Chapter 5.2: Substance-Based Income Exclusion (SBIE)

Learning Objective

After completing this chapter, you will be able to calculate the Substance-Based Income Exclusion (SBIE) using the payroll and tangible asset carve-outs, apply the correct transition rates for each fiscal year, and determine the Excess Profit subject to Top-Up Tax.

Key References

OECD GloBE Model Rules: - Article 5.3.1 — SBIE amount definition - Article 5.3.2 — Exclusion calculation (sum of carve-outs) - Article 5.3.3 — Payroll carve-out - Article 5.3.4 — Tangible asset carve-out - Article 5.3.5 — Location rules (50% threshold) - Article 9.2.1 — Transition payroll rates - Article 9.2.2 — Transition tangible asset rates - Article 10.1 — Definitions (Eligible Payroll Costs, Eligible Tangible Assets, Eligible Employees)

Administrative Guidance: - June 2024: SBIE uses accounting carrying value, not GloBE carrying value - February 2023: Mobile employee allocation clarification

OECD Commentary: - Chapter 5, paragraphs 52-95 — SBIE calculation methodology

1. What SBIE Does

The Substance-Based Income Exclusion reduces the amount of income subject to Top-Up Tax by recognising that genuine economic substance (employees and physical assets) represents real business activity deserving a fixed return.

1.1 The Concept

```
                                              SBIE
                                               ↓
┌─────────────────────────────────────────────────────────────┐
│                   Net GloBE Income                          │
│  ┌─────────────────────────────────────┬───────────────┐    │
│  │       Substance-Based               │    Excess     │    │
│  │       Income Exclusion              │    Profit     │    │
│  │       (SBIE)                        │               │    │
│  │                                     │    ← Subject  │    │
│  │       ← Excluded from               │      to       │    │
│  │         Top-Up Tax                  │      Top-up   │    │
│  │                                     │      Tax      │    │
│  └─────────────────────────────────────┴───────────────┘    │
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1.2 The Formula

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 Excess Profit = Net GloBE Income − SBIE

Top-Up Tax = Top-Up Tax % × Excess Profit
```

Key insight: SBIE reduces the **base** on which Top-Up Tax is calculated, not the rate. Higher substance = lower Top-Up Tax.

2. SBIE Components

Article 5.3.2 defines the SBIE amount as the sum of two carve-outs for each Constituent Entity in the jurisdiction:

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SBIE = Payroll Carve-out + Tangible Asset Carve-out
```

2.1 Component 1: Payroll Carve-out (Article 5.3.3)

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Payroll Carve-out = Eligible Payroll Costs × Payroll Rate
```

2.2 Component 2: Tangible Asset Carve-out (Article 5.3.4)

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Tangible Asset Carve-out = Carrying Value of Eligible Tangible Assets ×
```

3. Transition Rates (Article 9.2)

The SBIE percentages are **higher** in early years and **reduce** over a 10-year transition period to the permanent rates of 5%.

3.1 SBIE Transition Rate Table

Fiscal Year (beginning in)	Payroll Rate	Tangible Asset Rate
2024	10.0%	8.0%
2025	9.8%	7.8%
2026	9.6%	7.6%
2027	9.4%	7.4%
2028	9.2%	7.2%
2029	8.4%	6.6%
2030	7.6%	6.0%
2031	6.8%	5.4%
2032	6.0%	4.8%
2033	5.2%	4.4%

Fiscal Year (beginning in)	Payroll Rate	Tangible Asset Rate
2034+	**5.0%**	**5.0%**

Practical implication: In early transition years, the higher rates provide greater SBIE—reducing Top-Up Tax exposure. As rates decline, more income becomes subject to Top-Up Tax.

3.2 Which Year's Rate Applies?

Use the rate for the **fiscal year** being calculated based on when the fiscal year **begins**: - FY beginning 2025: Use 2025 rates (9.8% / 7.8%) - FY beginning 2024: Use 2024 rates (10.0% / 8.0%)

Note: Consult domestic implementing legislation for the specific rule applicable in each jurisdiction.

4. Eligible Payroll Costs (Article 10.1)

4.1 What Qualifies

Category	Examples	Included?
Salaries and wages	Base salary, hourly wages	✅ Yes
Bonuses and allowances	Performance bonuses, housing allowance	✅ Yes
Stock-based compensation	Share options, RSUs (expensed amount)	✅ Yes
Employee benefits	Medical insurance, pension contributions	✅ Yes
Payroll taxes	Employer social security, fringe benefits tax	✅ Yes

Category	Examples	Included?
Retirement benefits	Employer pension fund contributions	✅ Yes

4.2 What Does NOT Qualify

Category	Why Excluded
Capitalised payroll	Already in tangible asset carve-out (avoid double-counting)
Contractor payments	Not "employees" under Article 10.1
International shipping payroll	Excluded income under Article 3.3
Payroll for excluded entities	Investment Entities excluded from SBIE

4.3 Eligible Employees Definition

An **Eligible Employee** is an employee (including part-time) of a Constituent Entity who performs activities for the MNE Group in the jurisdiction.

Critical test: Where does the employee **perform activities**?

Scenario	Treatment
Employee works 100% in Jurisdiction A	100% of payroll costs → Jurisdiction A
Employee works 70% in Jurisdiction A, 30% in Jurisdiction B	70% → A, 30% → B
Employee works less than 50% in any single jurisdiction	Proportionate allocation required

5. Eligible Tangible Assets (Article 10.1)

4.1 What Qualifies

Asset Type	Examples	Included?
Property, plant and equipment	Buildings, machinery, vehicles	✅ Yes
Natural resources	Mining rights, oil and gas assets	✅ Yes
Leased assets (ROU)	Right-of-use assets under IFRS 16	✅ Yes
Licensed assets	Government licences on land	✅ Yes

4.2 What Does NOT Qualify

Asset Type	Why Excluded
Intangible assets	IP, goodwill, software (not "tangible")
Financial assets	Investments, receivables
Cash and equivalents	Not tangible productive assets
Inventory	Current asset, not long-term productive asset
Assets under construction	Not yet in use (until capitalised)

5.3 Carrying Value

Use the **accounting carrying value** (net book value) from financial statements:

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Carrying Value = Cost − Accumulated Depreciation − Impairment
```

June 2024 Administrative Guidance clarification: Use the **accounting** carrying value, not GloBE-adjusted carrying value. Any adjustments to derive GloBE Income do not affect SBIE calculation.

5.4 Average Carrying Value

Article 5.3.4 requires using the **average** of opening and closing carrying values:

```
                        Opening Carrying Value + Closing Carrying Value
Average Carrying Value = ─────────────────────────────────────────────────
                                              2
```

Example:

Asset	Opening NBV	Closing NBV	Average
Factory	€10,000,000	€9,500,000	€9,750,000
Equipment	€2,000,000	€1,800,000	€1,900,000
Total	**€12,000,000**	**€11,300,000**	**€11,650,000**

6. Location Rules (Article 5.3.5)

6.1 The 50% Threshold

If an employee or tangible asset is located in a jurisdiction for **50% or less** of the time, only the proportionate share of the carve-out applies.

6.2 Mobile Employees

Scenario: An employee is based in the UK but travels extensively.

Jurisdiction	Days Worked	% of Year	Treatment
UK (home base)	150	60%	60% of payroll → UK

Jurisdiction	Days Worked	% of Year	Treatment
Germany	60	24%	24% of payroll → Germany
France	40	16%	16% of payroll → France

Total = 100% — Full payroll cost is allocated across jurisdictions.

6.3 Mobile Assets

Scenario: A shipping container travels between jurisdictions.

Jurisdiction	Days Located	% of Year	Treatment
Netherlands	200	55%	55% of carrying value → Netherlands
Belgium	165	45%	45% of carrying value → Belgium

7. SBIE Cannot Create a Loss

Critical rule: The SBIE cannot reduce Excess Profit below zero.

```
Excess Profit = MAX(0, Net GloBE Income − SBIE)
```

If SBIE exceeds Net GloBE Income, the excess is **lost**—it cannot be carried forward or used to offset other jurisdictions.

7.1 Example: High-Substance, Low-Profit Jurisdiction

Item	Amount
Net GloBE Income	€2,000,000

Item	Amount
Payroll Carve-out	€1,800,000
Tangible Asset Carve-out	€1,500,000
Total SBIE	**€3,300,000**
Excess Profit	MAX(0, €2M − €3.3M) = **€0**

Result: No Top-Up Tax, but €1,300,000 of "wasted" SBIE cannot be used elsewhere.

8. Stratos Worked Example: Complete SBIE Calculation

8.1 Data for FY 2025

Stratos has identified two low-taxed jurisdictions from Chapter 5.1: - **Singapore** (ETR 9.81%) - **Ireland** (ETR 11.80%)

Germany (ETR 23.00%) is not low-taxed, so no SBIE calculation is required.

8.2 Singapore SBIE Calculation

Step 1: Gather payroll data

Entity	Eligible Payroll Costs
SG Singapore Pte Ltd	€850,000

Step 2: Gather tangible asset data

Asset	Opening NBV	Closing NBV	Average
Office building	€1,200,000	€1,150,000	€1,175,000

Asset	Opening NBV	Closing NBV	Average
IT equipment	€180,000	€150,000	€165,000
Leased vehicles (ROU)	€95,000	€80,000	€87,500
Total			**€1,427,500**

Step 3: Apply FY 2025 transition rates

Component	Base	Rate	Carve-out
Payroll	€850,000	9.8%	€83,300
Tangible Assets	€1,427,500	7.8%	€111,345
Total SBIE			**€194,645**

Step 4: Calculate Excess Profit

```
 Net GloBE Income:                                    €4,000,000
Less: SBIE:                                          (€194,645)
                                                     ___________
Excess Profit:                                       €3,805,355
```

8.3 Ireland SBIE Calculation

Step 1: Gather payroll data

Entity	Eligible Payroll Costs
SG Ireland Ltd	€4,200,000

Step 2: Gather tangible asset data

Asset	Opening NBV	Closing NBV	Average
Office building	€8,500,000	€8,200,000	€8,350,000
R&D equipment	€2,100,000	€1,900,000	€2,000,000
Data centre	€5,400,000	€5,100,000	€5,250,000
Leased assets (ROU)	€620,000	€580,000	€600,000
Total			**€16,200,000**

Step 3: Apply FY 2025 transition rates

Component	Base	Rate	Carve-out
Payroll	€4,200,000	9.8%	€411,600
Tangible Assets	€16,200,000	7.8%	€1,263,600
Total SBIE			**€1,675,200**

Step 4: Calculate Excess Profit

```
 Net GloBE Income:                                    €15,000,000
Less: SBIE:                                          (€1,675,200)
                                                     ____________
Excess Profit:                                       €13,324,800
```

8.4 SBIE Summary

Jurisdiction	Net GloBE Income	SBIE	Excess Profit
Singapore	€4,000,000	€194,645	€3,805,355

Jurisdiction	Net GloBE Income	SBIE	Excess Profit
Ireland	€15,000,000	€1,675,200	€13,324,800

Key observation: Ireland has significant substance (high payroll and tangible assets), which reduces its Excess Profit by over €1.6M. Singapore has less substance relative to income.

9. Multi-Entity Jurisdictions

When a jurisdiction has multiple Constituent Entities, calculate SBIE for **each entity** and aggregate:

9.1 Example: Ireland with Two Entities

Entity	Payroll Costs	Tangible Assets (Avg)
SG Ireland Ltd	€4,200,000	€16,200,000
SG Dublin Services Ltd	€1,800,000	€3,400,000
Jurisdiction Total	**€6,000,000**	**€19,600,000**

SBIE Calculation (FY 2025):

Component	Base	Rate	Carve-out
Payroll	€6,000,000	9.8%	€588,000
Tangible Assets	€19,600,000	7.8%	€1,528,800
Total SBIE			**€2,116,800**

Jurisdictional blending applies: The combined SBIE reduces the combined Net GloBE Income.

10. Election Not to Apply SBIE (Article 5.3.1)

An MNE may elect **not** to apply SBIE for a jurisdiction in any fiscal year.

10.1 When to Consider This Election

Scenario	Recommendation
SBIE exceeds Net GloBE Income (wasted SBIE)	Election irrelevant—no Top-Up Tax either way
Minimal payroll/assets relative to income	May simplify compliance if SBIE is immaterial
QDMTT applies and covers liability	May skip SBIE if QDMTT already collects full Top-Up Tax

Practical note: This election is rarely beneficial. SBIE always reduces or eliminates Top-Up Tax liability.

11. Common Pitfalls

11.1 Pitfall 1: Using Gross Rather Than Net Book Value

Error: Including accumulated depreciation in tangible asset value.

Correct approach: Use **net book value** (carrying value after depreciation).

11.2 Pitfall 2: Including Intangible Assets

Error: Adding software or patents to the tangible asset carve-out.

Correct approach: Only tangible assets qualify. Intangibles are excluded.

11.3 Pitfall 3: Double-Counting Capitalised Payroll

Error: Including payroll costs that were capitalised into an asset (e.g., construction labour) in both carve-outs.

Correct approach: Capitalised payroll is excluded from the payroll carve-out—it's already in the tangible asset base.

11.4 Pitfall 4: Forgetting the Average Calculation

Error: Using only closing NBV for tangible assets.

Correct approach: Use the **average** of opening and closing carrying values.

11.5 Pitfall 5: Applying Wrong Year's Transition Rate

Error: Using 2024 rates for a FY 2026 calculation.

Correct approach: Apply the transition rate for the **fiscal year** being calculated.

11.6 Pitfall 6: Ignoring Location Rules for Mobile Employees

Error: Allocating 100% of a travelling employee's payroll to their home jurisdiction.

Correct approach: Allocate based on **time spent** performing activities in each jurisdiction.

12. SBIE Calculation Worksheet

Use this worksheet for each low-taxed jurisdiction:

```
 SBIE CALCULATION WORKSHEET
Jurisdiction: _________________________
Fiscal Year: _________________________
Transition Rates: Payroll ______% | Tangible Assets ______%

SECTION A: CONSTITUENT ENTITIES
List all CEs in this jurisdiction (excluding Investment Entities):
```

```
| # | Entity Name |
|---|-------------|
| 1 | ___________ |
| 2 | ___________ |
| 3 | ___________ |

SECTION B: PAYROLL CARVE-OUT
B1  Eligible Payroll Costs (all CEs)           €__________________
B2  Less: Capitalised payroll                  (€__________________)
B3  Less: International shipping payroll       (€__________________)
B4  Net Eligible Payroll Costs (B1-B2-B3)      €__________________
B5  Payroll Transition Rate                    __________________%
B6  PAYROLL CARVE-OUT (B4 × B5)                €__________________

SECTION C: TANGIBLE ASSET CARVE-OUT
C1  Opening carrying value (all CEs)           €__________________
C2  Closing carrying value (all CEs)           €__________________
C3  Average carrying value ((C1+C2)÷2)         €__________________
C4  Less: Assets under construction            (€__________________)
C5  Net Eligible Tangible Assets (C3-C4)       €__________________
C6  Tangible Asset Transition Rate             __________________%
C7  TANGIBLE ASSET CARVE-OUT (C5 × C6)         €__________________

SECTION D: TOTAL SBIE
D1  Payroll Carve-out (B6)                     €__________________
D2  Tangible Asset Carve-out (C7)              €__________________
D3  TOTAL SBIE (D1 + D2)                       €__________________

SECTION E: EXCESS PROFIT
E1  Net GloBE Income (from Chapter 5.1)        €__________________
E2  SBIE (D3)                                  €__________________
E3  EXCESS PROFIT (MAX(0, E1 - E2))            €__________________

    If E3 = 0: No Top-Up Tax for this jurisdiction.

SECTION F: VERIFICATION CHECKLIST
```

```
□ Correct transition rates applied for fiscal year
□ Average carrying value used (not just closing)
□ Capitalised payroll excluded
□ Intangible assets excluded
□ Location rules applied for mobile employees/assets
□ Investment Entities excluded
```

13. Policy Rationale

Why does SBIE exist?

13.1 The Theory

GloBE targets **excess profits**—income beyond what genuine business operations would generate. The SBIE recognises that:

1. **Employees** represent real economic activity
2. **Tangible assets** represent physical investment
3. A **fixed return** on these factors should be excluded from minimum taxation

13.2 The Formula Logic

Factor	Rate	Justification
Payroll	5-10%	Return on human capital investment
Tangible Assets	5-8%	Return on physical capital investment

The rates approximate a "normal" return on these investments, excluding it from the minimum tax calculation.

13.3 Who Benefits Most?

Business Type	Payroll	Tangible Assets	SBIE Benefit
Manufacturing	Medium	High	**High**
Distribution	High	Medium	**Medium-High**
Retail	High	Medium	**Medium-High**
IP Holding	Low	Low	**Low**
Financial Services	High	Low	**Medium**
Tech (asset-light)	Medium	Low	**Low-Medium**

Practical implication: MNEs with significant manufacturing or distribution operations in low-tax jurisdictions benefit most from SBIE.