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Tax Insights

Expanded definition of Significant Global Entity

Snapshot

On 12 February 2020, the Government introduced the Treasury Laws Amendment (2020 Measures No. 1) Bill 2020 (the SGE Amendment Bill) into Parliament which will extend the definition of a Significant Global Entity (SGE) and introduce a new concept of a Country-by-Country reporting entity (CbCRE).

The changes were originally announced as part of the 2018-19 Federal Budget. The proposed changes were first introduced in 2018 within Treasury Laws Amendment (Making Sure Multinationals Pay their Fair Share of Tax and Other Measures) Bill 2018 which lapsed at the May 2019 election. The proposed changes were then released as an Exposure Draft in November 2019.

The final legislation is broadly similar in objective to the earlier versions; however, Treasury has made some changes to attempt to make the legislation clearer and work more effectively, particularly around the CbCRE definitions.

A significant change from the previous exposure draft to the final legislation is a one year delay on its application, which will now apply to income years or periods starting on or after 1 July 2019. Transitional provisions ensure that penalties that arise from the measure do not apply until 1 July 2020 for entities that were not previously SGEs.

The provisions are particularly complex. In many cases (e.g., involving typical corporate group structures), the changes to the definition of SGE and creation of the CbCRE concept will have no impact. However, in some fact patterns, investment structures will fall within the scope of the amendments, and in these cases, there are likely to be changes in the SGE status, CbCRE status, and as a result, exposure to additional provisions (including significant late lodgment penalties).

It is important that taxpayers clarify their SGE status and CbCRE status as soon as possible.

What are the implications of being designated a SGE?

Presently, SGEs are subject to additional obligations such as the Diverted Profits Tax (DPT) and the Multinational Anti-Avoidance Law (MAAL), substantially increased penalties for late lodgment (SGE penalties) and Country-by-Country reporting. They may also be required to lodge General Purpose Financial Statements (GPFS) with the ATO, where these are not already lodged with ASIC.

What will change?

Under the current definition, an SGE is broadly a parent entity or a member of a group headed by a parent entity required to provide consolidated financial statements which has "annual global income" of $1 billion or more. The Government's aim is to broaden the definition of SGE to ensure members of all groups of that size including those headed by individuals, partnerships, trusts, private companies and investment entities are SGEs and potentially subject to the all of the particular provisions that apply to SGEs.

The final legislation makes three principal amendments to the definition of SGE and CbC obligations;

- 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 now includes those entities excluded from consolidation under the accounting rules (such as the investment entity exception to consolidation and the materiality exception)
- 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 differs to the definition of SGE, and more closely aligns to the OECD standard.

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.

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

Why the changes?

The amendments to the definition of SGE are to ensure that the definition applies consistently across all types of entities.

The Explanatory Memorandum to the SGE Amendment Bill (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.".[1]

The final legislation to extend the SGE group definition will bring in a wider range of large business groups, regardless of how, or if, they consolidate, including potentially, entities owned by investment entities, a term that could include some private equity vehicles.

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[1] Treasury Laws Amendment (2020 Measures No. 1) Bill 2020 Explanatory Memorandum 1.21 & 1.22

Proposed definition of SGE

The proposed 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

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

Pursuant to the extension to notional listed company groups (NLCGs), large groups headed by unlisted companies, trusts, partnerships, wealthy individuals and investment entities that are not required to prepare consolidated global financial statements, will be included in the proposed definition of SGE. For instance, a global parent entity that was an investment entity not permitted[2] 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.

Groups that fall under the existing definition (that is, accounting consolidated groups) will **also** fall under the proposed definition of a SGE, that is, will also be a NLCG.

What is an investment entity?

"Investment entity" is a defined term within *AASB 10 Consolidated financial statements*. 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.

[2] AASB 10 Paragraph 31

What is a notional listed company group?

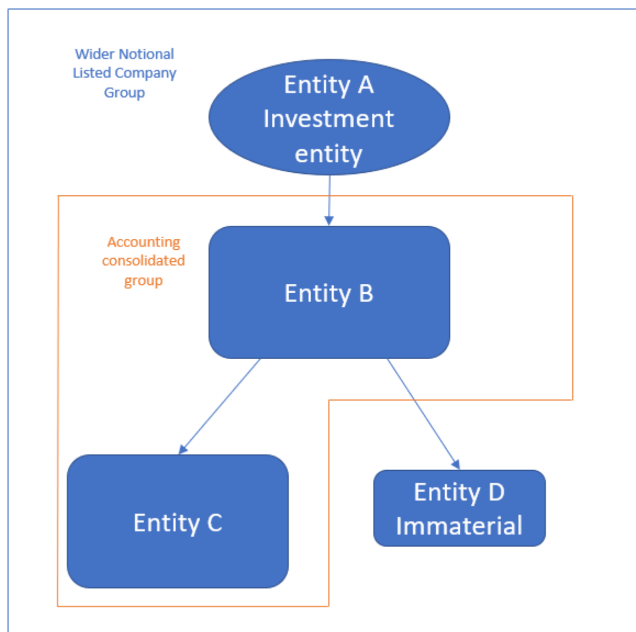
A NLCG is a group of entities that would be required to be consolidated as a single group under applicable accounting rules, **on the assumption that the parent entity of the group was a listed company** (i.e. its shares were listed for quotation on any public exchange). Further, under the definition of NLCG, exceptions to requirements to consolidate are disregarded. This in effect deems controlled groups headed by entities which would not normally be required to consolidate as notionally consolidated for the purpose of the SGE definition.

Whether entities would be required to be consolidated for accounting purposes as a single group is to be determined based on relevant accounting principles or commercially accepted principles relating to accounting (if accounting principles do not apply in relation to those entities).

The EM affirms 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 (that is, an entity and a group can fall under two definitions of an SGE)
- 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 in a NLCG.
- 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 group[3]



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 not for 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.

[3] Explanatory Memorandum Example 1.1

Control in the context of consolidation

Accounting Standard AASB 10 *Consolidated Financial Statements* defines the principle of control, and establishes control as the basis for consolidation which is critical in interpreting who is a member of a NLCG. This concept is complex and requires professional judgement particular in the case of investment from vehicles such as private equity, superannuation funds, wealth funds and fund managers.

The Standard states that[4]:

- An investor, regardless of the nature of its involvement with an entity (the investee), shall determine whether it is a parent by assessing whether it controls the investee.
- An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.
- Thus, an investor controls an investee if and only if the investor has all the following:

(a) power over the investee;

(b) exposure, or rights, to variable returns from its involvement with the investee; and

(c) the ability to use its power over the investee to affect the amount of the investor's returns.

Groups headed by individuals, partnerships and trusts

Significantly, the Explanatory Memorandum to the SGE Amendment Bill includes a number of examples showing in what type of scenarios individuals and partnerships may be included in notional listed consolidated groups. These examples illustrate where Treasury considers control may exist, depending on the circumstances.

Example 2: NLCG - Individuals and trusts[5]

Jesse, an individual, wholly owns and controls Pyramid Co, a company that itself wholly owns and controls a number of subsidiaries with which it (Pyramid Co) 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, Jesse, Pyramid Co and its subsidiaries and AUMi Trust form a notional listed company group, of which Jesse is the global parent entity.

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[4] AASB 10 paragraphs 5-7
[5] Explanatory Memorandum Example 1.2

Example 3: NLCG – partnerships[6]

Zac, an individual, is the general partner of a limited partnership, Buzz Partners. The partnership owns and controls Service Co, a company.

Were Zac a listed company, he may (depending on the circumstances of the case and the relevant accounting standards) have been required to consolidate for accounting purposes with Buzz Partners and Service Co.

If Zac would be required to consolidate with Buzz Partners and Service Co were he a listed company, the three entities (Zac, Buzz Partners and Service Co) would form a notional listed company group, of which Zac would be the global parent entity.

If Zac would not have been required to consolidate with Buzz Partners and Service Co were he a listed company, but, under the relevant accounting standards, Buzz Partners, would have been required to consolidate with Service Co were it a listed company, Buzz Partners and Service Co would form a notional listed company group. The group would not include Zac. Buzz Partners would be the global parent entity, as no entity within the notional listed company group controls Buzz Partners.

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 SGE Amendment 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 adequate global financial statements for a period (i.e. It either has no statements or those statements do not show annual global income)- the amount that would have been its annual global income if appropriate global financial statements had been prepared.

The EM 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.

[6] Explanatory Memorandum Example 1.3

Country-by-Country reporting entities

Under the current rules and definitions, SGEs must lodge a CbC report.

However, under the SGE Amendment 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 CbC reporting group.

This change has been reportedly made to better align with international standards under Action 13 of the BEPS Action plan.

A **CBC reporting entity** (CbCRE) 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;
- It is either not a member of a country by country reporting group or is not controlled by any other entity in the same country by country reporting group; and
- Either:
  - If it is a member of a country by country reporting group—the annual global income of the group is $1 billion or more; or
  - Otherwise—the annual global income of the entity alone 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 is exclusion 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.

The SGE Amendment Bill[7] has clarified that where entities are members of more than one potential CbC reporting group, they will only be subject to reporting and other obligations in respect to the largest such group (i.e. the group with the most members).

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 CbCRE 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 CbC reporting group 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.

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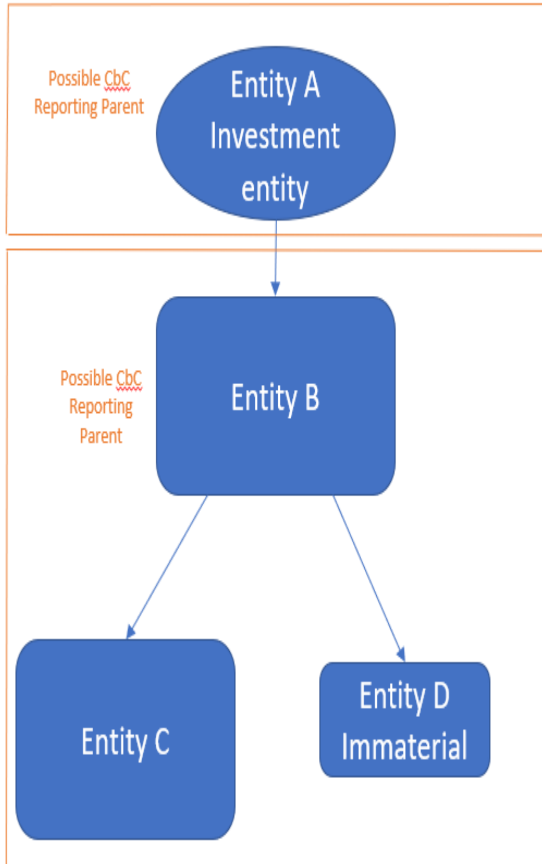
[7] Section 815-380 (3) to (5), Income Tax Assessment Act 1997

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. The EM states that if the amendments apply to a period, they also apply for the purpose of determining if an entity was a CbC entity for a previous period, when this is relevant to the CbC reporting obligations of the entity in a period after 1 July 2018, even if the previous period began before 1 July 2019.



Example 4: Identifying the country by country parent entity and country by country reporting entity (CbCRE)[8]

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. However, it can still be a CbC reporting parent and a CbCRE 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 reporting parent and a CbCRE 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 Entity B and Entity C do not form a separate country by country reporting group, even though they are a group of entities that are consolidated as a single entity for accounting purposes. This is because a group of entities is not a CbC reporting group if all of the members of the group are members of another CbC reporting group - both Entity B and Entity C are members of the larger CbC reporting group with Entity D.

Example 5: Entities in a group subject to CbC reporting obligations[9]

Assume Entity C is a non-resident company without an Australian permanent establishment. All other facts are based on the example above with Entities A, B and D assumed to be Australian resident entities. It is determined that Entity B is a CbC reporting parent and therefore, a CbCRE for the 2025-26 income year. This also means that Entity C and Entity D, as members of the same CbC reporting group, are CbC reporting entities for that year.

As CbCREs for 2025-26, Entities B, C and D may be required to provide statements for the 2026-27 income year that, among other things, relate to the global operations and activities and pricing policies relevant to transfer pricing of each of the entities (a Master File) as well as statements about the allocation between countries of the income, activities and tax paid by each of the entities (a country by country report).

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[8] Explanatory Memorandum Example 1.4
[9] Based on Explanatory Memorandum Example 1.6

Entities B and D satisfy the requirements set out in subsection 815-355(1) and so must provide statements. Entity C does not satisfy these requirements (as it is a non-resident company without an Australian permanent establishment) and so is not required to provide statements under section 815-355. In practice, the obligations of Entities B and D will be satisfied if one of the entities provides country by country reporting statements (including a country by country report and Master file) consistent with the relevant OECD reporting standards that covers all three entities.

Both the CbC report and Master File must cover all three entities in the CbC reporting group, including Entities C and D. This obligation applies despite Entity D not being consolidated with the other two entities as a single group for accounting purposes due to materiality rules and despite Entity C not itself being subject to reporting obligations under section 815-355.

CbC reporting statements that only cover Entity B and Entity C or Entity B and Entity D would not satisfy the CbC reporting requirements as they would not cover all of the members of the relevant CbC reporting group. Similarly, the statements do not need to and should not include Entity A as it does not form part of the CbC reporting group (even though Entity A does form part of a notional listed company group with the other entities).

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 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 corporate tax entities that are CbCREs.

The EM states that this will ensure that the obligation to provide GPFS remains aligned with the relevant accounting standards and avoids unnecessary compliance burdens for investment entities.

The EM confirms that whilst the requirement to provide GPFS remains limited to corporate tax entities, the changes will result in a wider range of entities being CbCREs. This means more entities are likely to be subject to the requirement to provide GPFS to the Commissioner.

The types of entities that are most likely to be affected are entities that are members of NLCGs that are not actually consolidated for accounting purposes as a single entity with some or all of the members of that NLCG.

The SGE Amendment Bill includes amendments which provide the Commissioner with a power to exempt government related entities from the requirement to lodge GPFS. This new measure was introduced as there was a concern that government entities would be captured under the new definition of CbCRE that are already subject to alternative disclosure or accountability regimes through the government budget processes.

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