

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.

Introduction

The GloBE framework's jurisdictional blending approach—calculating a single ETR for all entities in a given country—works smoothly when each entity is a distinct legal person taxed where it resides. Reality is messier. Multinational groups routinely operate through permanent establishments that have no separate legal identity but are taxed as if they did. They structure investments through partnerships, limited liability companies, and other vehicles that different countries classify differently for tax purposes. Some entities are transparent to their owners; others are opaque; still others are transparent in one jurisdiction but opaque in another. Without allocation rules to address these structures, the framework would either double-count income, miss income entirely, or attribute income to the wrong jurisdiction—undermining the minimum tax's fundamental purpose. Articles 3.4 and 3.5 provide the machinery to untangle these complexities, ensuring that every euro of GloBE Income lands in exactly one jurisdiction for ETR calculation purposes.

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.

The decision to treat PEs as separate Constituent Entities reflects the economic reality that many PE operations are substantial businesses in their own right, even without separate legal personality. A manufacturing plant, a sales office, or a research facility operating as a PE may generate significant profits and employ hundreds of people. Tax treaties have long recognised this reality by giving the PE jurisdiction primary taxing rights over profits attributable to the PE. The GloBE framework honours this by treating the PE as a separate CE located in its operating jurisdiction, ensuring that the PE's ETR is measured there—not blended with the main entity's home jurisdiction. This prevents groups from sheltering PE profits in high-tax home countries while actually operating in low-tax environments. The three-tier PE definition (treaty, domestic law, deemed) ensures comprehensive coverage: if any framework creates PE status, the GloBE allocation rules apply.

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
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

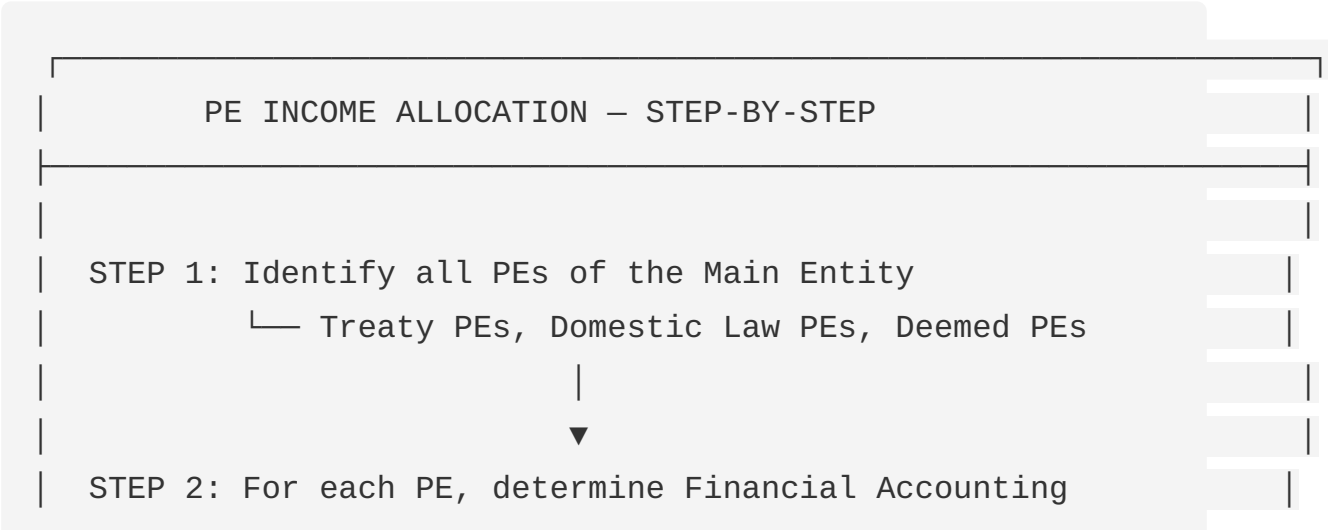
Year 3: - Belgium PE earns GloBE Income of €400,000

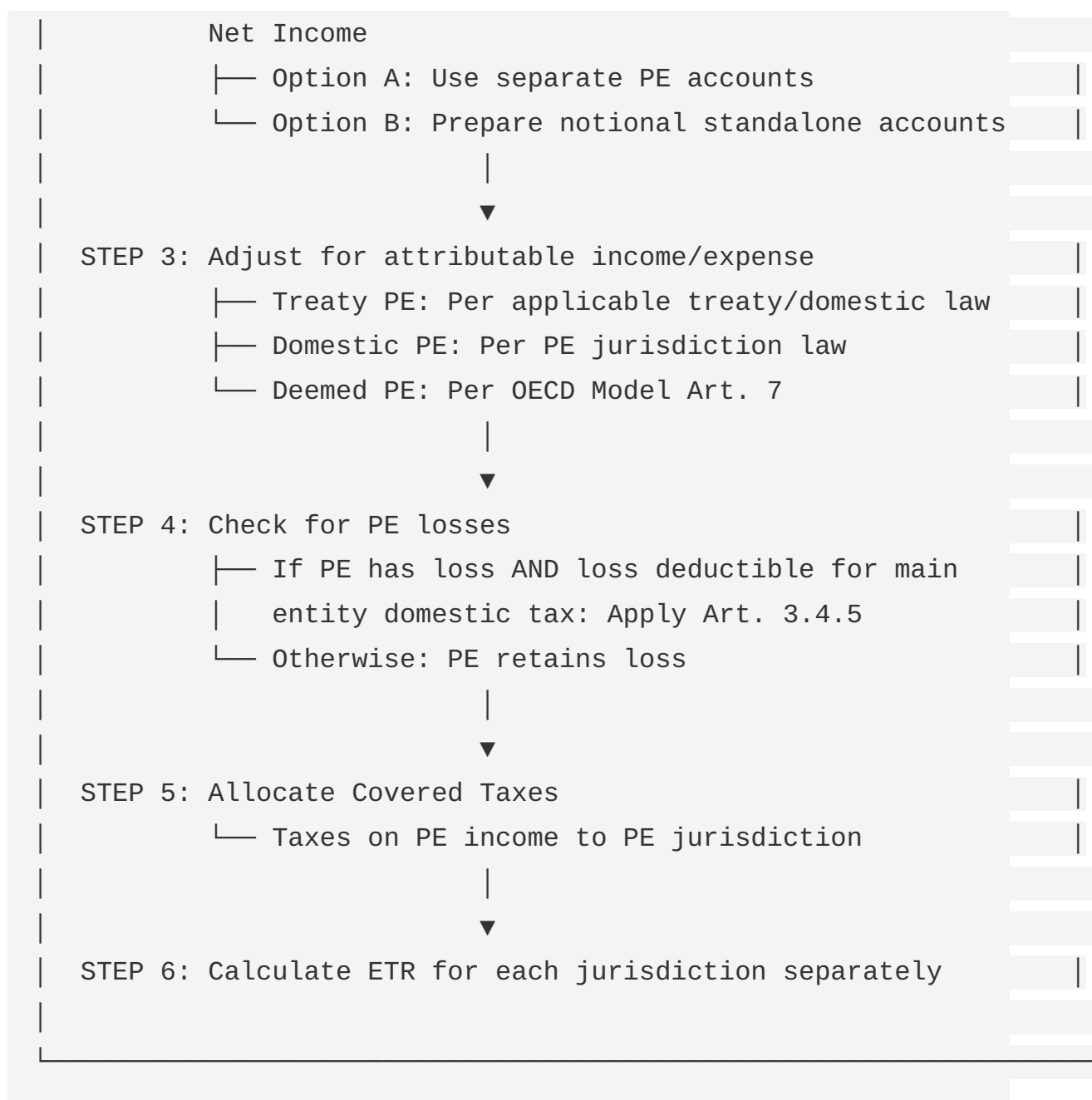
Entity	GloBE Income	Recapture
Belgium PE	€200,000	€200,000 completes recapture
SG France SAS	+ €200,000	Final recapture
Remaining		€0 (fully recaptured)

The PE loss push-down rule addresses a specific asymmetry that would otherwise arise. Many jurisdictions allow taxpayers to deduct foreign PE losses against domestic income—a policy designed to prevent economic double taxation of overall losses. Without the GloBE adjustment, a group could benefit twice: first by reducing its main entity's domestic tax through the PE loss deduction, and second by retaining a GloBE loss in the PE jurisdiction that might shield future profits. Article 3.4.5 closes this gap by following the tax: if the main entity jurisdiction grants the deduction, the GloBE loss moves there too. The recapture mechanism then ensures that future PE profits first replenish the main entity's GloBE Income before returning to the PE jurisdiction—maintaining symmetry over the full cycle. This creates administrative complexity but prevents the framework from inadvertently subsidising loss-making foreign operations.

PE Income Allocation Methodology

Step-by-Step Process





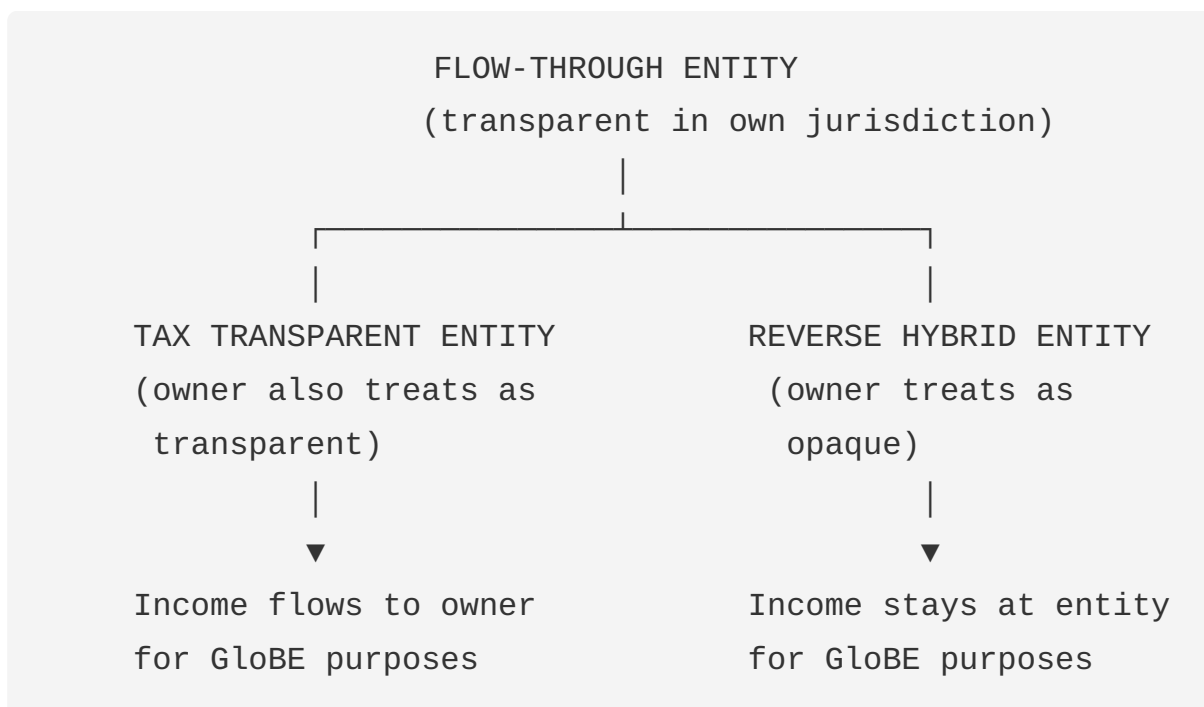
Part B: Flow-Through Entity Treatment

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)

Term	Definition
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



The flow-through entity rules represent one of the more technically complex areas of the GloBE framework because they must navigate the fundamental divergence in how different jurisdictions classify the same legal structures. A US LLC may be a corporation for German tax purposes but a disregarded entity for US purposes; a Luxembourg SCSp may be transparent to its UK owner but opaque to a French owner. Rather than imposing a uniform GloBE classification, Articles 3.5.1 and 3.5.2 work with existing tax classifications—but they must determine whose classification controls. The key insight is that transparency is determined from the perspective of both the entity's jurisdiction and the owner's jurisdiction: only when both agree the entity is transparent does income flow through. When they disagree—the reverse hybrid scenario—income stays at the entity level. This approach respects existing tax

classifications while ensuring that every item of income lands somewhere for ETR calculation.

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

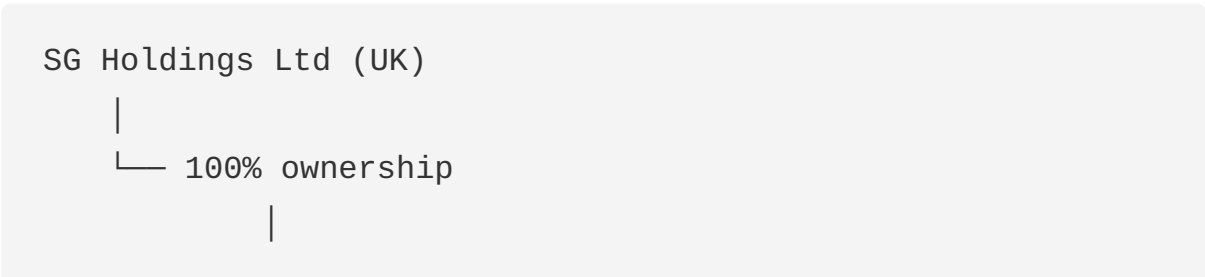
The entity must be: 1. Fiscally transparent in its jurisdiction of creation, AND 2. Fiscally transparent in the jurisdiction of its owners

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.

The reverse hybrid problem illustrates why the GloBE framework cannot simply defer to domestic tax classifications. A US LLC owned by a Japanese parent is the paradigmatic example: the US views the LLC as transparent and doesn't tax its income; Japan views the LLC as a corporation and doesn't tax its income until distribution. Without special rules, this income would be "stateless" for GloBE purposes—not included in any jurisdiction's ETR calculation. Article 3.5.2 resolves this by keeping income at the entity level when the owner's jurisdiction treats it as opaque. The consequence—often a 0% ETR in the entity's jurisdiction—is intentional. The framework is designed to surface undertaxation, and reverse hybrids that produce double non-taxation should indeed trigger Top-Up Tax. Groups using these structures must either accept the Top-Up Tax, restructure to eliminate the hybrid mismatch, or ensure the entity's jurisdiction imposes sufficient tax (perhaps through a QDMTT).

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):

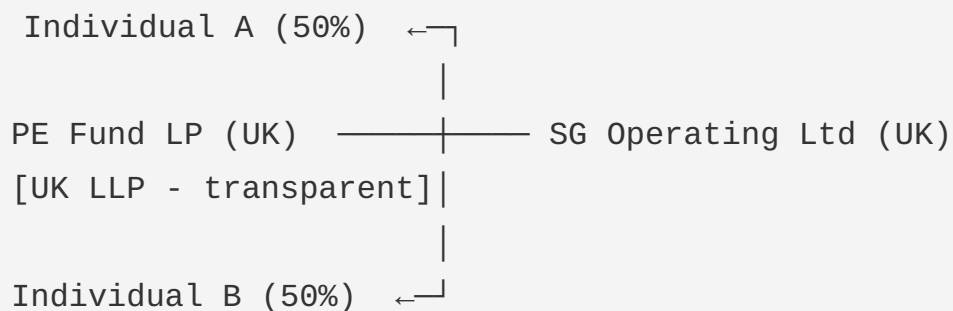
Scenario	Treatment
UPE is tax transparent to owners	GloBE Income may flow up to natural persons or non-MNE owners
UPE is reverse hybrid	GloBE Income stays at UPE level

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.

The UPE-as-flow-through rules address a conceptual challenge: how can there be a Constituent Entity that owns the group when that entity's income flows through to individual owners who are not themselves CEs? The framework resolves this by acknowledging that GloBE applies to MNE Groups, not to individuals or non-CE entities. Where a partnership or LLC sits atop a multinational structure and its owners are natural persons, the income attributable to those persons exits the GloBE calculation entirely—there is no Constituent Entity to which it can be allocated. This result respects the principle that Pillar Two targets undertaxation of corporate profits, not individual income. It also prevents the absurdity of taxing individuals under a corporate minimum tax framework. However, groups should not assume that flow-through status at the top of the structure eliminates all GloBE exposure: the reduction applies only to the extent of non-CE ownership, and any corporate owners down the chain remain subject to the full framework.

Allocation in Ownership Chains

Multiple Flow-Through Entities

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



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



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	—

Item	France	Belgium PE
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	—
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

Document	Purpose
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.

The PE and flow-through allocation rules reveal the GloBE framework's fundamental commitment to jurisdictional accuracy over simplicity. The drafters could have imposed uniform classifications—treating all PEs as part of their main entities, or mandating that all flow-throughs are transparent. Instead, they chose to work with the rich diversity of existing domestic and treaty classifications, creating a set of allocation rules that respect those classifications while ensuring comprehensive coverage. The result is a technically demanding area of compliance that requires groups to understand not just their own legal structures, but how each jurisdiction in their chain views every entity. For groups with complex PE networks or multi-tier flow-through structures, building and maintaining accurate classification databases is essential. The June 2024 Administrative Guidance on chain resolution provides welcome clarification, but the fundamental challenge remains: the GloBE calculation is only as accurate as the underlying entity classification analysis.