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To:	Delegations
Subject:	OPINION of the European Economic and Social Committee - Proposal for a Council Directive establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU (COM(2023) 528 final - 2023/0320 (CNS))

Delegations will find attached the abovementioned opinion. This opinion is available in all language versions via the following link:

https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/establishing-head-office-tax-system-smes-hot



OPINION

European Economic and Social Committee

Establishing a Head Office Tax system for SMEs (HOT)

Proposal for a Council Directive establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU
[COM(2023) 528 final - 2023/0320 (CNS)]

ECO/632

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Referral	Council of the European Union, 10/11/2023
Legal basis	Articles 115 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	18/12/2023
Adopted at plenary	17/1/2024
Plenary session No	584
Outcome of vote (for/against/abstentions)	222/0/4

1. **Conclusions and recommendations**

1.1 The European Economic and Social Committee (EESC) supports the European Commission's proposal to establish a Head Office Tax (HOT) system for micro, small, and medium-sized enterprises (MSMEs) and its objectives, since they are in line with enhancing MSMEs, simplifying their cross borders activities, and reducing administrative and financial barriers, increasing the overall competitiveness of MSMEs.

1.2 The EESC notes that the adoption of the HOT system proposal will bring high added value to businesses, employees and Member States. SMEs currently account for almost all European Union (EU28) non-financial business sector enterprises (99.8%), two-thirds of total EU28 employment (66.6%), and slightly less than three-fifths (56.8%) of the value added generated by the nonfinancial business sector[1]. The reduction of the administrative burden for MSMEs will bring more competitive advantages to their everyday operations.

1.3 The EESC urges no delays in the adoption of the Commission proposal on the HOT system to enhance MSMEs' growth and promote a level playing field for the participation of MSMEs with cross border operations in the internal market, thus contributing to long-term GDP and employment growth.

1.4 The proposal aims to reduce corporate income tax (CIT) related compliance costs to MSMEs already doing cross-border business through permanent establishments. The EESC shares the Commission's assessment that the introduction of the HOT system will reduce compliance costs to companies already working internationally, reducing barriers and possible saving on tax compliance costs. The proposal could also incentivise other MSMEs to start cross-border operations.

1.5 The proposal also aims to reduce administrative and financial burdens for MSMEs in terms of taxation regulations at the national level. In this respect, EESC calls for the regular assessment of national procedures on computing and paying taxes to reduce regulatory burdens and increase companies' overall competitiveness.

1.6 For the time being, the EESC agrees with the Commission approach limiting the scope of the HOT proposal to standalone MSMEs operating cross-border in one or more Member States exclusively through permanent establishments (PE). At the same time the EESC notes that, in performing the planned ex-post assessment to evaluate the effectiveness of the HOT System for MSMEs five years after entry into force of the Directive, the Commission should consider and evaluate the possibility to extend the HOT system to include SMEs operating cross-border through subsidiaries.

1.7 The EESC notes that the HOT system and BEFIT (Business in Europe: Framework for Income Taxation) proposals are considered complementary by the Commission, since BEFIT is primarily aimed at large groups operating across the EU and will be optional for groups of SMEs with subsidiaries in other member States adopting consolidated accounts.

1.8 At the same time, the EESC observes that the optional nature of the HOT proposal with regard to SME's in general and of the BEFIT proposal with regard to SME groups with consolidated accounts

[1] Tax compliance costs for SMEs. Tax compliance costs for SMEs - Publications Office of the EU (europa.eu).

will create different legal frameworks across the EU for companies in potentially comparable situations. The EESC hence encourages the Commission to monitor the evolution of the new HOT rules and their implications in this respect, since the coexistence of different legal frameworks applicable to comparable players might generate fragmentation and discrepancies, possibly harming the consolidation of the internal market.

1.9 The EESC believes that the HOT system will increase and improve cooperation between tax authorities in Member States. Cooperation between them is key for the successful and meaningful implementation of the proposed HOT system and the achievement of set objectives.

1.10 The EESC is convinced that the proposed timeline for the transposition of the Directive is sufficient to adjust the IT systems of tax authorities in the Member States and ensure the smooth exchange of data among Member States at later stages, encouraging Member States to take swift action in this respect.

1.11 The EESC urges the Commission to work closely with Member States and organisations representing MSMEs after the adoption of the Proposal to raise awareness of the available HOT mechanism between MSMEs to better achieve the objectives of reducing regulatory burdens, increasing cross-border activity and using the advantages of the Single Market to the full. Relevant parties should also dedicate resources to ensure training and methodological support for MSMEs on how to prepare "HOT tax return".

2. Background

2.1 In September 2023, the Commission published the SME Relief Package, including a proposal for a Late Payment Regulation, a proposal for a Directive on tax simplification for SMEs, establishing a Head Office Tax System and a set of measures to improve SMEs' performance, with the emphasis on improving the Better Regulation Agenda, increasing access to finance, upskilling the workforce and other supporting mechanisms.

2.2 The Commission's proposal on Establishing a Head Office Tax System for micro, small and medium-sized enterprises deals with simplified rules in favour of standalone SMEs operating cross-border in the EU, with regard to their permanent establishments[2] (PE) located in other Member States.

2.3 SMEs currently account for almost all European Union (EU-28) non-financial business sector enterprises (99.8%), two-thirds of total EU28 employment (66.6%) and slightly less than three-fifths (56.8%) of the value added generated by the non-financial business sector[3].

2.4 The Commission Proposal's scope of application is limited to standalone SMEs[4] operating cross-border exclusively through PEs in one or more Member States according to the criteria set forth in

2 Permanent establishment means a fixed place of business situated in another Member State, as defined under the relevant bilateral convention on the avoidance of double taxation or, in the absence thereof, in national law.

3 Tax compliance costs for SMEs. Tax compliance costs for SMEs - Publications Office of the EU (europa.eu).

4 For the definition of SMEs, the proposed Directive refers to Directive 2013/34/EU on the annual financial statements, consolidated financial statements, and related reports of certain types of undertakings. Following the definitions of SMEs in that Directive, a company would only be in scope if, on the date of its balance sheet, it does not exceed the limits of at least two of the three following criteria: Balance sheet total: EUR 20 million; Net turnover: EUR 40 million; and/or average number of employees during the financial year: 250.

Article 2 of the Proposal for Directive[5]. On the other hand, subsidiaries are not included in the European Commission proposal and won't be eligible to use the advantages of the HOT system.

2.5 In practical terms, eligible SMEs will be enabled to calculate the taxable results of their PEs based only on the taxation rules of the Member State where their head office is located, while the applicable tax rates will remain that/those of the Member State(s) where the PE(s) is/are actually placed.

2.6 The simplification measures implemented by the HOT proposal, and their possible renewals over time, are strictly limited by specific eligibility requirements[6] aimed at avoiding the risk of taxation rules being circumvented.

2.7 The option made available by the HOT system proposal shall last for five years (Article 7), unless the Head Office residence is changed in the meantime, or the joint turnover of the PEs becomes at least triple the head office's turnover (Article 8). In such cases, the HOT system rules will be no longer applicable.

2.8 At the end of each five-year period, SMEs will be entitled to renew their choice for five additional years without limits, provided they continue to meet the eligibility requirements set forth by the Commission proposal (Article 9). In case a standalone SME decides to set up a subsidiary, or the joint turnover of its PEs becomes at least double the head office's turnover, or when it ceases to qualify as an SME altogether, it cannot renew the HOT system rules when the five-year period expires (Article 10).

2.9 From an organisational standpoint, a one-stop shop will enable the SMEs to interact only with the tax administration of the Member State of their head office for both the procedure to opt in, as well as for filing obligations and paying taxes.

2.10 More specifically, the "filing entity" for all PEs will be the head office of the SME, which will hence file one single tax return with the tax administration of their head office (the "filing authority" – Article 11). This tax administration will apply the tax rates applicable in the Member State(s) where

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5 According to Article 2, "this Directive applies to SMEs which fulfil the following criteria:

(a) they are established under the law of a Member State and take one of the forms listed in Annexes I and II;

(b) they are resident for tax purposes in a Member State in accordance with the tax laws of that Member State, including its bilateral conventions for the avoidance of double taxation;

(c) they are subject, directly or at the level of their owners, to a tax on profits listed in Annexes III and IV, or to any other tax with similar characteristics;

(d) they qualify as micro, small and medium-sized (SMEs), as defined in Directive2013/34/EU;

(e) they operate in other Member States exclusively through one or more permanent establishments;

(f) they are not part of a consolidated group for financial accounting purposes in accordance with Directive 2013/34/EU and constitute an autonomous enterprise that fulfils either of the following conditions:

– it is not an associated enterprise within the meaning of Article 2(13) of Directive 2013/34/EU;

– it is not a linked enterprise within the meaning of Article 3(3) of Commission Recommendation 2003/361/EC.

6 The head office may opt to apply the head office taxation rules in respect of its permanent establishment(s) in other Member States if it meets the following requirements:

(a) the joint turnover of its permanent establishments did not exceed, for the last two fiscal years, an amount equal to double the turnover generated by the head office;

(b) it has been resident for tax purposes in the head office Member State during the last two fiscal years;

(c) it has met the conditions laid down in Article 2(1), point d) for the last two fiscal years".

the SME maintains PEs and subsequently transfer the resulting tax revenues to each Member State where the SME maintains a PE (Article 12).

2.11 A timely and streamlined exchange of information between the several national tax authorities concerned, including joint audits, is included in the proposal, in particular by using the existing framework set up by the Directive on Administrative Cooperation (DAC) in the field of taxation (Article 13).

3. General comments

3.1 The EESC supports the Commission proposal and its objectives, since they are in line with supporting MSMEs, simplifying their cross-border activities and reducing the administrative and financial burden, increasing the overall competitiveness of MSMEs. The importance of reducing compliance costs for MSMEs pursued by the HOT system proposal has been highlighted in several previous opinions of the EESC.

3.2 The EESC notes that, according to the Commission's estimates, SMEs spend approximately 2.5% of their turnover on compliance with their tax obligations, while large enterprises spend 0.7% since it is proportionally more difficult for SMEs to deal with different sets of tax rules across the Member States. The EESC hence urges the swift approval of the HOT system proposal to support MSMEs in reducing the burden of compliance costs and the related competitive disadvantage faced by small and especially micro-enterprises compared to large enterprises.

3.3 At the same time, the EESC would like to encourage individual Member States to regularly assess procedures for computing and paying taxes and make the necessary improvements to reduce the administrative and financial burden on businesses. The EESC notes that there are differences between Member States when it comes to the length (time spent) of computing and paying taxes. The HOT system proposal could have a positive impact on the harmonisation of taxation procedures and digitalisation.

3.4 The EESC agrees with the Commission that an EU Directive is better suited than a plurality of national legislative initiatives to simplify to the taxation of MSMEs with cross-border activities and the interlinked compliance costs. Such problems are common to all Member States and cannot effectively be addressed by several national actions, which would lead to fragmentation and discrepancies. In this respect, the Commission proposal is fully in line with the subsidiarity principle and it seems able to simplify the regulatory framework in favour of MSMEs.

3.5 The Commission proposal also respects the proportionality principle, since it does not go beyond what is necessary to facilitate cross-border activities by the MSMEs, thereby contributing to the consolidation of the Single Market. As to this matter, it is worth noting that the proposed measures only concern the computation of the taxable results of permanent establishments, without harmonising the taxation rules in the Member States which will keep on applying their own tax bases and rates.

4. **Specific comments**

4.1 The EESC deems the eligibility and termination provisions provided for by Articles 4 and 8 of the Directive proposal as duly designed to discourage potential tax planning practices aimed at strategically deliberating the transfer of the Head Office to a low(er)-tax country.

4.2 The EESC concurs that the period of 5 years established for the duration of the first opting in within the HOT system framework and for its possible renewals over time seems reasonable in order to give stability and effectiveness to the new rules, while at the same time preventing tax planning and allowing the evolution and growth of a given enterprise to be assessed over time in order to allow MSMEs to choose the most appropriate taxation options.

4.3 The EESC believes that the HOT system proposal will ensure long-term added value for the Member States, unlike a short-term increase of adjustment costs to update tax authorities' IT systems. Systems for the exchange of information between tax authorities such as the DAC are already in place and they are widely used. The EESC is convinced that good cooperation between tax authorities is needed for the successful implementation of the Proposal.

4.4 The EESC also agrees with the Commission on the expected positive impact of the potential increase of tax base, GDP growth, and employment in Member States after the implementation of an optimal HOT System for MSMEs.

4.5 However, the EESC deems that the collection of more specific data within the impact assessment analysis carried out by the Commission would have certainly improved the proposal by better singling out the quantitative aspects of the expected benefits.

4.6 The EESC encourages the Commission to carefully evaluate the application of the Directive five years after its entry into force considering possible adaptation if deemed fit as envisaged by Article 19 of the Proposal for a Directive. The Member States' collaboration to provide useful information is crucial in this respect.

4.7 The constant monitoring regarding the effectiveness and efficiency of the HOT system proposal set forth by the Commission will certainly prove useful. All the considered evaluation parameters devised by the Commission seem relevant[7]. The EESC recommends particular attention with regard to compliance costs for MSMEs opting into the HOT scheme relative to: i) their turnover and ii) relative to comparable MSMEs that do not apply the proposed simplification. Such aspects will be key to understanding the actual benefit for MSMEs in simplification terms and to assessing the usefulness of the new HOT system framework for additional companies eligible to opt in.

4.8 The EESC suggests that, in performing the planned ex-post assessment to evaluate the effectiveness of the HOT System for MSMEs five years after entry into force of the Directive, the Commission should

[7] Art. 19, par. 2: "Member States shall communicate to the Commission relevant information for the evaluation of the Directive, in accordance with paragraph 3, including aggregated data regarding the number of eligible SMEs compared to SMEs that opted in, their turnover and compliance costs relative to turnover; data on the number of SMEs that expanded cross-border by setting up a permanent establishment and the number of SMEs that disqualified due to creating a subsidiary, or the compliance costs for SMEs that apply the option".

consider and evaluate the possibility to extend the HOT system to include SMEs operating cross-border through subsidiaries.

4.9 The EESC notes that the HOT system and BEFIT proposals are considered complementary by the Commission since BEFIT is primarily aimed at large groups operating across the EU and will be optional for groups of SMEs with subsidiaries in other Member States adopting consolidated accounts. According to the Commission, the "HOT proposal simplifies rules for SMEs during their early stages of expansion. If SMEs successfully expand and grow, they may outgrow the scope of the HOT rules, but then they will be able to opt into BEFIT".

4.10 The EESC observes that the optional nature of both the HOT proposal and BEFIT proposal with regard to SME groups with consolidated accounts will result in different tax rules for companies in otherwise comparable situations both across the EU and within Member States, encouraging the Commission to monitor the evolution of the new HOT rules and their implications in this respect. The coexistence of different legal frameworks applicable to comparable players might indeed generate fragmentation and discrepancies, possibly harming the consolidation of the internal market.

4.11 The EESC underlines the importance of adequately promoting and making known to SMEs across Member States the added value in terms of simplification and reduction of compliance costs of the HOT system legislative proposal favour MSMEs operating cross-border, given that the actual benefits of such an initiative might be unclear or even unknown to several undertakings. Thus, the possibility of opting into the HOT system measures could become more widespread and accessible, reducing the risk of distorted competition, and enhancing the chances of further consolidating the Single Market.

4.12 The EESC urges the Commission to work closely with Member States and organisations representing SMEs after the adoption of the Proposal to raise awareness, among MSMEs, regarding the available HOT mechanism to enhance its use and benefits across the EU. Relevant parties should also dedicate resources to ensure training and methodological support for MSMEs on how to prepare "HOT tax return". This also includes support to increase MSME's digital literacy.

Brussels, 17 January 2024.

Oliver RÖPKE
President of the European Economic and Social Committee