

Mr. Paolo Gentiloni
European Commissioner for
economy and taxation
European Commission
Rue de la Loi 200, 1049 Brussels,
Belgium
Submitted online

Brussels, 17 November 2023

Subject: Accountancy Europe's feedback on Head Office Tax System for SMEs ("HOT") proposal

Dear Commissioner,

Accountancy Europe is pleased to provide its views on the [proposal](#) for a Council Directive for a Head Office Tax System for SMEs ("HOT").

We welcome any initiative to cut administrative burden and encourage SMEs to engage in cross-border trade. HOT will not significantly reduce the requirements for those SMEs looking to set up branches in other Member States, such as the need to appoint a local advisor or accountant to make appropriate registrations, obtain business licenses etc. However, we believe that it will remove some of the tax administration burdens of engaging in cross-border trade.

In particular, we welcome that:

1. if a business opts to use it, HOT will remain in force for 5 years (unless certain thresholds are breached), which will reduce the ongoing administrative effort in applying the system
2. the taxable base of the permanent establishments in Host Member States will be that of the Head Office Member State, which will reduce the costs of dealing with the rules and computations of a different tax base
3. the provision for making a single return (and payment of tax) to the tax authority of the Head Office Member State will simplify the process of filing tax returns and alleviate the issues of dealing with a different tax authority using different processes and potentially a different language.

We are also pleased to observe that this proposal would most probably not lead to significant abuse, or a race to the bottom by Members States of tax rates or tax base. This is because of the following features:

- the tax liability of the Host Member States will be calculated using the Host's applicable rate of tax
- the proposed Directive contains anti-avoidance measures to limit the possibility of moving significant income from the Head Office jurisdiction to those of the permanent establishment(s)
- the risk of abuse is further reduced by the provision that a Host Member State can request a joint audit with the Head Office Member State if it believes that the taxable income due in its jurisdiction has not been correctly reported.

We have some suggestions that we believe would make the proposal clearer and more effective:

1. Article 2 1. (e) states that to be able to apply for Head Office treatment the SME “operates’ “in other Member States **exclusively** through one or more permanent establishments.” We understand that this is meant to exclude operating in a Host Member State via a separate legal entity and which is thereby subject to income tax on its taxable results in the Host Member State.
2. **Proposed solution: We would recommend that this be clearly stated in the preamble.**
3. The current scope in Article 2 1. (e) is very narrow and will restrict the usefulness of the system to a relatively small number of SMEs engaged in intra-EU cross border trade. Although an SME group could use the proposed BEFIT system, this would be far too complex for most SMEs.
4. **Proposed solution: We would recommend that the scope of HOT be increased to also include SME groups that have subsidiaries in other Member States.**
5. Article 6 1. states that SMEs must notify the filing authority at least three months prior to the end of the fiscal year in which the SME wishes to start applying the system. This means that if an SME opens its first branch in another Member State in the middle of the year it will have to submit at least one set of tax returns using the current national procedures. This would greatly limit the advantage of HOT as an incentive to start cross-border trade, especially as such SMEs are more likely to have less experience in dealing with other Member States’ tax rules and tax authorities.

Proposed solution: The application procedure in the draft Directive should be amended to make it possible for SMEs to use the system during the year when they establish their first branch in another Member State. As SMEs have normally at least six months from the end of a fiscal year to file their annual financial statements and associated tax returns, it should be possible to include a mechanism that allows, for example, the SME to apply to use HOT for up to 3 months after the end of the fiscal year for which they set up their first branch\PE in another Member State.

6. There is a lack of harmonisation amongst Member States of what constitutes a permanent establishment. The rules for defining what constitutes a permanent establishment for direct tax purposes and a fixed establishment for VAT purposes are not the same. Additionally, SMEs that wish to engage in cross-border trade must deal with the issue of different interpretations of what constitutes a fixed establishment for VAT purposes between Member States. This can cause considerable problems for all businesses, and for SMEs in particular.

These problems have been recognised in respect of VAT and efforts have been made to alleviate them. In Council Directive (EU) 2020/485 of 18 February 2018, SMEs established in a Member State will, as from 1 January 2025, subject to conditions, be able to take advantage of an EU-wide VAT exemption threshold to reduce obligations to register for VAT in member states other than that of the business’ establishment. The definition of ‘establishment’ for the purposes of this directive is to be determined by the rules as set down in EU Implementing Regulation 282/2011. However, the divergences of what constitutes a ‘fixed establishment’ and a ‘permanent establishment’ remain.

Proposed solution: whilst it would be outside the scope of this proposed Directive to deal with this problem in a comprehensive manner, it would be most beneficial if the definition of ‘permanent establishment’ in Article 3 (1) provided more clarity and gave less scope for Member States to use the definition enshrined in national law.

As SMEs can face prolonged legal challenges from Host tax authorities as to whether a presence constitutes a genuine permanent establishment. Therefore, we propose that as part of the application process, the Head Office tax authority obtains confirmation from the Host tax authority that the establishment in the Host Member State constitutes a Permanent Establishment for treaty purposes.

However, in the longer term, it would be a considerable simplification for SMEs (with a commensurate reduction in administrative costs) for the EU to have a single definition of 'permanent establishment' that covers both direct and indirect taxes. Such a definition would, of course, have to be compatible with any international treaty obligations that the EU and Member States are subject to.

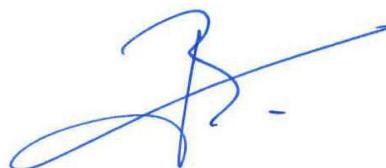
Additionally, harmonising across the EU the statute of limitations and tax administrative processes would provide a major increase in tax certainty and business confidence when contemplating intra-EU cross-border trade.

7. Although the use of the host country's tax rate to calculate the tax due for the branch reduces the possibility of abusive tax planning, we can still envisage challenges by the tax authorities in the host jurisdiction where the tax calculated is lower than it would have been if the host tax base rules had been used. Such challenges would be costly for both the SME and the relevant tax authorities and many of the potential remedies are too costly and complex for SMEs to use.
8. **Proposed solution: we recommend that Article 13 2. be amended to mandate that joint audits are required when either the head office Member State or the host Member State commence a tax audit of the returns of an SME using the system. This would reduce the possibility of SMEs using the system facing double taxation and should streamline the audit process.**

Sincerely,



Mark Vaessen
President



Olivier Boutellis-Taft
Chief Executive

About Accountancy Europe

Accountancy Europe unites 50 professional organisations from 35 countries that represent close to 1 million professional accountants, auditors and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond.

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