does not specifically remove item 2.1.1 of section 30-25 of the ITAA 97 outright. Accordingly, UniSA considers that the ED requires amendment to achieve the actual objectives.

In the event the ED remains substantially unchanged, no university will be able maintain DGR status without significant and expensive restructuring. This restructuring would involve at a minimum setting up a separate legal entity (for example a company) or DGR fund that would then be required to seek separate income tax exemption and DGR status. Further, the separate entity/fund would need to establish an alternative basis for DGR status, as the DGR status conferred by the item 2.1.1 of section 30-25 of ITAA 97 to public universities would not be available (under the current rules).

Setting up and maintaining separate legal entities or funds by its nature will overlay significant additional and on-going costs. It is necessary to factor in costs of creation including legal and accounting advice (essential when seeking endorsement for tax concession), expenses in the

⁹ http://www.ato.gov.au/download.asp?file=/content/downloads/NPC_00013269_n3194.pdf

transferring of assets, costs of additional reporting obligations (for example regular taxation and GST reporting, as well as the new reporting requirements under the Australian Charities and Not-for-profit Committee), and necessary audit requirements. This seems inefficient when the current endorsement and operations of universities as DGR entities works effectively.

4.3. Current drafting of the special conditions is unnecessarily draconian to achieve the underlying policy objectives

From the EM, it is apparent that the dominant policy objectives for the restating of these ‘in Australia’ special conditions are as follows:

- Preventing the transfer of tax exempted/tax deductible gift revenue from Australia to a foreign country and ensuring that tax supported funds remain in Australia; and
- Providing an ‘additional measure’ to address the possible abuse of not-for-profit entities for money laundering and terrorist financing. The EM outlines Australia’s commitment to comply with the Financial Action Task Force (FATF) Special Recommendation VIII (SR VIII) relating to combating the misuse of not-for-profits for the purposes of terrorism financing.

UniSA understands the importance of these policy objectives. The University agrees that the DGR tax concession, which is funded by Australian taxpayers, must be focused on providing for the broad benefit of all Australians.

However, as exceptionally few DGR funds are spent by UniSA on overseas activities, there is no real risk of ‘leakage’ of taxpayer supported funds to overseas beneficiaries. Furthermore UniSA considers that the ED legislation designed to prevent money being sent overseas fails to recognise the reality of the Higher Education Sector where activities are conducted overseas to generate funds and benefits for use in Australia. UniSA considers the application of the special conditions as currently drafted will ultimately result in a reduction in benefits and services that it, and most other Universities, offers to Australian students.

In respect of Australia’s commitment to the FATF SR VIII, UniSA notes that ‘best practice’ (as defined by FATF¹⁰) is improved transparency, verification of programs and increased oversight. With all respect, there is no suggestion that all (or almost all) international activities be prohibited for not-for-profit entities. There is no recognition in the ED of the already substantial reporting obligations and audit oversight that exists for Australian universities. UniSA is audited by the South Australian Auditor-General’s Department, and has regular reporting obligations to the Department of Industry, Innovation, Science, Research and Tertiary Education (DIISRTE). These already significant reporting requirements together with the soon to be introduced requirements of the new regulatory body, the Australian Charities and Not-for-profit Commission should provide some comfort regarding the risk of misuse of donated funds. There is also the additional ‘program verification’ checks, review and reporting requirements under the new Tertiary Education Quality and Standards Agency (TEQSA), aimed at ensuring the quality of services delivered by public universities.

The University considers the identified important policy objectives can be achieved without denying UniSA (or other public universities) DGR status or impinging on its international activities and presents the following alternative recommendations for Treasury’s consideration.

¹⁰ <http://www.aic.gov.au/publications/current%20series/rpp/100-120/rpp114.aspx>

5. Recommendations

5.1. Recommendation one

- Exempt public universities from the application of these provisions

UniSA notes that the ED already provides an exemption from the 'solely within Australia' special conditions for:

- 'International affairs deductible gift recipients' under proposed subsection 30-18(4); and
- Entities listed under the 'register of environmental organisations' under proposed subsection 30-18(5).

UniSA proposes the following new provision be added to proposed section 30-18 in the ED:

30-18(6) An institution that is a listed provider according to section 16-15¹¹ of the Higher Education Support Act 2003 satisfies the conditions in this section if it satisfies the conditions in paragraph (1)(a).

This suggested provision would have the effect of simply excluding the 'solely in Australia' special conditions as it applies to Australian public universities.

5.2. Alternative recommendation two

- Exempt activities that have a purpose of bringing funds into Australia or generating benefits for Australia

As outlined above, UniSA's international activities are undertaken with a range of purposes. The common thread for these activities is that they ultimately bring benefits into Australia, either financially, or in a less tangible manner (improving the profile of Australian universities, attracting talent etc.).

UniSA therefore proposes the following new provision be added to proposed section 30-18(2) in the ED:

30-18(2) Despite subsection (1), a fund, authority or institution that operates or pursues purposes outside Australia does not fail the conditions in paragraphs (1)(b) and (c) if:
(a) its activities ...; or
(b) its activities ...; or
(c) its activities outside Australia are undertaken with the intent to, directly or indirectly, generate revenue to be returned into Australia; or otherwise generate benefits for Australia.

UniSA considers this option would appropriately resolve the issue by ensuring that all international activities undertaken by a DGR must be for the direct or indirect benefit of Australia. The University notes that it is critical for indirect benefits to be sufficient to enable exemption, to ensure that intangibles such as improved global reputation and attracting high level academic recruits are suitably recognised.

¹¹ Note that this captures those higher education providers listed under Table A of HESA.

5.3. Alternative recommendation three

- Exempt international activities by entities that can establish not more than minor or incidental DGR funds have been spent on overseas activities

As discussed, the EM outlines the intent for these special conditions to only apply to those 'portions of the entity that is a DGR'. To achieve this objective, the University considers that there needs to be a provision allowing for the tracing of the purpose and expenditure of these 'DGR' funds by entities that are endorsed as a whole.

UniSA therefore proposes the following adjustments be made to proposed section 30-18 in the ED:

30-18 Fund, authority or institution must operate in Australia etc.

- (1) *A fund, authority or institution satisfies the conditions in this section if:*
 - (a) *it is established in Australia; and*
 - (b) *it **only expends funds for which it has issued a deductible gift receipt on its operations solely in Australia; and***
 - (c) *it **only expends funds for which it has issued a deductible gift receipt on pursuing its purposes solely in Australia.***

- (2) *Despite subsection (1), a fund, authority or institution that operates or pursues purposes outside Australia does not fail the conditions in paragraphs (1)(b) and (c) if:*
 - (a) *its activities outside Australia **that are funded by DGR funds** are merely incidental to its activities in Australia; or*
 - (b) *its activities outside Australia **that are funded by DGR funds** are minor in extent and importance when considered with reference to its activities in Australia."*

5.4. Alternative recommendation four

- expand the minor and incidental examples to specifically cover the activities commonly undertaken by Australian public universities

In the event Treasury considers that the activities undertaken by Australian universities should fit under the existing exclusions in proposed subsection 30-18(2) on the basis they are minor or incidental, then UniSA requests this be specifically clarified by way of an example in the EM.

UniSA proposes the example of minor or incidental activities should expressly cover the situation where an Australian university pursues a range of cumulative activities overseas including:

- Undertakes research projects overseas, on either a grant or commercial contract basis;
- Develops research partnerships and collaborations with international education institutions and technology-based industries;
- Partners with international education institutions to provide in-country education, involving direct teaching to students and training international lecturers to deliver on its behalf;
- Assists students to research and study abroad;
- Licences educational Intellectual Property (IP) for international institutions use as a basis for the development their own courses;
- Offers jointly conferred degrees with international education institutions; and
- Has a physical campus in an international location.

The size, scale and cost of these international operations is very low when compared to the Australian public universities' total activities in Australia and will satisfy section 30-18(2)(b). Accordingly institutions will satisfy the 'in Australia' special conditions.

UniSA considers this extensive example is required, as any public university may be undertaking a mix of any or all of these activities from time to time, and that the cumulative effect of multiple activities should not result in failing the DGR test. Any definition of minor or incidental activities for universities should be developed in consultation with the sector.

6. Conclusion

UniSA supports the broad policy objectives of the 'in Australia' special conditions:

- Tax payer supported funds should be applied the benefit of Australia and Australians; and
- Not-for-profit entities should be wary of potential misuse of tax exempt funds by terrorist organisations.

UniSA does not support adopting an approach that would force Australian universities to choose between DGR status and operating in the global education marketplace or have to restructure operations and legal structures to maintain DGR status. This outcome is not justified by the limited 'tax leakage' and 'terrorist funding' risk presented by Australian higher education institutions.