



## Tax Insights

# More headaches for more Significant Global Entities: Part 1

### Snapshot

On 20 July 2018, the Government released [draft legislation and explanatory memorandum](#), which will extend the definition of a Significant Global Entity (SGE). The extended scope is intended to include members of large business groups (>A\$1 billion in income) headed by unlisted companies, trusts, partnerships and investment entities.

The measure is proposed to apply to income years commencing on or after 1 July 2018.

The draft legislation makes three substantial 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

- Amending the definition of SGE so it includes in the test those entities excluded from consolidation under the accounting rules. The definition also now includes those entities not required to be consolidated under the accounting rules due to the materiality exception
- Creating a new definition or category of taxpayer – a Country-by-Country Reporting Entity- more closely aligned to the OECD standard, which will have obligations to lodge Country-by-Country reports.

The final legislation may differ, however, given the 1 July 2018 start date, these changes deserve attention.

### Why was the change needed?

In OECD BEPS Action 13 dealing with Country-by-Country 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.**”

In 2015, Australia legislated the Multinational anti avoidance law (MAAL) which for the first time, also introduced the concept of a SGE. As compared to the OECD approach, the definition of SGE had a much narrower focus. Despite this, many people interpreted the SGE provisions widely and conservatively, to encompass both the groups that were required to produce consolidated financial statements under the accounting standards together with those groups that chose to do so.

However, Treasury has stated that “The current SGE definition however **only includes groups headed by listed companies and private companies required to prepare general purpose financial statements.** By extending the definition, the proposed legislation will ensure the multinational tax avoidance rules apply to all relevant entities”<sup>1</sup>.

The draft legislation now extends the SGE group definition to align more closely with the OECD definition of group. It will bring in a wider range of large business groups, regardless of how, or if, they consolidate, including potentially, companies owned by investment entities, a term that could include some private equity vehicles.

The changes also correct a “technical loophole” concerning the Tax Commissioner’s ability to make a determination that an entity is a SGE.

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<sup>1</sup> <https://treasury.gov.au/consultation/c2018-t311619/>

## Proposed definition of SGE

The proposed definition of an 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
<b>A global parent entity with annual global income of \$1 billion or more</b>	No change
<b>A member of a group of entities that are consolidated for accounting purposes and the annual global income of all members of the group is \$1 billion or more.</b>	No change
<b>No equivalent</b>	A member of a <b>notional listed company group</b> and the annual global income of all members of the group is \$1 billion or more.

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

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

Large multinational groups headed by unlisted companies, trusts, partnerships and investment entities that are not required to prepare consolidated global financial statements, should therefore be included in the proposed definition of an SGE. For instance, a global parent entity that was an investment entity not permitted to consolidate its subsidiaries because of paragraphs 27-33 of the AASB 10, could be treated as a parent of a notional listed company group.

## What is a notional listed company group (NLCG)?

A notional listed company group is a group of entities that would be required to be consolidated as a single group under applicable accounting rules, **on the assumption that a member of the group was a listed company** (i.e. its shares were listed for quotation on any public exchange). This in effect deems any controlled group as notionally consolidated for the purpose of the definition.

The draft explanatory memorandum notes that:

- An entity can be a member of a notional listed company group even if it is actually consolidated with other entities for accounting purposes as a single group
- 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 will be part of a notional listed group and other entities that are exempt from consolidation under the

relevant accounting rules, e.g. entities preparing special purpose financial statements on a stand-alone basis

- Any rules that permit an entity not to consolidate due to materiality are also disregarded.

### 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 that global parent entity of that group as shown in its latest global (consolidated) financial statements.

The ED expands the testing of Annual Global Income to incorporate:

- global financial statements prepared on a consolidated basis for a NLCG; and
- If a SGE (whether under the original test or a member of a NLCG) does not have global financial statements for a period - the amount a reasonable person in the position of the parent entity would conclude would be its annual global income were such statements prepared.

The ED states that this is an objective test based on what would reasonably be determined by a fully informed person. 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 decision to apply the test.

### Country-by-Country reporting entities (CbCRE)

Under the current rules and definitions, SGEs must lodge a country-by-country report (CbCR) with the ATO or with the parent entity's tax jurisdiction<sup>2</sup> that details the group's economic activity and tax paid in every jurisdiction in which it operates.

However, under the draft legislation, a new category of entity called a Country-by-Country reporting entity has been created. The CbC reporting obligations will only apply to a CbCRE. This means that from 1 July 2018, the scope of a group made up of SGEs **may** differ to the CbCRE group.

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<sup>2</sup> Who will automatically share the CbCR with the ATO if that country has signed the Multilateral Competent Authority Agreement on the Exchange of CbC Reports

An entity will be a CbCRE if it would be a SGE if it is assumed that:

- The entity was a global parent entity (irrespective of whether or not it is controlled by another entity); and
- The accounting exceptions to consolidation (other than the materiality<sup>3</sup> exception) applied in working out the membership of the notional listed company group<sup>4</sup>.

This will commonly, but not always, mean alignment between SGEs and CbCREs, but there will be differences and complexities, depending on the facts.

The complexities associated with this are explained in the EM as follows:

*For example, a company owned by an investment entity is a significant global entity because it is a member of a notional listed company group headed by the investment entity. For the purposes of the country by country reporting rules, it would not be part of notional listed company group with the investment entity as an exception to consolidation applied. However, if its own annual global income exceeds \$1 billion, it would be a country by country reporting entity as it would be a significant global entity were it a global parent entity itself.*

*Similarly, an investment entity may own an entity that controls a group of other entities. For the purposes of the country by country reporting regime, the group of entities may not be part of a notional listed company group as an exception to consolidation applies. However, the group excluding the investment entity may still form a notional listed company group or may be actually consolidated for accounting purposes as a single group. If this is the case, all members of that group will be country by country reporting entities if any member of the group would be a significant global entity disregarding the investment entity.*

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

This divergence of definitions and obligations creates further levels of complexity for large multinationals. 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 lodgement, an error which results in an incorrect classification of a group or a non-lodgement of a CbC report or other ATO document, could be costly.

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<sup>3</sup> Entities which are not included in the consolidated group due to materiality would now meet the definition of SGE and CbCRE.

<sup>4</sup> This is the main difference between an SGE and a CbCRE. The SGE definition would include those entities exempted from consolidating due to accounting principles, whereas a CbCRE would not include these entities. However they could be a CbCRE if, when tested separately, they meet the income test.

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