

Chapter 3.5: PE and Flow-Through Allocations

Learning Objective

After completing this chapter, you will be able to allocate GloBE Income between main entities and permanent establishments, and apply the correct treatment for flow-through entities including tax transparent structures and reverse hybrids.

Why Special Allocation Rules Are Needed

The GloBE Rules rely on financial accounting information, but:

| Structure | Challenge |
|--------------------------|--|
| Permanent Establishments | PEs are treated as separate CEs but may not have separate financial accounts |
| Flow-Through Entities | Income may be taxed at owner level, not entity level |
| Reverse Hybrids | Different jurisdictions may treat the same entity differently |

Result: Articles 3.4 and 3.5 provide allocation rules to ensure income is attributed to the correct jurisdiction for ETR calculation.

Part A: Permanent Establishment Allocations

PE as a Separate Constituent Entity

For GloBE purposes, a PE is treated as a **separate Constituent Entity** located in the jurisdiction where it operates (*Article 10.1*).

Key implication: Each PE has its own: - GloBE Income calculation - Covered Taxes calculation - ETR calculation - Potential Top-Up Tax

Three Types of PE (*Article 10.1*)

| Type | Definition | Reference |
|---------------------|--|--------------|
| (a) Treaty PE | PE under applicable tax treaty between main entity jurisdiction and PE jurisdiction | Art. 10.1(a) |
| (b) Domestic Law PE | PE under domestic law of PE jurisdiction (no treaty) | Art. 10.1(b) |
| (c) Deemed PE | Would be a PE under OECD Model if PE jurisdiction had a treaty with main entity jurisdiction | Art. 10.1(c) |

Step 1: Determine PE's Financial Accounting Net Income (*Article 3.4.1*)

Priority order:

1. Use PE's separate financial accounts (if they exist)



2. If no separate accounts:

Prepare notional standalone accounts using UPE's accounting standard

Step 2: Adjust to Reflect Attributable Amounts (*Article 3.4.2*)

The PE's income must reflect only amounts **attributable to the PE** under:

| PE Type | Attribution Basis |
|---|---|
| Treaty PE (<i>Art. 10.1(a)</i>) | Applicable tax treaty or PE jurisdiction domestic law |
| Domestic Law PE (<i>Art. 10.1(b)</i>) | PE jurisdiction domestic law |
| Deemed PE (<i>Art. 10.1(c)</i>) | Article 7 of OECD Model Tax Convention (arm's length) |

Important: The attribution is based on **what income is attributable**, not what income is actually taxed.

Worked Example: PE Income Attribution

Facts: - UK Co (main entity) has a PE in Country X - UK-Country X tax treaty applies
- PE earns €1,000,000 in royalties - Country X exempts 50% of royalties from tax

PE Income for GloBE:

| Item | Amount |
|---|-------------------|
| Royalties attributable to PE under treaty | €1,000,000 |
| Amount actually taxed in Country X | €500,000 |
| GloBE Income of PE | €1,000,000 |

Key point: GloBE uses the €1,000,000 attributable under the treaty, regardless of the €500,000 actually taxed.

Step 3: Exclude PE Income from Main Entity (*Article 3.4.4*)

The Rule

PE income is **not included** in the main entity's GloBE Income.

The Exception: PE Loss Push-Down (*Article 3.4.5*)

If the PE has a **GloBE Loss**, special rules apply:

Condition: The PE loss is treated as an expense for domestic tax purposes in the main entity's jurisdiction.

Treatment:

| Step | Action |
|------|---|
| 1 | PE Loss is treated as an expense of the main entity (not the PE) |
| 2 | PE's GloBE Loss for that year = €0 |
| 3 | Main entity's GloBE Income is reduced by the loss |
| 4 | Future PE profits are treated as main entity income until loss is recaptured |

Worked Example: PE Loss Push-Down

Year 1: - SG France SAS (main entity) has Belgium PE - Belgium PE has GloBE Loss of €(500,000) - France allows deduction for PE losses

| Entity | GloBE Income |
|--------------------------------|--------------|
| Belgium PE (before adjustment) | €(500,000) |
| Belgium PE (after Art. 3.4.5) | €0 |

| Entity | GloBE Income |
|-----------------------------------|--------------|
| SG France SAS (before adjustment) | €2,000,000 |
| SG France SAS (after Art. 3.4.5) | €1,500,000 |

Year 2: - Belgium PE earns GloBE Income of €300,000

| Entity | GloBE Income | Recapture |
|------------------------|--------------|------------------------------|
| Belgium PE | €0 | €300,000 allocated to France |
| SG France SAS | + €300,000 | Recaptured profit |
| Remaining to recapture | | €200,000 |

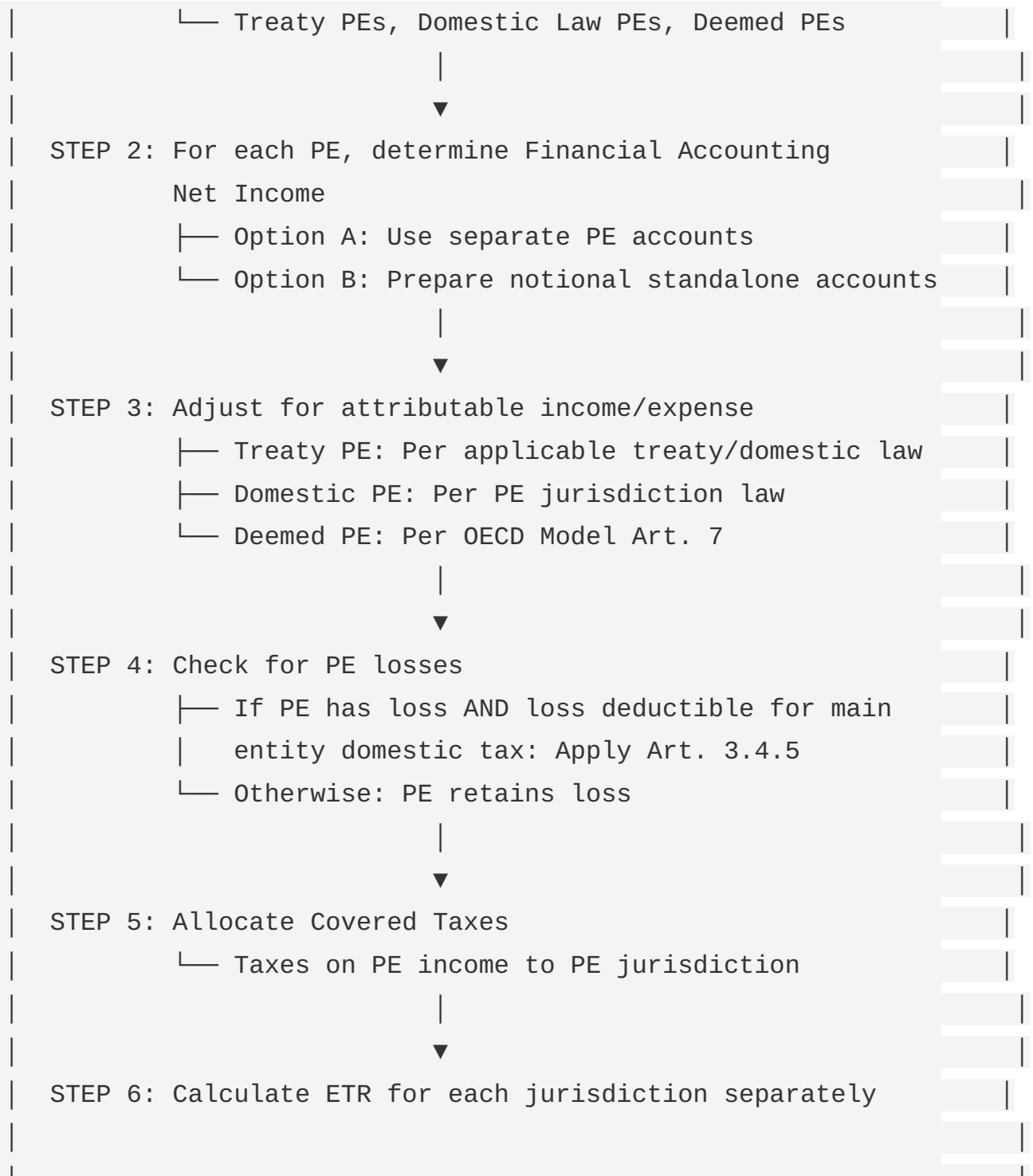
Year 3: - Belgium PE earns GloBE Income of €400,000

| Entity | GloBE Income | Recapture |
|---------------|--------------|------------------------------|
| Belgium PE | €200,000 | €200,000 completes recapture |
| SG France SAS | + €200,000 | Final recapture |
| Remaining | | €0 (fully recaptured) |

PE Income Allocation Methodology

Step-by-Step Process

| | |
|---|--|
| PE INCOME ALLOCATION – STEP-BY-STEP | |
| STEP 1: Identify all PEs of the Main Entity | |

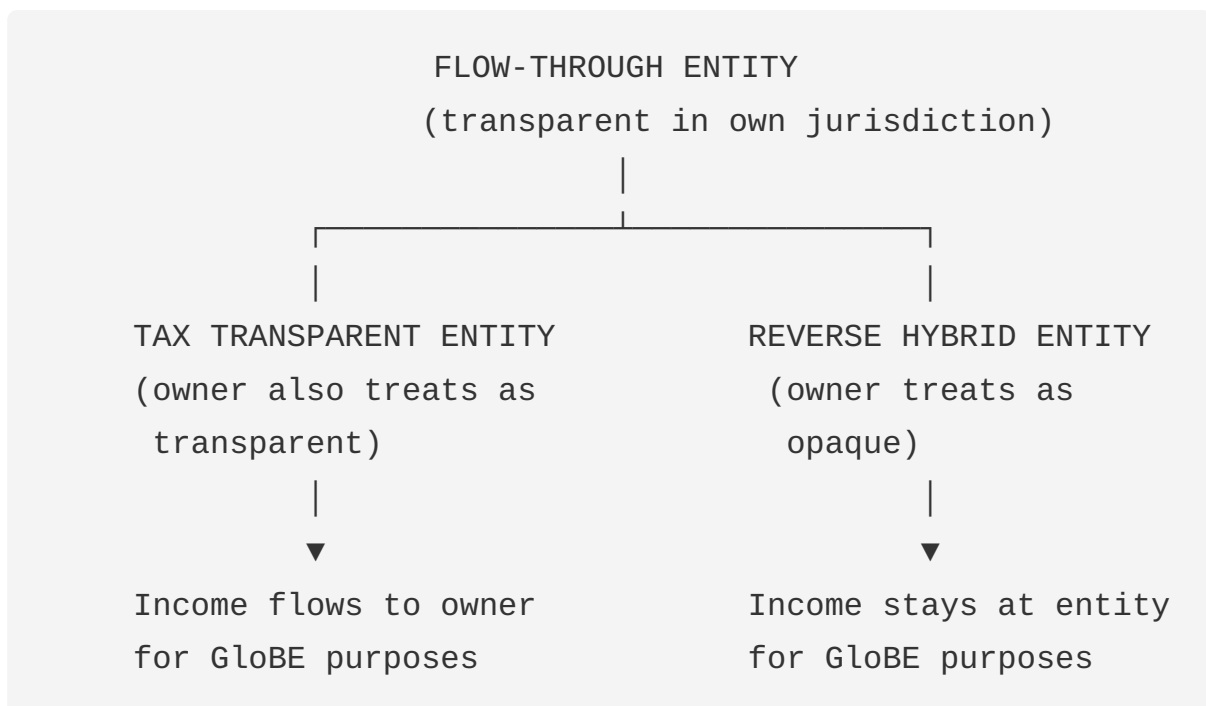


Part B: Flow-Through Entity Treatment

Flow-Through Entity Definitions (*Article 10.2*)

| Term | Definition |
|-------------------------------|---|
| Flow-Through Entity | Entity that is fiscally transparent in its jurisdiction of creation (unless tax resident elsewhere) |
| Tax Transparent Entity | Flow-through entity that is also treated as transparent by its owners' jurisdiction |
| Reverse Hybrid Entity | Flow-through entity that is treated as opaque (non-transparent) by its owners' jurisdiction |

Visual Summary



Tax Transparent Entity Treatment (Article 3.5.1)

The Rule

For a **Tax Transparent Entity**, the GloBE Income and Covered Taxes are allocated to the **Constituent Entity owners** in proportion to their ownership interests.

When This Applies

The entity must be: 1. Fiscally transparent in its jurisdiction of creation, AND 2. Fiscally transparent in the jurisdiction of its owners

Common Examples

| Structure | Typical Treatment |
|--|--|
| US LLC owned by US corporation | Tax transparent (single-member or check-the-box) |
| UK LLP owned by UK companies | Tax transparent |
| German KG owned by German GmbH | Tax transparent |
| Luxembourg SCSp owned by Luxembourg entities | Tax transparent |

Worked Example: Tax Transparent Entity

Structure:



SG US LLC (Delaware)
[Check-the-box disregarded entity]

SG US LLC financials: - GloBE Income: €3,000,000 - Covered Taxes: €0
(disregarded for US tax)

Allocation under Article 3.5.1:

| Entity | GloBE Income | Covered Taxes |
|----------------------|--------------|---------------|
| SG US LLC | €0 | €0 |
| SG Holdings Ltd (UK) | + €3,000,000 | + €0 |

Effect: The US LLC income increases the UK jurisdiction's GloBE Income. The UK ETR calculation includes this €3M.

Reverse Hybrid Entity Treatment (*Article 3.5.2*)

The Rule

For a **Reverse Hybrid Entity**, the GloBE Income and Covered Taxes **remain at the entity level**.

When This Applies

The entity is: 1. Fiscally transparent in its jurisdiction of creation, BUT 2. Treated as opaque (non-transparent) by the owners' jurisdiction

Common Examples

| Structure | Why It's a Reverse Hybrid |
|-----------------------------|---|
| US LLC owned by German GmbH | US: transparent; Germany: treats LLC as corporation |

| Structure | Why It's a Reverse Hybrid |
|------------------------------------|--|
| Luxembourg SCSp owned by French SA | Luxembourg: transparent; France: may treat as opaque |
| UK LP owned by Japanese KK | UK: transparent; Japan: treats LP as corporation |

Worked Example: Reverse Hybrid Entity

Structure:



SG US LLC financials: - GloBE Income: €2,500,000 - US Covered Taxes: €0 (not taxed at entity level)

Treatment under Article 3.5.2:

| Entity | GloBE Income | Covered Taxes | Jurisdiction |
|-------------|---------------|---------------|--------------|
| SG US LLC | €2,500,000 | €0 | USA |
| SG Japan KK | €0 (from LLC) | €0 (from LLC) | Japan |

Effect: The LLC's income stays in the US jurisdiction for ETR purposes. US ETR = $\frac{€0}{€2,500,000} = 0\%$. Top-Up Tax will arise.

The Reverse Hybrid Problem

Reverse hybrids can create **stateless income** for GloBE purposes:

| Jurisdiction | Tax Treatment | GloBE Treatment |
|------------------------------|------------------------------------|------------------------|
| Entity location (e.g., US) | Not taxed (transparent) | Income attributed here |
| Owner location (e.g., Japan) | Not taxed (waits for distribution) | No income attributed |

Result: Income sits in a jurisdiction with 0% ETR, triggering Top-Up Tax.

UPE as a Flow-Through Entity (*Article 3.5.3*)

Special Rules

When the **UPE itself** is a flow-through entity (e.g., a US LLC or UK LLP):

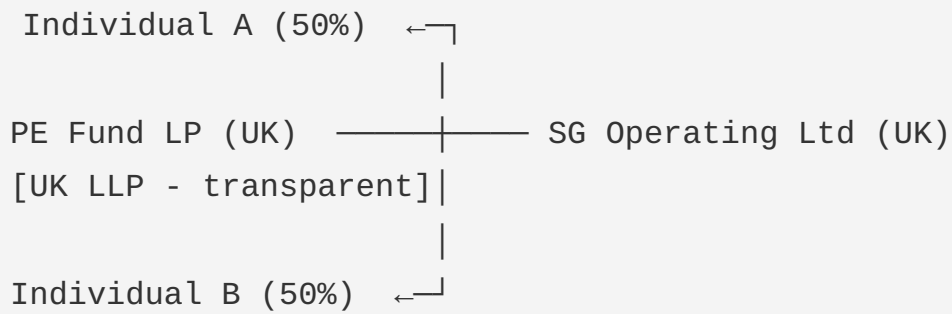
| Scenario | Treatment |
|----------------------------------|---|
| UPE is tax transparent to owners | GloBE Income may flow up to natural persons or non-MNE owners |
| UPE is reverse hybrid | GloBE Income stays at UPE level |

Reduction for Non-CE Owners

If the UPE is tax transparent and some owners are **not Constituent Entities** (e.g., individuals, excluded entities), the GloBE Income is reduced by their share (*Article 3.5.3*).

Worked Example: UPE as Flow-Through

Structure:



PE Fund LP financials: - GloBE Income from SG Operating: €10,000,000

Allocation:

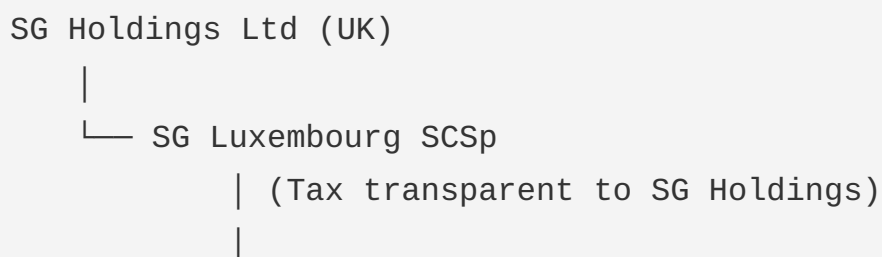
| Owner | Share | CE? | GloBE Income Allocated |
|-------------------|-------|-----------|------------------------|
| Individual A | 50% | No | €0 (excluded) |
| Individual B | 50% | No | €0 (excluded) |
| PE Fund LP | — | Yes (UPE) | €0 |

Effect: The 100% owned by individuals reduces the GloBE Income to €0. No Top-Up Tax arises because income flows to non-CE owners.

Allocation in Ownership Chains

Multiple Flow-Through Entities

When flow-through entities are stacked, determine transparency at each level:



└─ SG US LLC
(Tax transparent to SCSp)

Analysis: 1. SG US LLC: Transparent in US, transparent to Luxembourg SCSp owner 2. SG Luxembourg SCSp: Transparent in Luxembourg, transparent to UK owner 3. **Result:** Income flows up to SG Holdings Ltd (UK)

Chain Resolution Rule

The **June 2024 Administrative Guidance** clarifies:

When a flow-through entity is owned by another flow-through entity, classification is determined by reference to the next owner up the chain who is NOT a flow-through entity.

Stratos Worked Example: PE and Flow-Through

Structure

```
Stratos Group plc (UK)
|
├─ SG France SAS (France)
|   └─ Belgium PE
|
├─ SG Holdings Ltd (UK)
|   └─ SG US LLC (Delaware) [disregarded]
|
└─ SG Japan KK (Japan)
    └─ SG Singapore LP [reverse hybrid]
```

Analysis: Belgium PE

SG France SAS — Belgium PE Allocation

| Item | France | Belgium PE |
|------------------------------|------------|------------|
| Total entity income | €8,500,000 | — |
| Less: PE attributable income | — | €1,200,000 |
| Remaining main entity | €7,300,000 | — |
| PE GloBE Income | — | €1,200,000 |

Analysis: SG US LLC (Tax Transparent)

SG US LLC — Flow-Through to UK

| Item | USA | UK (SG Holdings) |
|---------------------------------|--------------|------------------|
| LLC GloBE Income | €2,800,000 | — |
| Less: Allocated to UK owner | (€2,800,000) | + €2,800,000 |
| Remaining at LLC | €0 | — |
| Added to UK GloBE Income | — | €2,800,000 |

UK Covered Taxes on LLC income: - UK taxes SG Holdings on worldwide income including LLC - UK corporate tax at 25% on €2,800,000 = €700,000 - This €700,000 goes into UK Covered Taxes

Analysis: SG Singapore LP (Reverse Hybrid)

SG Singapore LP — Stays in Singapore

| Item | Singapore | Japan (SG Japan KK) |
|-------------------------------|------------|---------------------|
| LP GloBE Income | €1,500,000 | — |
| Singapore taxes (17% assumed) | €255,000 | — |

| Item | Singapore | Japan (SG Japan KK) |
|----------------------|-----------|---------------------|
| Allocated to Japan? | No | — |
| Singapore ETR | 17% | — |

Note: Singapore LP remains a Singapore CE. Japan doesn't recognise the income until distribution.

Summary Table

| Entity/PE | Jurisdiction | GloBE Income | Covered Taxes | ETR |
|-------------------|--------------|--------------|---------------|------------|
| Stratos Group plc | UK | €45,600,000 | €10,944,000 | 24.0% |
| SG Holdings Ltd | UK | +€2,800,000* | +€700,000* | (combined) |
| SG France SAS | France | €7,300,000 | €1,825,000 | 25.0% |
| Belgium PE | Belgium | €1,200,000 | €300,000 | 25.0% |
| SG US LLC | USA | €0 | €0 | N/A |
| SG Japan KK | Japan | €22,300,000 | €6,690,000 | 30.0% |
| SG Singapore LP | Singapore | €1,500,000 | €255,000 | 17.0% |

*LLC income flows to UK; taxes paid by UK on that income.

Documentation Requirements

For PE Allocations

| Document | Purpose |
|-------------------------------------|---|
| PE separate accounts (if available) | Primary source for PE income |
| Transfer pricing documentation | Supports arm's length attribution |
| Tax treaty analysis | Confirms PE existence and attribution rules |
| Domestic law analysis | For domestic law PEs |
| Loss tracking schedule | For Article 3.4.5 recapture |

For Flow-Through Entities

| Document | Purpose |
|------------------------------------|--------------------------------|
| Entity classification analysis | Transparent vs reverse hybrid |
| Ownership structure chart | Identifies CE vs non-CE owners |
| Tax treatment in each jurisdiction | Confirms classification |
| Allocation calculations | Shows income flow-through |

8. Common Pitfalls

Pitfall 1: Double-Counting PE Income

Error: Including PE income in both PE and main entity GloBE Income.

Correct: Exclude PE income from main entity under Article 3.4.4.

Pitfall 2: Ignoring PE Loss Recapture

Error: Pushing PE loss to main entity without tracking future recapture.

Correct: Maintain schedule to recapture future PE profits to main entity.

Pitfall 3: Misclassifying Flow-Through Entities

Error: Assuming all LLCs/LPs are tax transparent.

Correct: Check treatment in **both** entity jurisdiction AND owner jurisdiction.

Pitfall 4: Forgetting Reverse Hybrid Consequences

Error: Assuming income flows to owners as for tax transparent entities.

Correct: Reverse hybrid income stays at entity level—often creates low ETR jurisdiction.

Pitfall 5: Missing Non-CE Owner Reduction

Error: Including full GloBE Income when UPE is flow-through with non-CE owners.

Correct: Reduce GloBE Income by share attributable to non-CE owners.