Significant global entity

April 2022

The concept of a significant global entity (SGE) was first introduced into tax legislation in 2015 for determining whether an entity is subject to some tax integrity measures and reporting requirements. More recently, the SGE concept has been expanded to capture more entities, and a new subset was created - country-by-country (CBC) reporting entities. It is only CBC reporting entities that may now have CBC reporting obligations and may be required to provide general purpose financial statements (GPFS) to the ATO.

We discuss the key considerations to assess when determining whether an SGE and a CBC reporting entity exist. Such an assessment is not a one-off event - reassessments should be performed as entities grow or group structures change. Careful and timely assessment will be required as entities that fail to consider this appropriately may be subject to substantial penalties.

1. Is there an SGE or CBC reporting entity?

Significant global entity

The scope of the legislation is wide, and applies to any entity (company, partnership, trust or individual). An entity is an SGE when it is a:

- Global parent entity
- Member of a group of entities consolidated for accounting purposes as a single group

  Or
- Member of a *notional listed company group* (NLCG)

with an *annual global income*[1] of A$1 billion or more.

Global income

Income is defined in the *Conceptual Framework for Financial Reporting*[2] as increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims. This would typically include revenue, gains from investment activities and other income that go to the determination of the total comprehensive gain or loss.

In the determination of annual global income, the ATO has clarified that some transactions recorded as part of income on a net basis, such as net foreign exchange gain and loss or net investment income and loss may be considered as part of global annual income as long as it is in accordance with the applicable accounting standards.

Notional listed company group

The NLCG concept was introduced in 2020. In addition to creating global consistency, the introduction means all entities are treated consistently, whether part of a listed group or not. An NLCG consists of all entities that would be required to be consolidated for accounting purposes as if the parent of the group is a listed company and all exceptions to AASB requirements to consolidate were disregarded. This includes exemptions such as the investment entity exemption under paragraph 4B of AASB 10 *Consolidated Financial Statements* and exclusion of immaterial entities.

> Entities likely to be impacted (and therefore need to be included) by the introduction of the NLCG concept are:
>
> - Entities controlled by investment entities
> - Entities previously not consolidated as considered immaterial
> - Entities for which no financial statements were historically prepared and lodged anywhere in the world
> - Non-reporting entities that historically did not prepare consolidated financial information, including those grandfathered/unaffected from the removal of SPFS, refer our publication [The time has come: Changes to Australian financial reporting]
> - Entities controlled by individuals, trusts and partnerships

[1] Annual global income is determined in accordance with global financial statements of the stand-alone SGE or consolidated global financial statements of an SGE group. Where such statements are not prepared (or are inadequate) then annual global income is the amount that would be the annual global income were such global financial statements prepared.

[2] *Conceptual Framework for Financial Reporting* as issued by AASB: https://www.aasb.gov.au/admin/file/content105/c9/Conceptual_Framework_05-19_COMPmar20_07-21.pdf

CBC reporting entity

CBC reporting entities are a subset of the SGE population that have additional reporting obligations compared to SGEs. CBC reporting entities are SGEs within a group (excluding individuals) that would still be SGEs even if the exceptions to consolidation (excluding materiality) were to be applied.

> **Challenges – determining control**
>
> Due to consolidation exemptions that exist under accounting standards, some entities have not historically considered whether they have control over some of their investments. For example, investment entities measure most investments at fair value through profit or loss and therefore distinguishing between subsidiaries, associates, and other investments (under AASB 10, 128 and 9) was not critical. Because the legislation requires you to not apply consolidation exemptions for the purpose of determining SGE status, entities will need to carefully consider whether they control other entities under AASB 10.

2. What are my requirements as an SGE or CBC reporting entity?

Requirements for SGEs

Once identified as an SGE, the entity will be subject to:

- Diverted Profits Tax
- Multinational Anti-Avoidance Law
- SGE penalty provisions

An entity must complete the relevant SGE label in their annual (company, trust, partnership and fund) income tax return if it is an SGE.

Additional requirements for CBC reporting entities

A CBC reporting entity, in addition to the above, may also need to comply with:

- Country-by-country reporting obligations, triggered by its CBC reporting entity status in the previous income year
- GPFS obligations (refer below), triggered by its reporting entity status for the current income year

GPFS obligations

The GPFS obligations vary based on several factors. An entity is required to lodge GPFS with the ATO where it:

- Is a corporate tax entity as defined under the Income Tax Assessment Act 1997 (e.g., a company, corporate limited partnership or public trading trust) for the income year
- Is a CBC reporting entity for the income year
- Is an Australian resident or a foreign resident operating an Australian permanent establishment, at the end of the income year; and
- Does not lodge GPFS with ASIC for the financial year most closely corresponding to the income year within the Corporations Act deadlines.

A GPFS is to be prepared in accordance with Australian Accounting Standards (AAS) where an entity has an obligation to prepare financial statements under the Corporations Act. Otherwise the GPFS may be prepared in accordance with commercially accepted accounting principles (CAAP).

<table>
<tr><th colspan="2"></th><th>ATO reporting</th></tr>
<tr><td rowspan="4">Corporations Act entities</td><td>Lodge GPFS with ASIC</td><td>Nil</td></tr>
<tr><td>Lodge SPFS with ASIC</td><td rowspan="3">AAS GPFS</td></tr>
<tr><td>“Grandfathered” large proprietary companies</td></tr>
<tr><td>Foreign controlled small proprietary companies relieved from preparing FS because parent lodges FS in accordance with AAS</td></tr>
<tr><td rowspan="3">Other entities</td><td>Other Corporation Act entities (eg Australian controlled small proprietary companies, other foreign controlled small proprietary companies with preparation relief)</td><td rowspan="3">AAS or CAAP GPFS</td></tr>
<tr><td>Corporate limited partnership or trust</td></tr>
<tr><td>Foreign resident operating a PE (no ASIC requirements)</td></tr>
</table>

Entities entering or leaving a tax consolidated group, or multiple entry consolidated group (MEC), part-way through the year may also have GPFS obligations.

> **Entities will have some choices in determining the GPFS to be lodged**
>
> - The GPFS may be those of the entity or their consolidated parent. If an entity has an obligation to lodge AAS GPFS, a foreign parents' financial statements can only be lodged for ATO purposes where they are AAS compliant, which may not be possible
> - For AAS GPFS, Tier 1 or Tier 2 GPFS are considered acceptable
> - The GPFS are not required to be audited although the ATO recommends the GPFS be audited to provide "reliable evidence" that they are prepared in accordance with AAS or CAAP
> - If the head entity of a MEC has an obligation to lodge GPFS (generally, subsidiary members of such groups are not required to separately lodge a GPFS), the ATO acknowledges that a MEC combined set of financial statements would not be compliant with AAS. It suggests under a heading "Best Practice" that the GPFS of the head company "may give a very limited perspective of the Australian operations". The placement of the comment under a best practice heading suggests an entity may consider preparing combined MEC financial statements
>
> However, the GPFS submitted to the ATO must be available in English.

Commercially accepted accounting principles

In addition to the ability for certain entities to prepare their GPFS in accordance with CAAP, CAAP may also be used to determine the NLCG and global income. CAAP includes:

- IFRS as issued by the IASB
- Accounting standards that are IFRS compliant as published on IFRS.org (e.g., NZ IFRS or IFRS as adopted by the EU)
- US GAAP
- Accounting standards accepted by the ASX
- Where an entity does not apply one of these standards, accounting standards that align with the principles and guidance in paragraph A8, and Appendix 2, paragraphs 3 and 4 of ASA 210 Agreeing the Terms of Audit Engagements.

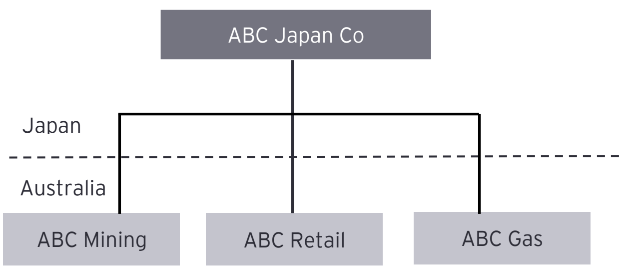
> Accounting principles promulgated by an authorised or recognised standard setting organisations in a particular jurisdiction may be acceptable for CAAP, provided the organisation follows an established and transparent process involving deliberation and consideration of the views of a wide range of stakeholders. Consideration also needs to be given to whether the financial reporting framework exhibits the following attributes that result in information provided in financial reports that is useful to the intended users: relevance, completeness, reliability, neutrality and understandability. We believe most accounting standards set by authorised standard setting bodies would be considered acceptable as CAAP, including Japanese, UK, German and French GAAP.

3. Practical issues and examples

Immaterial subsidiaries

This example illustrates the impact of the materiality consolidation exemption.

Example 1 Immaterial subsidiaries



ABC Mining, ABC Retail and ABC Gas are sister companies operating in Australia. The immediate parent is ABC Japan Co.

ABC Japan Co has A$7 billion of annual income, while the Australian companies collectively generate A$4 million of annual income.

Applying Japanese GAAP, all Australian entities were considered immaterial and not consolidated into ABC Japan Co's financial statements.

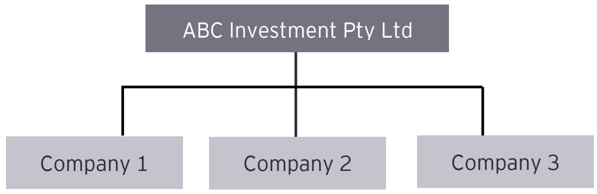
Applying the requirements of both SGE and CBC reporting entities, the NLCG (which includes the immaterial subsidiaries) has more than A$1 billion in income. Consequently, ABC Japan Co and its subsidiaries are SGEs and CBC reporting entities despite not being part of the actual consolidated group. This is because the NLCG ignores the materiality exemption.

However, assuming ABC Japan Co is not a foreign resident operating an Australian permanent establishment, it itself will not have a GPFS obligation.

Investment entities

These examples illustrate the impact of the difference between the SGE and CBC reporting entity definitions.

Example 2 Investment entity - company



ABC Investment Pty Ltd (ABC) is an investment entity and therefore, does not prepare consolidated financial statements. Instead, it measures each of its investee companies at fair value through profit or loss in accordance with AAS.

ABC individually has annual income of A$700 million. Company 1, 2 and 3 each have income of A$250 million.

While ABC does not, on its own, generate more than A$1 billion income, an assessment of whether it has A$1 billion or more income on a consolidated basis as a NLCG is needed.

By not applying the investment entity exemption (and thereby consolidating all subsidiaries), ABC will need to determine which entities it controls under AASB 10 to determine the global income of the group. In this scenario, ABC concludes that it controls Company 1 and Company 3. ABC, Company 1 and Company 3 are SGEs as the NLCG collectively has more than A$1 billion income[3] when not applying the investment entity exemption.

[3] Calculation is simplified for illustration purposes. In practice, ABC would eliminate the profit or loss attributable to the fair value movement of Company 1 and Company 3 and any other intercompany transactions.

Furthermore, the investment in Company 2 will likely be taken up as profit or loss under the equity method (if associate/joint venture) or fair value movement (if no significant influence/joint control).

However, as ABC does not exceed the global income threshold when the consolidation exemption is applied (and none of the subsidiaries would be SGEs in their own right), none of the entities are CBC reporting entities.

Example 3 Investment entity - partnership

Assume the same facts as above, except ABC is a partnership rather than a company.

As a partnership, ABC has never been required to prepare consolidated financial statements.

As a result of the NLCG concept, a partnership can be a global parent entity and therefore the analysis above is the same for this example. ABC Partnership (and Company 1 and 3) are SGEs, but not CBC reporting entities.

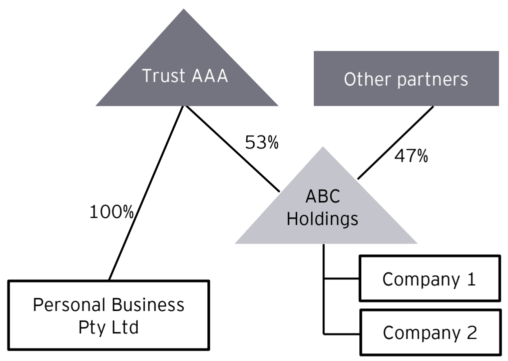
Assessing the group

Entities should not be limiting their SGE and CBC reporting entity assessment to themselves and the subsidiaries they control, but consideration should also be given to whether they are a member of a larger group, including where foreign parents exist.

Example 4 Assessing the group

ABC Holdings and its controlled entities assessed that they were not SGEs or CBC reporting entities when assessing the global income threshold for its group.

However, Trust AAA has a controlling interest in ABC Holdings. Assume Trust AAA is not a corporate tax entity and not itself controlled by an individual or any other entity.



As a result, the SGE and CBC reporting entity assessment will need to be extended to Trust AAA, as the global parent entity. Therefore, the assessment further captures Personal Business Pty Ltd that Trust AAA also controls.

Assuming the group controlled by Trust AAA has global income in excess of A$1 billion, then all entities will be SGEs.

All subsidiaries will also be CBC reporting entities as no consolidation exemptions are available to Trust AAA however, Trust AAA itself will not have a GPFS obligation as it is not a corporate tax entity.

Challenges – identifying groups

As illustrated in the example above, SGE and CBC reporting entity assessments should consider the broader group which the entity is a member. For SGE purposes this can include an individual that controls the entity and any other entities that individual controls.

This can be challenging for large groups with investments across multiple jurisdictions, diverse management and/or differing levels of ownership. However, entities will need to ensure they have the appropriate processes in place for proper determinations to be made.

Change in SGE/CBC reporting entity status

The SGE and CBC reporting entity assessments are not one-off tests, but instead, entities should continuously assess their status. Changes in ownership or growth/decline in a business can lead to a change in status.

Practical considerations

Do entities have systems in place to reassess their status?

If GPFS have not historically been prepared on a regular basis and entities risk falling into and out of GPFS obligations, then perhaps consider the following:

- Should you now prepare GPFS regularly?
- Can comparative information be easily recreated?
- What processes are needed for performing consolidation procedures?

4. Conclusion

While for some, understanding whether there is an SGE or CBC reporting entity will be relatively straight forward, for others it will be challenging. Whether it is the effort required in obtaining relevant information from an investor, or whether it is the difficulty of performing a control assessment when otherwise not required, determining an entity's status should be a priority.

In some cases the current year status will trigger certain obligations in the current income year, and in other cases obligations will arise for the next income year. Understanding the impact of the legislation (and reassessing regularly) is important since the penalties for non-compliance are significant.

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