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What does it mean to be a Significant Global Entity under Australian tax law?

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In brief

Under Australian tax laws, there are special reporting obligations and integrity measures that apply to an entity that is a 'significant global entity' (SGE). Broadly, an SGE is an entity which has annual global income of AUD1 billion or more, or which is part of a group of entities consolidated for accounting purposes that has annual global income of AUD1 billion or more.

Since 2015, the Australian Government has been progressively introducing tax laws targeted at SGEs. These include additional reporting obligations in the form of Country-by-Country (CbC) reporting and a requirement to lodge General Purpose Financial Statements (GPFS) with the Australian Taxation Office (ATO) where not already lodged with the Australian Securities and Investment Commission (ASIC), and targeted integrity measures in the form of the Multinational Anti-Avoidance Law (MAAL) and the Diverted Profits Tax (DPT). In addition, SGEs are subject to significant administrative penalties for failing to meet their tax obligations.

In the 2018-19 Federal Budget, the Australian Government announced a broadening of the definition of SGE to ensure that it can include members of large groups controlled by private companies, trusts and partnerships for income years commencing on or after 1 July 2018.

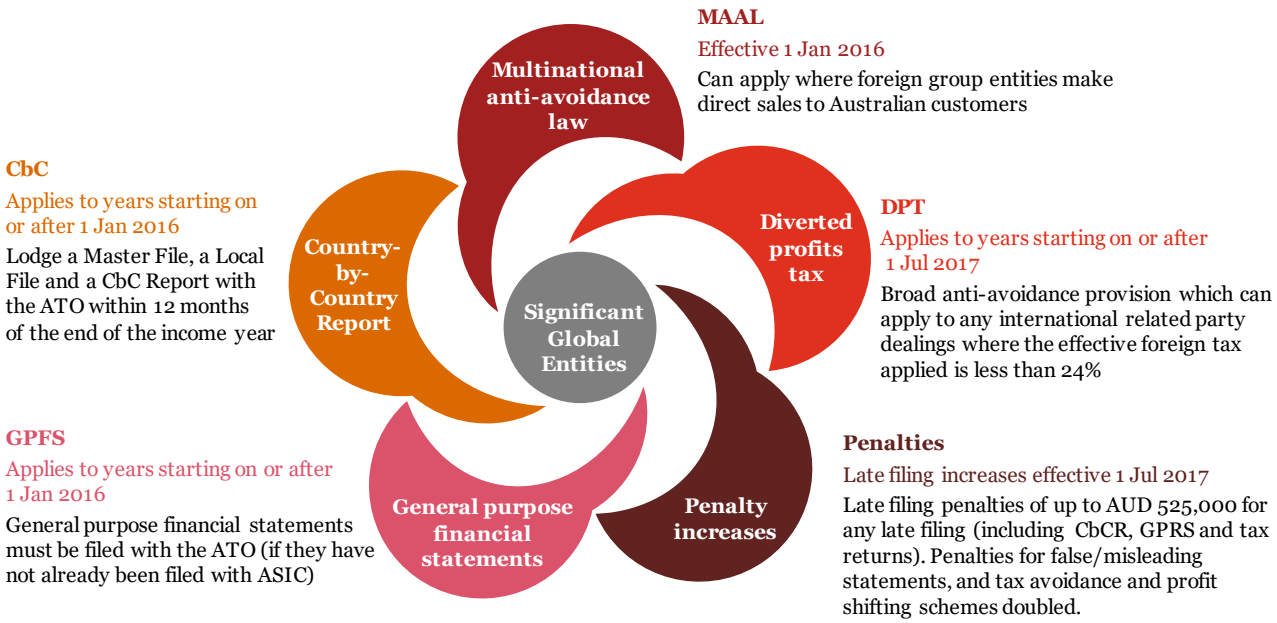
The consequences for an entity that is an SGE are significant. This publication reviews the SGE concept and summarises the different rules which can apply to an SGE under Australian tax law.

In Detail

The specific reporting and integrity measures that apply to SGEs are:

- Provision of GPFS to the ATO by corporate tax entities
- CbC reporting
- MAAL
- DPT
- Increased administrative penalties for SGEs.

Figure 1: Overview of the reporting and integrity measures that apply to SGEs



What is a Significant Global Entity?

There are broadly three ways in which an entity can be classified as a SGE for Australian tax purposes:

1 The entity is a 'global parent entity' that has annual global income of AUD1 billion or more in its global financial statements.

2 The entity is a member of a group of entities that are consolidated for accounting purposes, and one other member of the group is a global parent entity that has 'annual global income' of AUD1 billion or more in its 'global financial statements'.

3 The Commissioner makes a determination in relation to a global parent entity and gives notice that the entity is a SGE.

Notwithstanding the inclusion of the word 'global' in the terms 'significant global entity', 'global parent entity' and 'global financial statements', a purely domestic entity or group can be an SGE. No part of the SGE concept requires an entity to be controlled by a foreign resident or have foreign operations or foreign subsidiaries. Additionally, an SGE is not limited to a company or corporate tax entity - an SGE can include any entity that meets the requirements set out above, including trusts, superannuation funds and partnerships, but that does not necessarily mean that all of the SGE reporting and integrity measures will apply to the entity.

The Australian Government's recent Federal Budget announcement to broaden the definition of an SGE (to apply to income years commencing on or after 1 July 2018) to include members of a large group headed by private companies, trusts, partnerships or investment entities should also be borne in mind when considering an entity's status as an SGE. The intention of this proposal seems to be to ensure that the definition of SGE covers instances in which an entity is controlled by another entity that is not required to prepare consolidated financial statements (for example, where, due to applicable regulations and/or accounting standards, a foreign private company or trust is not required to prepare consolidated accounts).

Table 1: Key terms relevant to determining if an entity is an SGE

Term	*Meaning*
Global parent entity	An entity will be a global parent entity if, according to Australian accounting principles or, if these do not apply in relation to the entity, commercially accepted principles relating to accounting, it is not controlled by another entity.
Annual global income	Annual global income for a period is: • If the entity is a member of a group of entities consolidated for accounting purposes as a single group - the total annual income of all members of the group; • *Otherwise* - the total annual income of the entity as shown in the latest global financial statements for the entity for the period.
Global financial statements	Global financial statements for a relevant period are financial statements that are: • Prepared and audited in accordance with Australian accounting and auditing principles, or, if these do not apply, commercially accepted accounting and auditing principles that give a true and fair view of the financial position and performance of the relevant entity or entities on a consolidated basis, and • for the most recent period ending no later than the end of the relevant period and no earlier than 12 months before the start of the relevant period.

Some tips for determining if an entity is an SGE:

- Where amounts shown in the global financial statements are not in Australian dollars, these amounts must be converted to Australian dollars using the average exchange rate for the period for which the statements are prepared in order to assess if the annual global income meets the AUD1 billion threshold.
- According to ATO guidance material:
  - if financial statements are prepared for a period other than 12 months, the annual global income should be prorated or extrapolated to an annual amount; and
  - extraordinary income, gains from investment activities and other inflows that go to the determination of the profit or loss are included in annual global income as shown in the global financial statements, but other comprehensive income is excluded.

Provision of General Purpose Financial Statements

Applies to income years commencing on or after 1 July 2016

Under measures enacted in December 2015, corporate tax entities (that is, companies and entities taxed like companies) that are SGEs and are required to file an income tax return in Australia, must lodge GPFS with the ATO, unless they already lodge GPFS with ASIC. Subject to administrative extensions, the GPFS must be lodged with the ATO by the due date for lodgment of the entity's income tax return.

There are a number of different types of entities that are significantly impacted by this requirement, and which may need to prepare GPFS for the first time to satisfy their tax reporting obligations. This includes:

- foreign owned companies that are currently lodging special purpose financial statements (SPFS) with ASIC
- grandfathered exempt proprietary companies not required to lodge any financial statements with ASIC
- small foreign owned proprietary companies that are not currently required to lodge any financial reports with ASIC as they are not part of a large group in Australia
- branches of foreign companies that are only required to lodge selected statements with ASIC, and
- public trading trusts and limited partnerships that currently have no obligations to prepare financial statements under the *Corporations Act 2001*.

There is a degree of uncertainty over how and when this measure applies to many affected taxpayers. After consulting with stakeholders since August 2016, the ATO published its first guidance on this lodgment requirement in September 2017.

Companies and other taxpayers that are affected by the GPFS obligation should consider how they will satisfy their GPFS reporting requirement. The ATO has granted a transitional administrative concession for the first year (i.e. for income years that commence between 1 July 2016 and 30 June 2017) which may reduce the compliance burden. However, if this transitional concession is not extended in subsequent periods, it may be necessary for some entities to collect and prepare additional information which is likely to involve significant additional time and cost.

For further information regarding the requirement to lodge GPFS with the ATO, and in particular, the ATO's 2017 guidance materials, refer to our TaxTalk Alert from September 2017.

Country-by-Country Reporting

Applies to income years commencing on or after 1 January 2016

CbC reporting is part of a wide range of international measures aimed at combating tax avoidance through more comprehensive exchanges of information between countries. CbC reporting implements Action 13 of the Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting (BEPS) action plan. Australia implemented CbC reporting in legislation that was enacted in December 2015.

Australian CbC reporting obligations apply to any taxpayers who were a SGE in the prior income year. Under these obligations, a Master File, a Local File and either a CbC Report or notification need to be lodged with the ATO by 12 months after the end of the relevant income year, subject to any extensions of time granted.

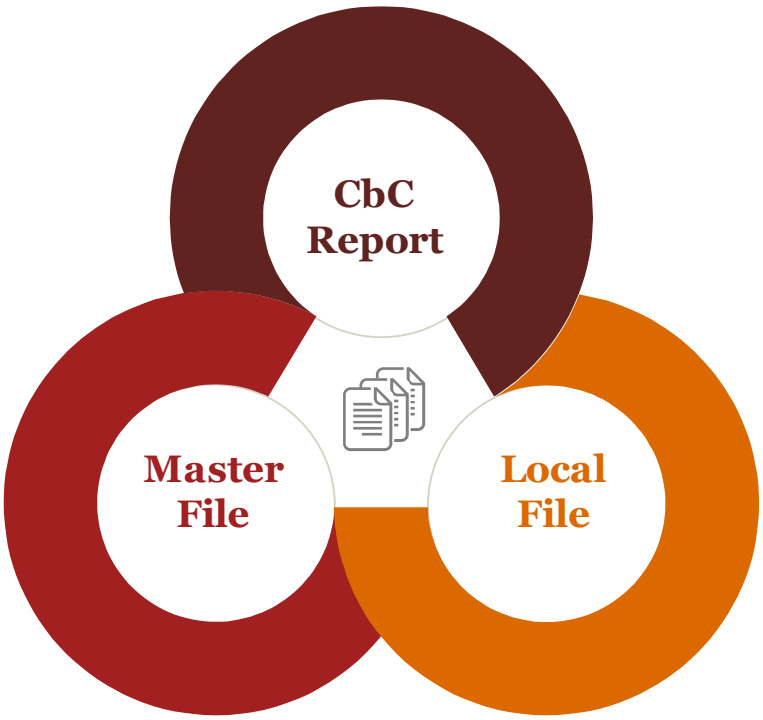
Master File

Australia has adopted the information requirements as outlined in Annex I of the guidance from Action 13 of the OECD/G20 BEPS action plan for the Master File. Accordingly, an English language Master File prepared to OECD standards should be sufficient for Australian reporting purposes.

Local File

The Australian Local File requirements are very different to OECD requirements. Rather than a report format, the Local File is an electronic XML Schema form which requires disclosure of a range of qualitative and quantitative data about the taxpayer and their international related party dealings.

Figure 2: Country-by-Country Reporting comprises 3 statements: Master File, Local File and CbC report



The taxpayer will also need to provide the ATO with copies of legal agreements and any rulings or Advance Pricing Agreements (APAs) with foreign tax authorities which relate to those dealings. A 'short form only' Local File is available for qualifying taxpayers whose international related party dealings for the income year fall below certain thresholds.

CbC Report

Australia has adopted the OECD's XML Schema in relation to the CbC Report. Where a foreign associate of the taxpayer lodges the CbC Report in a jurisdiction which is a signatory to the multilateral agreement facilitating the automatic exchange of CbC information, or has a bilateral exchange of information (EOI) agreement with Australia, the taxpayer would generally only be required to notify the ATO of the foreign associate's details. In other cases, the taxpayer would need to lodge the CbC Report with the ATO.

Exemptions

A range of exemptions from one or more of the Australian CbC reporting obligations may be available in specific circumstances such as where the taxpayer's global group is not required to prepare a Master File in any other jurisdiction, where the taxpayer has no international related party dealings and a range of other scenarios. Taxpayers may also choose to apply to the ATO for customised exemptions which are considered by the ATO on a case by case basis.

Multinational Anti-Avoidance Law

Applies on or after 1 January 2016

The MAAL is designed to target inbound SGEs which make supplies of goods or services to Australian customers but structure the sale in a manner such that they are not attributable to an Australian permanent establishment (PE) of the non-resident entity, with the usual outcome being that the sales are booked entirely offshore and fall outside the Australian tax net.

Broadly for the MAAL to apply, all of the following criteria must be satisfied:

- a non-resident entity makes a supply to an Australian customer;
- activities are undertaken in Australia directly in connection with the supply (e.g. direct marketing);
- some or all of those activities are undertaken by an Australian resident entity (or Australian PE of a non-resident entity) which is either an associate of, or commercially dependent on, the non-resident supplier;

- the non-resident supplier derives income from the supply which is not attributable to an Australian PE of the non-resident; and
- one of the principal purposes of the arrangement was to obtain an Australian tax benefit (or a foreign tax benefit and an Australian tax benefit) having regard to similar matters as Australia's general anti-avoidance provision.

Where applicable, the MAAL causes the non-resident supplier to be taxed as if it had made the sales through a deemed Australian PE, meaning that it will be subject to Australian tax on the notional profits attributable to the deemed PE, as well as withholding taxes where royalty or interest expenses are attributable to the deemed PE. Penalties will also apply on top of these taxes, generally at a rate of 100 per cent. As the MAAL is incorporated into Australia's anti-avoidance provisions, no tax treaty relief is available.

Retrospective legislative amendments are also proposed to prevent taxpayers from using foreign trusts and partnerships in corporate structures to avoid the application of the MAAL. The proposed amendments provide that, when determining if the MAAL applies to a scheme, supplies made and income received by a closely related (to the foreign entity) trust or partnership are treated as being made or received by the foreign entity.

The ATO has published a Law Companion Ruling and client experience roadmap which outlines how it intends to apply and administer the MAAL. Further guidance has also been recently released by the ATO in the form of a draft Tax Determination (TD 2018/D1) which provides context and examples to enable taxpayers to correctly interpret what is meant by the MAAL criteria that activities are undertaken in Australia 'directly in connection with the supply'.

Diverted Profits Tax

Applies to income years commencing on or after 1 July 2017, irrespective of whether the particular arrangements were entered into before that time

Broadly, the Australian DPT applies to SGEs by imposing a penalty rate of tax of 40 per cent, plus interest, in circumstances where the amount of Australian tax paid is reduced (the Australian tax benefit) by diverting profits offshore through contrived related-party arrangements.

The 40 per cent DPT penalty tax rate applies to the amount of an Australian tax benefit if it would be concluded that there was a principal purpose (a lower hurdle than 'sole or dominant purpose') of obtaining an Australian tax benefit, or both, to obtain an Australian tax benefit and reduce foreign tax liabilities.

The DPT does not apply to managed investments trusts, certain foreign collective investment vehicles, entities owned by foreign governments, complying superannuation entities and foreign pension funds.

Furthermore, the DPT will not apply (even if the principal purpose test is satisfied) if it is 'reasonable to conclude' that one of the following exemptions applies:

- broadly, Australian income does not exceed AUD25 million, or
- the 'sufficient foreign tax test' is satisfied, requiring an increase in foreign tax liabilities from the arrangement to be equal to, or to exceed, 80 per cent of the corresponding reduction in the Australian tax liability, or
- the 'sufficient economic substance test' is satisfied, requiring income derived, received or made by each entity connected with the arrangement to 'reasonably reflect the economic substance' of the entity's activities in connection with the arrangements (and having regard to the OECD transfer pricing guidelines).

Where a DPT assessment is made by the Commissioner, the DPT must be paid in full before the assessment can be contested or a settlement reached with the ATO. The DPT is incorporated into Australia's anti-avoidance rules and, as a result, there is no recourse to double tax relief under Australia's tax treaties, nor to the arbitration mechanisms anticipated by the OECD's Multilateral Instrument. The only avenue to object beyond the ATO is to the Australian Federal Court.

Overall, the DPT is extremely broad and has the potential to apply to a number of multinational groups. Some guidance in interpreting the 'principal purpose' test in a DPT context and the complexities in applying the 'sufficient foreign tax test' and the 'sufficient economic substance test' can be found in the ATO's draft Law Companion Ruling (LCR 2017/D7) and draft Practical Compliance Guideline (PCG 2018/D2) which were

released by the ATO for public consultation in December 2017 and February 2018 respectively. Refer to our TaxTalk Alert from February 2018 for further details.

Administrative penalties

Increased penalties for tax avoidance and profit shifting apply to income years commencing on or after 1 July 2015. Increases to other administrative penalties apply from 1 July 2017.

There are a range of administrative penalties that can apply to taxpayers under Australian tax laws. These include penalties for entering into tax avoidance and profit shifting schemes, failure to lodge documents with the ATO on time, and making false or misleading statements to the ATO. For SGEs, the quantum of these administrative penalties is increased as set out below to encourage full compliance with relevant tax obligations:

- the penalty for tax avoidance and profit shifting schemes is doubled
- the penalty for making a false or misleading statement is doubled, and
- the penalty for failing to lodge a document with the Commissioner on time is multiplied by 500.

Penalties for tax avoidance and profit shifting schemes

Taxpayers that have obtained a 'scheme benefit' from entering into a tax avoidance or profit shifting scheme are liable to an administrative penalty. With effect from 1 July 2015, the penalties for SGEs are as follows:

- Tax avoidance schemes - 100 per cent of the scheme shortfall
- Profit shifting (transfer pricing) scheme - 50 per cent of the scheme shortfall.

The above penalty amounts can be increased by 20 per cent where aggravating factors exist, or be reduced by 20 per cent in the case of voluntary disclosure. A lower penalty will apply where it is reasonably arguable that the relevant adjustment provision (for example, Part IVA of the *Income Tax Assessment Act 1936*, or the relevant transfer pricing provisions) did not apply.

Penalties for making a false or misleading statement

Administrative penalties apply for making statements to the ATO that are false or misleading in a material particular. The quantum of the penalty generally depends on what caused the false or misleading statement to be made, and whether it resulted in a tax shortfall. For statements made on or after 1 July 2017, the penalty amounts have been doubled. These amounts are set out in table 2.

Table 2: Penalties for making false or misleading statements

False or misleading statements resulting from...	Penalties for SGEs		Penalties for non-SGEs	
	Where there is a shortfall amount...	Where there is no shortfall amount...	Where there is a shortfall amount...	Where there is no shortfall amount...
Intentional disregard of the law	150% of the shortfall amount	120 penalty units AUD25,200	75% of the shortfall amount	60 penalty units AUD12,600
Recklessness	100% of the shortfall amount	80 penalty units AUD16,800	50% of the shortfall amount	40 penalty units AUD8,400
Failure to take reasonable care	50% of the shortfall amount	40 penalty units AUD8,400	25% of the shortfall amount	20 penalty units AUD4,200
No reasonably arguable position	50% of the shortfall amount	N/A	25% of the shortfall amount	N/A

* As at 1 July 2017, 1 penalty unit = AUD210

The above amounts can be increased by 20 per cent where aggravating factors exist or reduced by 20 per cent in the case of voluntary disclosure.

Penalties for failure to lodge on time

A SGE which fails to lodge an 'approved form' with the Commissioner of Taxation by the required time for lodgment is liable for a penalty which is 500 times the penalty that applies to certain other taxpayers. This penalty could be as high as AUD525,000, subject to the Commissioner's discretion to remit all or part of the penalty. This penalty will apply not only in respect of the special reporting obligations for SGEs outlined above, but also for failure to lodge by the required due date, any other approved form such as tax returns, activity statements and other notifications.

Table 3: Penalties for failure to lodge tax documents on time

Days late	28 or less	29 to 56	57 to 84	85 to 112	More than 112
General case *(Multiplier 1)*	1 penalty unit AUD210	2 penalty units AUD420	3 penalty units AUD630	4 penalty units AUD840	5 penalty units AUD1,050
Medium entity *(Multiplier 2)*	AUD420	AUD840	AUD1,260	AUD1,680	AUD2,100
Large entity *(Multiplier 5)*	AUD1,050	AUD2,100	AUD3,150	AUD4,200	AUD5,250
Significant global entity *(Multiplier 500)*	**AUD105,000**	**AUD210,000**	**AUD315,000**	**AUD420,000**	**AUD525,000**

* From 1 July 2017, 1 penalty unit = $210

Historically, the quantum of the penalty for failure to lodge on time has depended on the size of the relevant taxpayer, as set out in the table above. The penalty for a SGE is 500 times the penalty that would otherwise apply under the general case, regardless of the size of the relevant taxpayer. The medium and large entity classifications (and corresponding penalties) still apply to entities that are not SGEs.

The increased penalties for SGEs apply to documents that were due for lodgment with the ATO on or after 1 July 2017.

The Takeaway

SGEs should continuously review their internal processes and systems to deal with the risks of the increased administrative penalties, reporting obligations and transfer pricing law changes impacting them. The severe new penalty environment poses a serious financial risk unless these obligations are carefully assessed and managed.

In our experience, these new rules and penalty arrangements have caused a range of taxpayers to review positions that they have adopted in the past. This includes technical positions, the reasonableness of positions taken, and the level of documentation available to evidence their arrangements. In addition, groups that are currently below the SGE income threshold, but projected to exceed it in the near future, should take time to consider their SGE implications in advance.

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Contacts

Warren Dick

Partner, Sydney

+61 (2) 8266 2935
warren.dick@pwc.com

Tony Chen

Director, Sydney

+61 (2) 8266 3678
tony.r.chen@pwc.com

Jonathan Malone

Partner, Sydney

+61 (2) 8266 4770
jonathan.r.malone@pwc.com

Gareth Kirkby

Director, Sydney

+61 (2) 8266 0957
gareth.kirkby@pwc.com

Nick Houseman

Partner, Sydney

+61 (2) 8266 4647
nick.p.houseman@pwc.com

Lynda Brumm

Principal, Brisbane

+61 (7) 3257 5471
lynda.brumm@pwc.com

WL127062437