
Opinion Statement FC 9/2023 on the EU Commission Proposal on establishing a Head Office Tax system for micro, small and medium sized enterprises and amending Directive 2011/16/EU

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CFE Tax Advisers Europe is the European umbrella association of tax advisers. Founded in 1959, CFE brings together 33 national tax institutes, associations and tax advisers' chambers from 24 European countries. CFE was the initiator of the Global Tax Advisers Platform through which it is associated with more than 600,000 tax advisers worldwide. CFE is part of the EU Transparency Register no. 3543183647-05.

We would be pleased to answer any questions you may have concerning our Opinion Statement. For further information, please contact Bruno Gouthière, Chair of CFE Fiscal Committee, Jos Goubert, Chair of the Direct Taxes Subcommittee, or Aleksandar Ivanovski, Director of Tax Policy at info@taxadviserseurope.org. For further information regarding CFE Tax Advisers Europe please visit our web page <http://www.taxadviserseurope.org/>

1. Background

On 12 September 2023, the European Commission launched a proposal for a directive establishing a head office tax (HOT) system for micro, Small, and Medium-sized Enterprises. The purpose of this directive is to create an option for growing and expanding Small and Medium-sized Enterprises operating cross-border through permanent establishments to apply the tax rules of the Member State of the head office to calculate the taxable result of their permanent establishments in other Member States. By opting in to this system, the local sets of tax rules in the Member State in which the permanent establishment is located would not need to be applied. If the directive is adopted in its proposed form, it would need to be implemented in the national legislation of the Member States by 31 December 2025 and apply as from 1 January 2026.

CFE welcomes the opportunity to contribute through ongoing engagement with the European Commission and European Parliament, in discussions in our role as a Member of the EU expert group, Platform for Tax Good Governance and Aggressive Tax Planning and via the public consultation process.

Given the degree of difficulty in finding a common ground concerning the reform of EU corporate taxation, our response does not necessarily represent the view of each and every Member Organisation of CFE, although reasonable efforts have been made to provide a coherent and representative view of European tax institutes and associations of tax advisers.

2. General Comments

CFE Tax Advisers Europe recommends that the following factors are taken into consideration by the European Commission:

- The Directive establishing a head office tax (HOT) system for micro, Small, and Medium-sized Enterprises is a further action to make it easier for small and medium-sized enterprises to do business in the internal market, as announced in the SME 'Relief Package'. The SME Relief Package, which the Commission adopted, delivers much-needed support for small and medium-sized enterprises to secure cash flow, to simplify and to invest and grow.
- The current systems of business taxation in the EU give rise to a significant degree of complexity. This translates into businesses facing high compliance costs, barriers to cross-border operation, risks of double and/or over-taxation leading to tax uncertainty and, frequently, time-consuming legal disputes. These setbacks constitute a significantly higher burden for Small and Medium-sized Enterprises than they do for large groups of companies.
- If Small and Medium-sized Enterprises wish to operate cross-border, they become taxable in more than one Member State as soon as their activity abroad creates a permanent establishment. Compliance with those obligations comes with fixed costs, which creates a barrier that can prevent Small and Medium-sized Enterprises from

developing their business cross-border. This is especially the case at the inception stage of expansion, when the extent of activities carried out abroad would mainly be ancillary to the primary business operations in the state of origin.

- It is thus important that Small and Medium-sized Enterprises, which envisage growth and expansion across the border, through permanent establishments, can continue to apply the tax rules that they are familiar with to calculate the taxable result of their permanent establishments in other Member States. This will give these Small and Medium-sized Enterprises the opportunity to take the business decision that suits best, either to continue applying different sets of tax rules to their business operations or opt in for the head office taxation rules, after having taken into account the size of the compliance costs and administrative complexity that can arise from dealing with distinct tax rules.
- The directive provides for a simplified approach to subjecting standalone Small and Medium-sized Enterprises operating cross-border in the EU to taxation in respect of their permanent establishments in other Member States. This simplified approach is referred to as 'Head Office Taxation'. The solution is limited to the taxation rules for the computation of the taxable result of permanent establishments and does not touch upon the social security rules applied in the Member State of the permanent establishment, nor does it affect the existing bilateral conventions on the avoidance of double taxation.
- Eligible Small and Medium-sized Enterprises will have the option to calculate the taxable result(s) of their permanent establishments based only on the taxation rules of the Member State of their head office, while the applicable tax rate(s) will remain that/those of the Member State(s) where the permanent establishment(s) is/are located. The option, and its renewal, are however strictly confined by eligibility requirements aimed to address potential risks of circumvention of the rules. Such an option shall last for five years, unless the Head Office changes residence in the meantime or the joint turnover of the permanent establishments becomes at least triple of the head office's turnover, in which case the HOT rules will cease to apply.
- At the end of each five-year period, Small and Medium-sized Enterprises will be entitled to renew their choice for another five years without limit as long as they continue to meet the eligibility requirements.
- The eligibility and termination provisions are designed to discourage abuse and potential tax planning practices, such as the deliberate transfer of the Head Office to a Member State with attractive features in its tax system that ensure low taxation. When a standalone Small and Medium-sized Enterprise decides to set up a subsidiary, or the joint turnover of its permanent establishments becomes at least double of the head office's turnover, or when it ceases to qualify as a Small and Medium-sized Enterprise altogether, it cannot renew the HOT rules when the five-year period expires.
- A one-stop shop will enable in-scope Small and Medium-sized Enterprises to interact only with the tax administration of the Member State of their head office both for the procedure to opt in and for filing obligations and paying taxes. The 'filing entity' for all

permanent establishments will be the head office of the Small and Medium-sized Enterprise. Small and Medium-sized Enterprises will thus file one single tax return with the tax administration of their head office (the 'filing authority'). This tax administration will then transfer the resulting tax revenues to each Member State where the Small and Medium-sized Enterprise maintains a permanent establishment. Such an approach will eliminate the complexities and related costs of having to deal with multiple tax systems and tax administrations.

- The Member State of the head office will apply the rates applicable in the Member State(s) where the Small and Medium-sized Enterprise maintains permanent establishments and subsequently, transfers the resulting tax revenues to the latter.
- Timely and streamlined exchange of information between the concerned tax authorities is provided for, in particular by using the existing framework set up by the directive on administrative cooperation in the field of taxation. Such exchanges shall be tailored so that it answers the needs and the simplification purpose aimed by this directive.
- In relation to audits, appeals, and dispute resolution, each Member State would retain the authority to audit permanent establishments within their jurisdiction. Member States also would be able to request joint audits that obligate the addressed Member State to participate, which would maintain the integrity of the tax audit process.
- Although in the opinion of CFE the aforementioned system of the optional application may create occasional competition distortions due to the varying tax rules for comparable businesses, according to the European Commission the proposed directive seeks to outweigh these risks, and the benefits overall would include significant reductions in tax compliance costs for enterprises availing themselves of the HOT system. CFE recognises that cross-border businesses face high tax compliance costs in the internal market, as they must comply with various legal frameworks. This is particularly the case for Small and Medium-sized Enterprises, for whom these costs are proportionately much higher. Moreover, the existing disparities between Member States could create mismatches that lead to double (non-)taxation.
- The option would be able to be renewed at the end of the five-year period, provided the eligibility requirements are met. Renewal would be permitted without limit, as long as eligibility conditions are satisfied. If a standalone Small and Medium-sized Enterprise opts to establish a subsidiary, the combined turnover of its permanent establishments exceeds twice that of the head office, or it no longer qualifies as a small and medium-sized enterprise, it would be ineligible to renew the application of the HOT rules when the five-year term ends.
- CFE is not opposed to this proposal, because it should bring simplifications for Small and Medium-sized Enterprises and prevent and lower the number of disputes arising over the presence and scale of permanent establishments. This proposal makes it easier for Small and Medium-sized Enterprise to expand abroad.

3. Scope & Implementation

In 2005, the European Commission presented a 'Home State Taxation' system based on the idea of voluntary mutual recognition and acceptance of tax rules by EU Member States. That system was never implemented by the Member States. The proposal for the directive establishing a head office tax (HOT) system for micro, Small, and Medium-sized Enterprises is based on the same ideas and is limited to standalone Small and Medium-sized Enterprises that operate exclusively through permanent establishments in one or more Member State.

As the proposed directive relates to direct taxation, unanimity within the European Council is required given taxation remains an element of the sovereignty of the Member States. CFE would note that in the field of direct taxation proposals can stall at the level of the European Council for many years due to for example a lack of political momentum. Given the speed of proposals being launched on direct taxes, it seems like missing momentum will not be the case. Nevertheless, CFE feels compelled to remark explicitly that the timeframe for further implementation compared with other Council proposals is very short, given the impact for the Member States and the enterprises involved. Also, this directive introduces a lot of legislative adjustments and needs to be more coherent in the broader perspective and we refer to our Opinion Statement on BEFIT to be published in January 2024 as well concerning this point. The administrations of Member States are not able and capable (yet) to complete all launched initiatives on time, often choosing to opt for average implementations with reference to the guidelines, which creates legal uncertainty (also in their rights) for the taxpayers and involved enterprises. That being said:

- CFE recognizes the current systems of business taxation in the EU could give rise to a significant degree of complexity for Small and Medium-sized Enterprises. Therefore, a solution which attempts to lower high compliance costs, barriers to cross-border operations, risks of double and/or over-taxation leading to tax uncertainty and frequently, time-consuming legal disputes, must be supported.
- The proposal is based on article 115 of the Treaty on the Functioning of the EU (TFEU). CFE would note that the justifications from the European Commission in this respect to almost all Council proposals on direct taxes are formulated in the same general manner. CFE also considers that this directive needs to be 'read' from the point of view of the EU's pressure to increase tax revenues. From taxpayers' and Member States' point of view, it is important to maintain a 'balanced allocation of taxing rights' for Member States to guarantee their current tax revenues. If the imbalance in taxing rights would result in an increase in domestic tax rates in the longer term, we view this as an unwanted consequence. Although this directive could be considered in line with EU law, the total initiatives from the European Commission that have been launched could raise questions in this respect.

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- The rules of the proposal aim to approximate the laws, regulations or administrative practices of the Member States as these directly affect the establishment or functioning of the internal market. It shall therefore be adopted under a special legislative procedure in accordance with this article and in the form of a directive. The competence of the Union in this area is shared with the Member States.
- According to the European Commission, in this context, only an EU-wide initiative which provides for simplification can be effective and is the only suitable legal instrument.
- For Small and Medium-sized Enterprises, simplification can only effectively work if, for the purpose of taxing permanent establishments, it is recognised as an extension of the legal personality of the head office and the taxation rules in the origin (headquarters) Member State can be applied for computing the tax base in the Member States of the 'expansion'. In addition, instead of filing in each Member State where a Small and Medium-sized Enterprise has a taxable presence by way of a permanent establishment, Small and Medium-sized Enterprises would be able to comply with all requirements through the head office and only in the Member State of the head office (one-stop-shop). For tax administrations, which currently assess the tax liabilities of the same cross-border businesses separately but each only with their own resources, this is also more efficient.
- This initiative could therefore be in line with the principle of subsidiarity laid down in article 5(3) TFEU, considering that the objectives cannot be sufficiently achieved through individual national action and that a common approach for all Member States would have the highest chances of achieving the intended objectives.
- CFE recognises that the proposal does not prescribe harmonisation of corporate tax systems but only sets out a possibility for Small and Medium-sized Enterprises to use one single set of tax rules (i.e. rules of the Member State of the Head Office) for computing the taxable result in respect of activities performed through a permanent establishment. The system relies on a mutual recognition and acceptance among Member States of each others' taxation rules for Small and Medium-sized Enterprises with permanent establishments. Moreover, such simplification is optional for all eligible Small and Medium-sized Enterprises. The envisaged measures do not go beyond the minimum requirements necessary to facilitate cross-border activities by the Small and Medium-sized Enterprises and thus ensure the proper functioning of the internal market. It is therefore compliant with the principles of proportionality.

4. Burden on Business

- The proposal is aimed at reducing regulatory burdens for both taxpayers and tax administrations. The European Commission will review the situation in the Member States 5 years after the rules of the Directive start to apply and publish a report.

- CFE recognises the nature of the option possibility as the measure that could bring benefits to Small and Medium-sized Enterprises with permanent establishments in (an)other Member State(s). This discretion which is left to the taxpayer should effectively reduce regulatory burdens. Small and medium-sized enterprises are likely to opt in when they can benefit from the simplification that the rules offer. If this is not the case, they will continue to apply the existing rules. In this way, the scope of the proposal ensures that compliance costs for Small and Medium-sized Enterprises are kept at a minimum. Finally, as the proposal is primarily aimed to address the needs for cross-border businesses which have a taxable presence in more than one Member State, many micro-enterprises will, effectively, be out of scope.
- The proposed directive includes rules on the exchange of information. Efficient exchange of information between relevant tax authorities would be facilitated, adhering to the EU directive on administrative cooperation in the field of taxation. This would ensure that the exchange of information would align with the simplification goals of the proposed directive.
- Tax administrations, in particular of the host Member States, should also benefit from the expected decrease in workload, as the filing, assessment and tax collection would be centralised in the head office Member State. This additional workload for the latter would to some extent be compensated by a reduced number of disputes and procedures which currently arise from the application of different sets of rules for the same income or transactions.

5. Conclusions

It is the optionality of the measure that could bring benefits to Small and Medium-sized Enterprises with permanent establishments in (an)other Member State(s). This discretion which is left to the taxpayer should effectively reduce regulatory burdens. Small and Medium-sized Enterprises are likely to opt in when they can benefit from the simplification that the rules offer. If this is not the case, they will continue to apply the existing rules. In this way, the scope of the proposal ensures that compliance costs for Small and Medium-sized Enterprises are kept low. Finally, as the proposal is primarily aimed at addressing the needs for cross-border businesses which have a taxable presence in more than one Member State, many micro-enterprises will, effectively, be out of scope.

The possibility of optionality makes the proposed directive itself in line with the subsidiarity and proportionality requirements according to EU legislation. As the proposed directive relates to direct taxation, unanimity within the European Council is required given taxation remains an element of the sovereignty of the Member States. CFE would note that in the field of direct taxation proposals can stall at the level of the European Council for many years due to for example a lack of political momentum.

Given the speed of launching proposals on direct taxes, it would seem that lack of momentum will not be an issue here. Nevertheless, CFE believes it is compelled to remark explicitly that the timeframe for further implementation, considering other Council proposals, is very short given the impacts on Member States and the enterprises involved. Also, this directive introduces a lot of legislative adjustments and needs to be more coherent in the broader perspective, and we refer to our Opinion Statement BEFIT to be published in January 2024 in this regard. Furthermore, the administrations of Member States are not able and capable (yet) to follow all launched initiatives on time, often instead choosing to opt for average implementations with reference to the guidelines, which creates legal uncertainty (also in their rights) for the taxpayers and enterprises involved.

CFE and its Member Organisations stand ready to assist the Commission in considering the issues above in the course of the policy dialogue and public consultation.