



Tax Insights

Expanded definition of Significant Global Entity

Snapshot

On 25 May 2020, Treasury Laws Amendment (2020 Measures No. 1) Bill 2020 received Royal Assent. The Bill contains amendments to extend the definition of a Significant Global Entity (SGE) and introduce a new concept of a Country-by-Country Reporting entity (CbCRE).

The amendments generally apply retrospectively to income years or periods starting on or after 1 July 2019. However, transitional provisions ensure that penalties that arise from the measure do not apply until 1 July 2020 for entities that were not previously SGEs.

Given the 1 July 2019 start date, potentially affected groups should consider the impact of these proposed measures as soon as possible.

Under the previous provisions, an SGE is an entity which is a member of a group headed by a company required to provide consolidated financial statements with “annual global income” of \$1 billion or more.

The Bill makes three principal changes

- Amending the definition of SGE so that it applies to groups of entities headed by an entity other than a listed company in the same way as it applies to groups headed by a listed company (by introducing the concept of a notional listed company group (NLCG)). This will include members of large Australian or multinational groups headed by private companies, trusts, partnerships and individuals even where there is no requirement to prepare consolidated financial statements.
- Amending the definition of SGE so it includes those entities excluded from consolidation under the accounting rules. The definition also includes those entities not required to be consolidated under the accounting rules due to the materiality exception. In addition, a global parent entity that was an investment entity not permitted¹ to consolidate its subsidiaries because of paragraphs 27-33 of the AASB 10 (or equivalent requirements under other accounting standards), can now be treated as a parent of a notional listed company group under the new law.
- Creating a new definition or category of taxpayer: a CbCRE, which will have obligations to lodge Country-by-Country (CbC) reports and GPFS. This definition results, in effect, in a subset of the SGEs.

The changes also address the ability of the Commissioner of Taxation to make a determination that an entity is a SGE parent, via amendments to the definition of annual global income.

Broadly, for income years or periods starting on or after 1 July 2019, SGE obligations will therefore be split between SGEs and CbCREs as follows:

Entities which are SGEs	Entities which are CbCREs
Diverted Profits Tax	Country by Country Reporting
Multinational Anti-Avoidance Laws	General Purpose Financial Reporting
Increased Administrative Penalties (from 1 July 2020 for entities not previously SGEs)	

For some existing SGE groups their obligations may not change, particularly where a group has interpreted the former SGE provisions widely and conservatively, to encompass both groups that were required to produce consolidated financial statements under the accounting standards together with those groups that choose to do so.

The following categories of entities may face a new requirement to prepare GFPS where their ‘annual global income’ exceeds A\$1 billion:

- 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, where the foreign jurisdiction does not require the preparation of financial statements
- Groups with ultimate parent entities previously preparing ‘stand-alone’ financial statements.

¹ AASB 10 Paragraph 31
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Why was the change needed?

In OECD BEPS Action 13 dealing with CbC reporting, the OECD adopted a concept of a “Group” as:

*“a collection of enterprises related through ownership or control such that it is either required to prepare Consolidated Financial Statements for financial reporting purposes under applicable accounting principles **or would be so required if equity interests in any of the enterprises were traded on a public securities exchange.**”²*

In 2015, Australia introduced the concept of a SGE. As compared to the OECD approach, 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 must prepare consolidated accounts covering that entity under the applicable accounting principles. This approach meant that groups who were not required to prepare consolidated accounts (e.g. those headed by investment entities) were not SGEs, and also that entities that were not included in the consolidated accounts (e.g. because they were immaterial in the overall group) were also not SGEs. However, the OECD model legislation seeks to also require reporting by entities that are not included in the consolidated accounts. The explanatory memorandum (EM) states; “The amendments to the country by country reporting rules in Subdivision 815-E ensure Australian law is aligned with international practice and the OECD model legislation.”³ The changes will bring in a wider range of large business groups, regardless of how, or if, they consolidate into the definition of an SGE and a CbC reporting entity.,

New definition of SGE

The new definition of a SGE retains the two limbs of the existing definition and adds an extra type of “assumed” group (a notional listed company group).

Current definition	Proposed definition
A global parent entity with annual global income of \$1 billion or more	No change
A member of a group of entities that are consolidated for accounting purposes and the annual global income of the group is \$1 billion or more.	No change
No equivalent	A member of a notional listed company group and the annual global income of all members of the group is \$1 billion or more.
The Commissioner makes a determination	Modified to include determinations in respect of NLCGs

What is a global parent entity?

“Global parent entity” is broadly defined as an entity that is not controlled by another entity according to accounting principles.

² <https://www.oecd.org/ctp/transfer-pricing/beps-action-13-country-by-country-reporting-implementation-package.pdf>

³ Explanatory Memorandum Paragraph 1.22

What is an investment entity?

"Investment entity" is a defined term within *AASB 10 Consolidated financial statements*. (or equivalent requirements under other accounting standards) An investment entity is an entity that:

- (a) Obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) Commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
- (c) Measures and evaluates the performance of substantially all of its investments on a fair value basis.

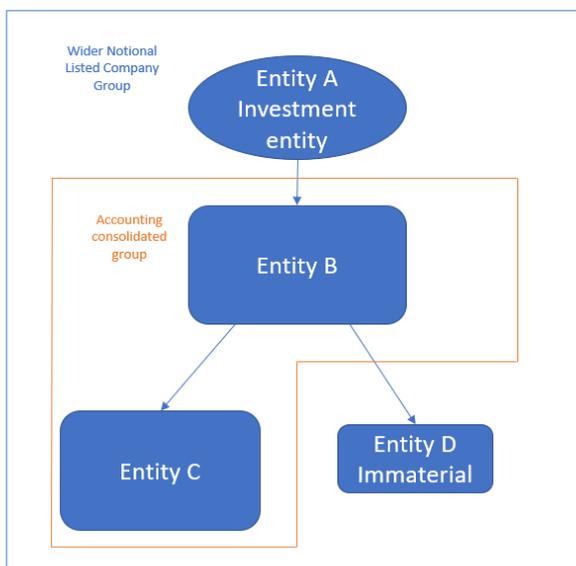
This term could include some private equity vehicles.

What is a notional listed company group?

A NLCG is a group of entities that would be required to be consolidated as a single group under applicable accounting rules, **on the assumption that any member of the group (such as the parent entity) was a listed company** (i.e. its shares were listed for quotation on any public exchange). Further, under the definition of NLCG, exceptions to requirements to consolidate are disregarded. This in effect deems any controlled group as notionally consolidated for the purpose of the SGE definition. The EM confirms that an individual can be a significant global entity.

We note that:

- An entity can be a member of a NLCG even if it is consolidated with other entities for accounting purposes as a single group. If an entity is a member of both types of groups, it is the annual income of the notional listed company group (which will be the larger group) that is used in determining the income of the entity.
- Any exceptions within the accounting rules which permit an entity not to consolidate are disregarded. In practical terms, this means that investment entities that control groups can be deemed to be a NLCG. Further, other entities that are excluded from accounting consolidation under the relevant accounting rules
- Any rules that permit an entity not to consolidate due to materiality (because of size or other reasons) are also disregarded.



Example 1: Notional listed company group⁴

Entity A is an investment entity and global parent entity that controls Entity B which in turn controls Entity C and Entity D. Only Entities B and C are consolidated for accounting purposes as a single group.

As Entity A is an investment entity, it is not required to consolidate with Entities B, C and D for accounting purposes.

Entity B is also not required to consolidate with Entity D as Entity D is so small that its activities are not material to Entity B's overall accounts. However, under the relevant accounting standards Entity A would be required to consolidate with all of the other entities if the exception for investment entities and the materiality rule both did not apply. As a result, Entities A, B, C and D are a notional listed company group.

⁴ Explanatory Memorandum Example 1.1
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Example 2: Notional listed company group – individuals and trusts⁵

Jesse, an individual, wholly owns and controls Pyramid Co, a company that itself wholly owns and controls a number of subsidiaries with which it is consolidated for accounting purposes as a single group. Jesse is also the trustee and primary beneficiary of AUMi Trust, and hence Jesse has effective control of the trust.

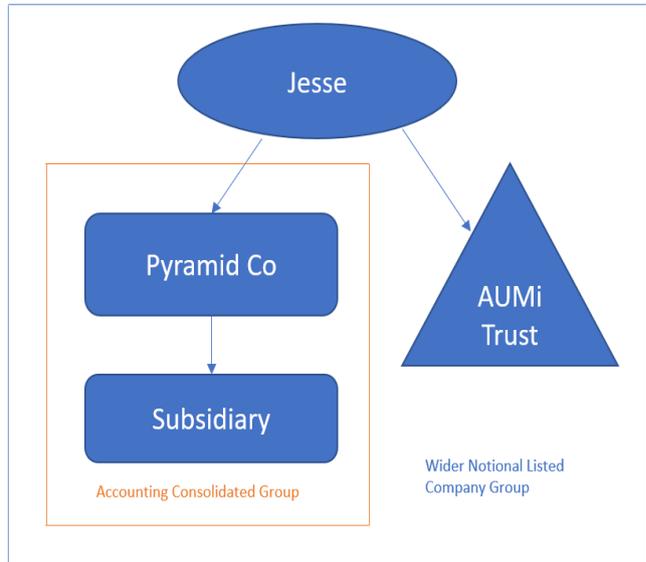
Were Jesse a listed company, under the relevant accounting standards, Jesse, Pyramid Co and its subsidiaries and AUMi Trust would be required to consolidate for accounting purposes as a single entity.

In the case of AUMi Trust, this involves applying the rules in the relevant accounting standard to determine if Jesse, were she a listed company, would be required to consolidate with AUMi Trust. This may involve an assessment of the circumstances of the trust, including the provisions in the trust deed, in light of the rules in the relevant accounting standards.

Depending on the applicable accounting standards, relevant circumstances may include:

- The provisions of the trust deed;
- The purposes and structure of AUMi Trust;
- Jesse’s involvement in the creation and structuring of AUMi Trust; and
- Jesse’s role in and influence over decisions made by AUMi Trust.

As a result, these entities form a notional listed company group, of which Jesse is the global parent entity.



Commissioner may make a determination that results in an entity being an SGE

The amendments also ensure that the Commissioner can continue to make a determination that results in an entity being a SGE.⁶

This provision currently applies in cases where the global parent entity has not prepared global financial statements for a period, and the Commissioner reasonably believes that, if global financial statements had been prepared, the “annual global income” for the period would have been \$1 billion or more. However, the definition of “annual global income” references the global financial statements, and hence assumes that such global financial statements exist.

The Bill makes amendments to ensure that the concept of annual global income can still be referenced in cases where there are either no global financial statements or the global financial statements do not show annual income for the period.

⁵ Explanatory memorandum Example 1.2

⁶ There were some technical issues with the interaction of the rules in Subsection s960-555(3) dealing with the Commissioner’s Determination and Section 960-565 defining annual global income, as legislated

Annual Global Income definition extended

Currently an entity's annual global income for a period is either:

- The total annual income of that entity shown in its latest financial statements for that period; or
- If it is a member of a group of entities consolidated for accounting purposes – the total annual income of all the members of the group as shown in its latest global (consolidated) financial statements.

The Bill expands the definition of annual global income to incorporate:

- The total annual income of all members of a NLCG; and
- If a SGE (whether under the general test or as a member of a NLCG) does not have global financial statements for a period - the amount that would have been its annual global income if such global financial statements had been prepared.

The Bill states that this is an objective test based on what would be expected to be the amount of such income if adequate statements were prepared. This provision is meant to be concessional, in that it does not require such an entity to formally prepare such accounts or seek a determination by the Commissioner to provide clarity about its status as a SGE. Nevertheless, it still requires an element of judgement and the application of accounting principles to be applied by taxpayers to make the relevant calculations of income.

Country-by-Country reporting entities

Under the current rules and definitions, SGEs must lodge a CbC report, that details the group's economic activity and tax paid in every jurisdiction in which it operates, with the ATO or with the parent entity's tax jurisdiction. SGEs must also lodge a Master File and a Local File in Australia as part of their CbC obligations under the current rules.

However, under the Bill, a new category of entity called a CbC reporting entity (CbCRE) has been created. The CbC reporting obligations will only apply to a CbCRE. This means that from 1 July 2019, the scope of a group made up of SGEs **may** differ to the CbCRE group.

A **CbC reporting entity** is an entity which is a CbC reporting parent, or a member of a CbC reporting group.

An entity is a **CbC reporting parent** for a period if:

- It is not an individual;
- Is either not a member of a CbC reporting group or, if a member of a CbC reporting group, is not controlled by any other entity in the CbC reporting group; and
- Either:
 - If it is a member of a CbC reporting group—the annual global income of the group is \$1 billion or more; or
 - Otherwise—the annual global income of the entity itself is \$1 billion or more.

A **CbC reporting group** is:

- A group of entities consolidated for accounting purposes as a single group; or
- A group of entities that would be a NLCG (however, for CbC reporting purposes, the definition of NLCG is modified as compared to that described above for SGE purposes).

In identifying a NLCG for CbC reporting purposes, the exclusion of investment entities from the consolidation requirements continues to apply (whereas this exclusion is disregarded in identifying a NLCG for SGE purposes). As is the case for SGE purposes, the consolidation exception for immaterial entities continues to be disregarded, so that immaterial entities will be included in a CbC reporting group. Individuals are also excluded from a CbC reporting group.

Where entities are members of two potential CbC reporting groups, the Bill specifies they will be a member of the larger country by country reporting group (measured in respect to the group with the most members). This approach is intended to prevent duplication of CbC reporting requirements within what is effectively the same group.

Often there will be alignment between SGEs and CBCREs, but there will be differences and complexities, depending on the facts. However, a CbC reporting group would not include:

- An individual. Although an individual can be an SGE, an individual cannot be a member of a CbC reporting group
- Investment entities. Investment entities can form part of a group of SGEs, via the NLCG definition, but they may not be included in a CbC reporting group.

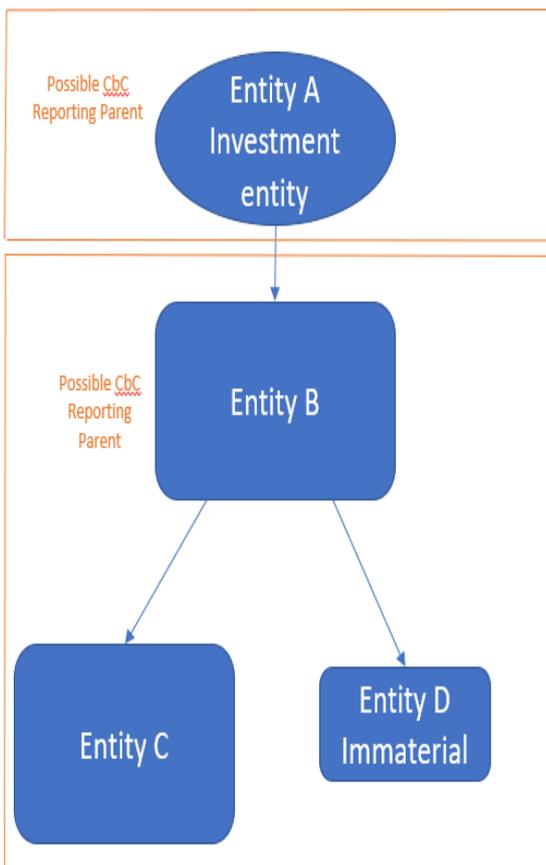
An investment entity which heads up a NLCG for SGE purposes may be a CbC reporting parent and a CbC reporting entity in its own right if its own total annual global income is \$1 billion or more.

In line with the creation of the new designation CbCRE, the information that is required in CbC reports that must be provided has also been amended to reflect information on the other members of the of which the entity is a member.

As mentioned, the amendments are proposed to apply to income years or periods starting on or after 1 July 2019. When determining if an entity has CbC reporting obligations for a period, it is necessary to determine if the entity was a CbCRE for the previous period when this is relevant to the CbC reporting obligations of the entity in a period after 1 July 2019, even if the previous period began before 1 July 2019.

In other words, a CBC reporting entity may have CBC reporting obligations in respect of financial periods beginning on or after 1 July 2019 if in the previous year they met the new definition of CBC reporting entity. Such reports would be due 12 months following the financial year end, or as part of the relevant tax return where taxpayer adopt the ATO’s administrative solution and file Part A of their Local File with their returns.

Example 3: Identifying the country by country parent entity and country by country reporting entity



Assuming the same facts as in Example 1 above, Entity A does not form part of a CbC reporting group with Entity B, Entity C and Entity D. This is because the exception to the requirement to consolidate for investment entities is taken into account when working out the entities that form part of a CbC reporting group.

Entity A is not a member of any CbC reporting group, but it can still be a CbC reporting parent. It will be a CbC reporting parent and a CbC reporting entity if its own total annual global income is \$1 billion or more.

Entity B controls Entity C and Entity D and, under applicable accounting standards would be required to be consolidated for accounting purposes as a single group were Entity B a listed company, disregarding the materiality rule. As a result, Entities B, C and D are a CbC reporting group.

Entity B is not controlled by any other entity in the group so it too may be a CbC reporting parent. It will be a CbC parent and a CbC reporting entity if, broadly, the annual global income of the group (the total annual income of Entities B, C and D worked out on a consolidated basis) is \$1 billion or more. If Entity B is a CbC reporting parent, Entities C and D will also be CbCREs. Note that only the entities in the group that are tax resident in Australia (or have a PE in Australia) will have Australian CbC reporting obligations.

This divergence of definitions and obligations as between SGEs and CbCREs creates further levels of complexity for large groups. Large groups (both domestic and multinational) will need to consider each of their controlled entities and test them under both SGE and CbCRE definitions.

Given the significant penalties that SGEs are subject to for late lodgment, an error which results in an incorrect classification of a group or a non-lodgment of a CbC report or other ATO document, could be costly.

Obligations in respect of General Purpose Financial Statements

Currently SGEs are required to consider whether they must lodge General Purpose Financial Statements (GPFS) with the Commissioner of Taxation. The proposed amendments transfer this obligation instead to entities that are CbC Reporting Entities. **This obligation continues to be applicable only to Corporate Tax Entities who lodge tax returns** (now within a CbC reporting group).

Given the retrospective nature of the amendments, there may be some new groups that will be required to lodge GPFS as early as 15 January 2021.

Note that after determining whether an entity is a country by country reporting entity, the accounting standard assumptions and modifications applied do not have wider relevance and do not affect what must be included in general purpose financial statements provided to the Commissioner.

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