Expansion of the definition of Significant Global Entity

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In brief

In the 2018-19 Federal Budget, the Government announced its intention to broaden the definition of Significant Global Entity (SGE) to include a broader range of entities. The measures to implement this proposal have now been introduced into Parliament.

In a welcome move, the start date for the application of the expanded definition has been pushed back one year from that initially announced in the 2018-19 Budget to now apply to income years commencing on or after 1 July 2019.

The concept of an SGE was introduced in 2015 as part of a package of reporting and integrity measures targeted at large Australian and multinational groups. As currently enacted, an SGE is broadly an entity that has an annual global income of A$1 billion or more or is a member of a group of entities, consolidated for accounting purposes, that has an annual global income of A$1 billion or more. The proposed expanded definition will now apply to include a broader range of entities that are subsidiaries of large groups, that did not fall within the existing definition of SGE because they are not included in consolidated financial statements.

The proposed new rules mean it will be necessary for some taxpayers to reassess whether they are classified as an SGE under the new definition as the consequences for SGEs that fail to meet certain tax lodgment obligations can be as high as A$525,000 per missed obligation.

In detail

On 12 February 2020, *Treasury Laws Amendment (2020 Measure No. 1) Bill 2020* (the Bill) was introduced into Federal Parliament. Amongst other things, this Bill expands the scope of what is an SGE. Such that it will also apply to groups of entities that would be required to consolidate for accounting purposes as a single group if the members of the group were assumed to be a listed company and were not affected by the accounting exceptions for consolidation or materiality. Once enacted, these amendments will apply to income years commencing on or after 1 July 2019.

The Bill also amends the Country-by-Country (CbC) reporting requirements and the requirement for corporate tax entities to lodge General Purpose Financial Statements with the ATO (if not lodged with ASIC) such that these measures will apply to a subset of SGEs that are referred to as Country by Country Reporting Entities (CbCREs).

The expanded definition of Significant Global Entity (SGE)

The current definition of SGE applies to an entity which is either:

- a global parent entity (that is, an entity that, according to accounting concepts, is not controlled by any other entity) with annual global income of at least AUD1 billion, or

- a member of a group of entities, consolidated for accounting purposes, that has annual global income of at least AUD1 billion

Central to the second limb of this definition is the requirement for the entity to be included in a set of consolidated financial statements. Examples, where an entity is not included in consolidated financial statements, can involve circumstances where the parent entity is not required to prepare consolidated accounts in its home jurisdiction (for example, trusts and partnerships are often not required to prepare consolidated accounts), or the parent entity applies a specific consolidation exemption in preparing its financial statements, or it excludes certain entities from its consolidated accounts due to materiality.

The amendments proposed by the Bill are aimed at addressing this perceived deficiency by introducing the concept of a 'notional (fictional) listed company' so that more entities are caught by the rules. Under the expanded definition, an entity will also be an SGE if it would be part of a consolidated group for accounting purposes if the following critical assumptions were made:

- the group members are listed companies (i.e. a 'notional listed company group'); and
- any exceptions to consolidation for accounting purposes, and materiality principles, are disregarded.

This means that entities that were previously not classified as SGEs because they were not consolidated in the financial statements of a larger group due to, for example, materiality or the investment entity exception in AASB 10 Consolidated Financial Statements (or its foreign equivalent), will now be classified as SGEs following these amendments.

These amendments introduce new complications for entities trying to determine if they are SGEs as they depart from the actual financial statements that are prepared by a group, and require entities to construct consolidated accounts that do not otherwise exist to assess whether or not the AUD1 billion annual global income threshold is exceeded. To do this, taxpayers may need to apply the accounting concept of control to entities and disapply the accounting exception applicable to investment entities.

The expanded definition of SGE will apply to income years commencing on or after 1 July 2019 for the purposes of:

- the Multinational Anti-Avoidance Law (MAAL)
- the Diverted Profits Tax (DPT), and
- increased administrative penalties for failing to meet tax obligations, false or misleading statements and tax avoidance and profit shifting schemes.

To ensure that the penalty provisions do not apply the amendments retrospectively, include a transitional provision so that the higher penalties that would otherwise apply to a taxpayer that is only now considered a SGE under the new rules do not apply for any income year that commences before 1 July 2020.

Country by Country Reporting Entity (CbCRE)

Under the current law, SGEs are required to comply with Australia's Country by Country Reporting requirements. In most cases these require the annual lodgment of a Master File and Australian specific XML format Local File with the Australian Taxation Office (ATO). SGEs with an Australian global parent entity must also lodge an annual Country by Country Report.

The concept of a CbC reporting entity is being introduced to more closely align to the definition provided by the Organisation of Economic Cooperation and Development (OECD) Base Erosion and Profit Shifting (BEPS) Action Plan. Under the new definitions, there is a narrower scope of entities subject to Australia's Country by Country Reporting requirements (so-called CbCREs) than under the expanded definition of SGEs. The key difference between the new definitions of SGE and CbCRE is that in determining which entities would be consolidated in the financial accounts of the 'notional listed company group', a CbCRE

can take into account exceptions to consolidation provided by the relevant accounting principles (other than materiality).

This means that if an entity would not be consolidated in its parent's financial statements because the parent has applied, for example, the investment entity exemption in AASB 10, that entity could be a SGE (if the AUD1 billion annual global income threshold is met) but remain not subject to Australia's Country by Country Reporting requirements.

It should be noted that even if an entity is not consolidated with its ultimate parent due to an exemption such as the investment entity exemption in AASB 10, it could still be a CbCRE in its own right if it (by itself, with its subsidiaries and/or with its immediate parent that is not an investment entity) meets the AUD1 billion annual global income threshold.

By contrast, where an entity is not included in consolidated financial statements (for example, because the parent entity is not required to prepare consolidated accounts in its home jurisdiction), the new concept of 'notional (fictional) listed company' proposed by the Bill would mean that the entity now becomes subject to Australia's Country by Country Reporting requirements.

The concept of CbCRE will also be used going forward to determine which corporate tax entities are required to lodge General Purpose Financial Statements (GPFS) with the ATO where they are not already lodged with ASIC. The Government has also taken the opportunity to introduce an exemption from the requirement to lodge GPFS with the ATO for certain government-related entities.

Consistent with the expanded definition of SGE, these amendments will apply in relation to income years commencing on or after 1 July 2019.

The takeaway

The consequences of an entity becoming an SGE or CbCRE are significant in terms of the additional compliance burdens and the cost of failing to determine status as an SGE correctly. The amendments bring with them additional complexity to an already complex set of provisions, which many taxpayers have grappled with over the last few years.

There is also new complexity in applying the accounting concepts of control to the notional listed entity. Entities with ultimate investment from private equity, funds management, superannuation and pension funds, sovereign wealth funds, and state-owned enterprises may find it difficult to ascertain the profile of their investors and obtain the requisite information to assess SGE status. It is therefore critical for potentially impacted taxpayers to understand these changes and, where necessary, seek guidance from the ATO. While ATO guidance may take some time to be developed, our previous experience with the ATO on matters relating to SGEs has shown that they are keen to work with taxpayers to resolve uncertainties.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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