



## Tax legislation expands entities required to prepare general purpose financial statements for 30 June 2020

Recent legislation broadens and changes how large taxpayers are classified and changes those required to prepare 'general purpose financial statements' (GPFS) under tax legislation

The changes:

- Introduce a new 'CBC reporting entities' category which will have obligations for country-by-country reporting and the lodgement of GPFS, with the latter only applying if the entity is a corporate tax entity preparing a tax return
- Do not impact entities that already prepare GPFS for tax purposes. They will continue to prepare GPFS, albeit as 'CBC reporting entities'
- Capture groups headed by entities that previously have not prepared consolidated financial statements, or only prepared stand alone financial statements, and entities which were not consolidated due to being immaterial for the purpose of considering whether the A\$1 billion threshold is met. This may introduce a new requirement to prepare GPFS for the following categories of entities:
  - Groups using non-corporate structures, e.g. trust, partnerships
  - Some privately held groups
  - Entities controlled by foreign parents, or foreign entities operating permanent establishments in Australia
  - Groups with ultimate parent entities previously preparing 'stand-alone' financial statements.
- Apply retrospectively to income years or periods commencing on or after 1 July 2019, meaning newly captured entities with June year ends will have a GPFS requirement at 30 June 2020.

The retrospective nature of the changes may surprise many entities as they are effective from 1 July 2019. This will mean that many entities will now be required to prepare GPFS for 30 June 2020

## Clarity in financial reporting

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# Understanding the changes

## What's changed?

The *Treasury Laws Amendment (2020 Measures No. 1) Act 2020* was passed by Federal Parliament in May 2020 and contains amendments to extend the definition of a Significant Global Entity (SGE) and introduce a new concept of a 'Country by Country reporting entity' (termed a 'CBC reporting entity' in the legislation).

The amendments:

- Transfer the requirement to prepare GPFS from SGEs to CBC reporting entities
- Require entities to ignore accounting exemptions from consolidation when testing whether the annual global income meets or exceeds the A\$1 billion threshold to be an SGE or CBC reporting entity (there are differences between how these consolidation exemptions are treated for the SGE and CBC reporting entity definitions)
- Require entities to determine annual global income<sup>1</sup> (and so whether the entity is an SGE or CBC reporting entity) for a 'notional listed company group' (NLCG) in some cases. This has the effect of ensuring that annual global income is determined on a consolidated basis, even though that amount may not be disclosed in the financial statements of the ultimate parent entity (because financial statements are not prepared or are only prepared on a stand alone basis).

The new CBC reporting entity category determines which entities are required to prepare GPFS



### Understanding the NLCG concept

A NLCG is a group of entities that would be required to be consolidated as a single group under applicable accounting rules if any member of the group (such as the parent entity) was a listed company. Listed companies are required to prepare consolidated financial statements and so a lack of a legal requirement to prepare consolidated financial statements is ignored. Preparation of financial statements is not required, but annual global income must be determined as if it were disclosed in those consolidated financial statements.

This concept is used to determine whether the members of a group are CBC reporting entities (or SGEs). Individual entities within the CBC reporting group may then be required to prepare GPFS (where they are a corporate tax entity preparing a tax return), in which case GPFS must be prepared for the entity or a parent.

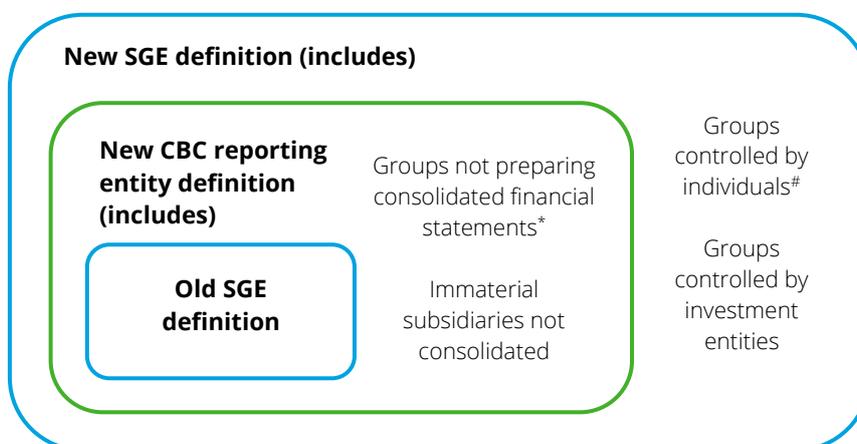
The definitions of an SGE and CBC reporting entity are related and linked. However, entities will be required to calculate their annual global income under two different definitions when determining whether the relevant SGE or CBC reporting entity requirements apply to them.

<sup>1</sup> 'Annual global income' is included in the tax legislation definitions. Essentially, annual global income includes revenue and other income.

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The following diagram shows how the old and new definitions are related (note that only those entities within the green box are subject to the preparation of GPFS requirement under s.3CA of the *Tax Administration Act 1953*).



\* This includes both groups or individual entities where no financial statements are prepared and groups where the parent prepares 'stand alone' financial statements (and is relevant for the purposes of applying the NLCG concept)

# For the purposes of the SGE definition, an individual can be the ultimate parent of a NLCG

## What is the difference between an SGE and a CBC reporting entity?

The key difference between SGEs and CBC reporting entities is that only CBC reporting entities are subject to the GPFS requirements (and the country by country reporting requirements).

The determination of whether an entity is an SGE or CBC reporting entity depends on the annual global income of the relevant group or entity. Additionally, the two definitions differ as to which entities are part of the relevant group and so how annual global income is determined when testing the A\$1 billion threshold. Generally, all entities consolidated for accounting purposes are included in each group, but the relevant accounting principles are broadened to include entities that might otherwise not be consolidated (e.g. the investment entity consolidation exemption is ignored in some cases).

The amendments to normal accounting principles are applied differently between the SGE and CBC reporting entity definitions, as set out in the table below:

Amendment to normal accounting principles when determining annual global income	SGE	CBC reporting entity
Consider a 'notional listed company group' where ultimate parent does not prepare financial statements <sup>2</sup>	Yes	Yes
Ignore other consolidation exemptions <sup>3</sup>	Yes	Yes
Consider immaterial subsidiaries to be consolidated	Yes	Yes
Consider an individual to be a global parent entity	Yes	No
Ignore the investment entity recognition exception	Yes	No

<sup>2</sup> This includes entities that are not required to prepare financial statements under their governing legislation or constituting document, e.g. closely held entities in foreign jurisdictions, and certain trusts, partnerships and similar entities that have no reporting mandate under their constituting document.

<sup>3</sup> For example, ultimate parent entities that are not reporting entities may not prepare consolidated financial statements. Foreign parents may not have an obligation to prepare financial statements, or be subject to other accounting standards, and these may contain differing or additional exemptions from consolidation.

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### Why is the new CBC reporting entity definition relevant?

Through changes made to s.3CA of the *Tax Administration Act*, only CBC reporting entities that are also corporate tax entities preparing a tax return are required to prepare GPFS where GPFS have not already been lodged with the Australian Securities and Investments Commission (ASIC). This replaces the previous GPFS requirement which applied to SGEs that are also corporate tax entities preparing a tax return<sup>4</sup>.

The determination of whether an entity is a CBC reporting entity requires the determination of the annual global income of the CBC reporting group. The tax legislation effectively requires this determination to be performed for the largest CBC reporting group, i.e. the group of entities that is consolidated (or where consolidated financial statements are not prepared, would be consolidated) for accounting purposes.

Only where the annual global income of the CBC reporting group exceeds A\$1 billion does the entity have a requirement to prepare GPFS in s.3CA. It is important to note that the determination of annual global income of the CBC reporting group is separate to the determination of the annual global income of the global parent entity of a group of SGEs. This means that entities may need to perform more than one calculation where the group structure and reporting mandate requires because an entity can be an SGE but not be CBC reporting entity.

All entities previously identified as SGEs will meet the new CBC reporting entity definition. This is because the annual global income for the CBC reporting group will continue to be determined for the same (or more) entities as under the previous SGE definition. As a result, these entities will continue to be subject to the GPFS requirements as a CBC reporting entity. However, additional entities may fall into the CBC reporting group and so may also have a new GPFS requirement<sup>5</sup>.

### When do the new requirements apply?

The new requirements become operative on 1 July 2020, but apply retrospectively in relation to income years or periods commencing on or after 1 July 2019.

Accordingly, entities required to prepare GPFS in accordance with the new definitions will be required to do so for income years beginning on or after 1 July 2019. This means that captured entities with an income year (and financial year) ending on 30 June 2020 will be required to prepare GPFS at that date.

No entities will 'drop out' of the GPFS requirements due to the changes, but more entities will become subject to them

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<sup>4</sup> Corporate tax entities are companies, corporate limited partnerships and public trading trusts.

<sup>5</sup> For example, the CBC reporting group may be larger than the previous SGE group due to the NLCG provisions, or entities not previously consolidated because they were immaterial may be included (as under the previous legislation they technically were not a SGE as only entities included in the consolidated financial statements of the ultimate parent were captured).

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### Who will have a new requirement to prepare GPFS?

Only CBC reporting entities that are also corporate tax entities are required to prepare GPFS. The CBC reporting entity definition captures all entities previously considered SGEs but broadens the definition to include 'notional listed company groups' and makes it clear it captures entities that are not consolidated due to being immaterial in the consolidated financial statements.

In other words, groups headed by parent entities that have not previously prepared consolidated financial statements disclosing their annual global income, or which only prepared stand alone financial statements when they had subsidiaries, can now be captured<sup>6</sup>. Previously these entities technically could not be an SGE (now CBC reporting entity) because consolidated 'global financial statements' of the 'global parent entity' did not exist from which to determine the annual global income of the group.

Accordingly, in broad terms, the following categories of entities will now be required to prepare GPFS for income years or periods commencing on or after 1 July 2019 where the annual global income in the relevant CBC reporting group exceeds the A\$1 billion threshold:

- Entities that are, or are ultimately controlled by, entities that have no other requirement to prepare financial statements or were only required to prepare stand alone financial statements. This may apply to groups headed by trusts, partnerships, co-operatives and similar entities
- Entities controlled by foreign entities where that foreign entity has no obligation to prepare financial statements (or prepares stand alone financial statements) in the foreign jurisdiction
- Branches of foreign entities operating permanent establishments in Australia that do not have an obligation to prepare financial statements in their home jurisdiction
- Australian corporate groups where consolidated financial statements were not previously prepared, e.g. unlisted corporate entities that are not 'reporting entities' preparing stand-alone special purpose financial statements (i.e. without consolidating subsidiaries).

In some cases, these entities may have already considered themselves to be SGEs under previous legislation and may have already prepared GPFS. These entities now have their obligations clarified through the amendments and will continue to be required to prepare GPFS, but as CBC reporting entities. Other entities may have adopted a technical reading of the previous legislation and not been SGEs, but will now be subject to the GPFS requirements where they are CBC reporting entities.



#### Interaction of reporting mandate and reporting requirements

The legislation only impacts the reporting mandate, i.e. which entities have an obligation to prepare and lodge GPFS by s.3CA of the *Tax Administration Act 1953*. The changes do not change the type of financial statements prepared. For example, some entities chose to prepare stand alone GPFS even though they have subsidiaries on the basis that a foreign parent prepared consolidated financial statements in accordance with IFRS and the entity was not a reporting entity (applying AASB 10 paragraph 4(a) in the context of paragraph Aus4.2).

The legislative changes do not change these requirements and CBC reporting entities could prepare stand alone financial statements where they are not a reporting entity for accounting purposes. However, the reporting entity concept will be eliminated for many for-profit entities for reporting periods beginning on or after 1 July 2021, and ultimate Australian parent entities will be required to prepare general purpose consolidated financial statements. For more information about these changes, see our Clarity publication, available at [www.deloitte.com/au/clarity](http://www.deloitte.com/au/clarity).

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<sup>6</sup> For instance, many privately held entities incorporated in the United States are not required to prepare financial statements, and in some jurisdictions the only legal requirement is the preparation of stand alone financial statements for taxation purposes.

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### Considering how to achieve compliance

Entities newly captured by the GPFS requirement will need to prepare those GPFS in accordance with either Australian Accounting Standards or, in some cases, 'commercially accepted accounting principles' (CAAP). Which of these apply will depend upon whether the corporate tax entity with the reporting obligation has any requirement to prepare financial statements in accordance with Australian Accounting Standards.

For instance, a large proprietary company that is an Australian taxpayer and which is part of CBC reporting group will need to apply Australian Accounting Standards in preparation of GPFS. This is because the entity would have a requirement to prepare financial statements under the *Corporations Act 2001* and those financial statements are required to be prepared using Australian Accounting Standards.

However, if the entity chooses to lodge special purpose financial statements with ASIC, it has a choice of which entity's GPFS are lodged with the ATO under s.3CA of the *Tax Administration Act 1953*. It could theoretically lodge consolidated GPFS of its foreign parent, so long as those GPFS were prepared in accordance with Australian Accounting Standards. In practice, many such entities would simply lodge their own GPFS with ASIC to fulfil their reporting obligations.

Conversely, a foreign entity operating a branch in Australia may not have any other reporting obligation requiring the use of Australian Accounting Standards, and so could lodge a foreign parent's consolidated GPFS prepared in accordance with 'CAAP' (e.g. International Financial Reporting Standards or US-GAAP).

## Do the SGE requirements remain relevant for CBC reporting entities?

Yes. As CBC reporting entities are effectively a subset of SGEs, all CBC reporting entities will be SGEs and so be subject to the significant SGE penalties. These penalties would apply where a CBC reporting entity fails to comply with the GPFS requirements, or the 'country by country' reporting obligations which also apply to these entities.

Not all SGEs will be subject to the GPFS requirements in s.3CA. An entity may be an SGE because the broader SGE group it belongs to has annual global income of A\$1 billion or more, but not be a CBC reporting entity because the smaller CBC reporting group to which it belongs has annual global income of less than A\$1 billion. For example, this might arise where an Australian corporate taxpayer is controlled by a large investment entity but does not have A\$1 billion or more in annual income in its own right (including any of its own consolidated or notionally consolidated subsidiaries).

In addition to the SGE penalty provisions, SGEs are subject to other tax requirements such as the diverted profits tax and Multinational Anti-Avoidance Law (MAAL). CBC reporting entities also need to comply with these requirements as they are also SGEs.

## What is the rationale for the changes?

In 2015, Australia introduced the concept of an SGE. As compared to the Organisation for Economic Co-operation and Development (OECD) concept of a group (as defined in the International Framework on Base Erosion and Profit Shifting (BEPS) Action 13 dealing with country by country reporting), the definition of SGE had a narrower focus. Specifically, the Australian concept of SGE only treated an entity as being part of a group of entities if the head entity of the global group was required to prepare consolidated financial statements covering that entity under applicable accounting principles.

In contrast, the OECD model legislation seeks to also require reporting by entities that are not included in the consolidated financial statements. The changes will bring the Australian definitions of SGE and CBC reporting entities closer to the OECD model and include a wider range of large business groups in the definition of an SGE and a CBC reporting entity, regardless of how, or if, they consolidate for accounting purposes.

Additionally, exemptions from consolidation under accounting requirements meant some entities were not considered to be SGEs, e.g. entities controlled by investment entities and which did not have A\$1 billion or more in annual global income. Both the SGE and CBC reporting entity definitions require entities to ignore some or all of these consolidation exemptions.

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As a result of the changes to the definition of an SGE, its scope differs from the scope of the entities required to undertake country by country reporting under Action 13 of the BEPS Action Plan. To better align with international standards, the amendments requires country by country reporting by CBC reporting entities rather than all SGEs. However, all SGEs remain subject to the other SGE provisions (including the SGE penalty provisions).

As part of the introduction of the new CBC reporting entity definition, the requirements for GPFS were transferred from SGEs to CBC reporting entities. This was designed to ensure that the obligation to provide GPFS remains aligned with the relevant accounting standards and avoids unnecessary compliance burdens for investment entities.



### Understanding the detail

We have also prepared a detailed *Tax Insights* publication, which explains the expanded definition of a significant global entity and the new country by country reporting entity definition in more detail. This publication can be downloaded from [www.deloitte.com.au](http://www.deloitte.com.au).

## Conclusion

The tax legislation changes were announced in the 2018-2019 Federal Budget, and so have been anticipated for some time. However, the retrospective effective date (income years or periods commencing 1 July 2019) will require impacted entities to act quickly to be ready to comply with the new reporting and other requirements.

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