

EU directive proposal laying down rules on Head Office Tax for SMEs (HOT)

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UEL response to the EU public consultation

The EU Commission released in September 2023 a proposal for a directive laying down rules on Head Office Tax for SMEs (hereafter “HOT” and / or the “Proposal”). The aim of this directive is to provide to SMEs an optional set of rules for computing the tax result of a permanent establishment (hereafter “PE”) based on the HOT system. In addition, this initiative foresees a centralised one-stop-shop for filing and collecting tax. Nevertheless, the determination of the tax rate applied to a PE will remain within the full competence of the Member State (hereafter “MS”) where the PE is located.

This HOT initiative thus aims to reduce compliance costs and eliminate the complexities for SMEs to deal with multiple tax systems and tax administrations within the EU without significantly impacting the amount of revenue owed to each MS where a business has presence.

UEL, and the Luxembourg business sectors it represents, generally support any EU Commission’s initiative to provide a fair, flourishing, and sustainable business environment within the EU, including any initiative that:

- reduces the tax compliance administrative burden;
- simplifies the operations across the Single Market for businesses; and
- facilitates cross-border activity for EU resident companies.

We therefore support the goal pursued through the HOT proposal to address the tax complexity deriving from the undertaking of cross-border activities within the EU for SMEs. Indeed, the complexity of the tax landscape and the administrative burden are among the main obstacles faced by SMEs willing to expand their business abroad.

The EU Commission mentioned that the HOT system could reduce SMEs’ current tax compliance costs by 32%.

However, we believe that the HOT proposal may not reach its goals of simplifying the tax environment and reducing compliance costs within the EU for SMEs, considering its current features and its quite narrow scope, as further explained below. Although this proposal would be a good starting point, further work and amendments would be required to create an efficient, coherent, and competitive framework for SMEs within the EU.

This position is also shared to some extent by the Committee on Economic and Monetary Affairs of the EU Parliament which recently stated in its draft report¹ on the HOT proposal that some changes are needed to “increase the ambition of the proposal while safeguarding the feasibility of this new system.”

¹ European Parliament, Committee on Economic and Monetary Affairs, [Draft report](#) on the proposal for a Council directive establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU, 17.11.2023

Therefore, we would like to stress the following points in relation to the HOT initiative:

Need to provide advance legal certainty regarding the existence of a PE

In practice, one of the first complexity that SMEs are facing while developing their business abroad at an early stage (and before deciding to set-up a subsidiary in another country) is determining whether they have a taxable presence qualifying as a PE in the concerned country.

However, the HOT initiative does not foresee to provide legal certainty to SMEs on this key aspect. Therefore, it would have been useful to embed a legal framework into the HOT initiative to provide SMEs with advance certainty on questions linked to the existence of a PE in the host MS. This could be done, for example, by building on the existing framework developed by the EU Commission in the ETACA program² and/or by offering them one single point of contact in the head office MS.

Need to maximise upfront the administrative simplification

One of the eligibility criteria foreseen in the Proposal entails to refer to the maximum turnover of the PEs during the last two fiscal years³. As a result, we understand that an SME with PEs in other MS will de facto be able to benefit from the HOT proposal only as from the third year of existence of the said PEs.

If our understanding is correct, we fear that such a condition would undermine the very goal of the Proposal. Indeed, the main complexity and administrative burden for SMEs expanding their business abroad results first from the determination of the existence of a PE and then from the fulfillment of the various foreign tax formalities and compliance deriving from having a PE. Once such an analysis is performed and the process is up and running, the on-going administrative burden and respective costs are expected to be lower. Therefore, if this reading of the HOT rules is confirmed, the potential reduction of the tax compliance burden through the HOT proposal would be fairly limited.

Therefore, we believe that SMEs should be allowed to benefit from the HOT rules already as from the first year of existence of the PEs to reduce efficiently compliance costs and administrative burden for taxpayers. In that context, the eligibility criteria should be adjusted accordingly. This would also be in line with the draft consultative opinion of the EU Parliament⁴ which suggested to simply remove the condition stating that “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”.

Furthermore, we believe that SMEs should be allowed to opt for the HOT regime until at least the end of the tax year for which they wish to apply the HOT rules to provide increased flexibility, as opposed to 3 months before the end of the preceding year (as currently foreseen in the Proposal). Such additional flexibility would allow many more SMEs to benefit from the HOT initiative and would take into consideration the fact that whether a business activity will lead to the recognition of a PE is not necessarily known in advance. In this respect, we therefore support the draft consultative opinion of the EU Parliament regarding the need to “shortens the deadlines for applications from SMEs and for national authorities to exchange information, guaranteeing a quicker and more efficient system of applications”.

² See suggestion [of the TP directive in p. 6](#)

³ See article 4 (a) of the HOT proposal

⁴ See note 1

Need to enlarge the scope of eligible SMEs

The HOT initiative currently foresees a certain number of conditions to be met for SMEs to benefit from this new regime. We fear that these conditions might significantly narrow down the number of eligible SMEs in practice.

For example, the benefit of the current HOT initiative is limited to head offices with cross-border activities through at least one PE, thus excluding any SME having even one subsidiary abroad. However, an SME may have a subsidiary in another MS for historical reasons (for example, family businesses organised through a holding company in another MS) or local legal requirements, while still needing some support to expand its business abroad at an early stage. Hence, the scope could be broadened to groups having one or several subsidiaries under certain conditions (for example, for groups which do not exceed the SMEs' group thresholds based on article 3 of the Directive 2013/34/EU⁵ or for groups having a total balance sheet below a certain threshold).

Consequently, we believe that the various eligibility criterion should be further adjusted and enlarged to ensure that the scope of the Proposal is better targeted and enlarged to most EU SMEs. In that respect, it would be useful to perform a more detailed assessment of the number of SMEs which could possibly benefit from the new rules and enlarge the scope accordingly.

Furthermore, we support the need for the Commission to perform a detailed examination and evaluation of the functioning of the Proposal after the first few years of implementation, as foreseen by article 19. This review would guarantee that the Proposal's scope is carefully crafted to achieve its goal of lowering compliance costs for SMEs in the EU and easing the cross-border expansion of their businesses. In addition, we suggest that the review is done already after 3 years (instead of 5 years) and that it is accompanied by precise proposals to further amend the text, where needed.

Envisage to broaden the scope to other tax and legal requirements

The scope of the HOT initiative is currently limited to corporate taxation. Nevertheless, SMEs often face other obstacles to expand their business on a cross-border basis, such as various local legal obligations, administrative formalities (e.g., business permit) and other tax requirements (i.e., VAT and payroll taxes).

As the current HOT initiative aims to implement a one-stop-shop approach for the concerned SMEs, it would therefore be useful to determine whether widening the scope of the one-stop-shop to other local legal, regulatory and tax requirements could be contemplated. Such one-stop-shop may indeed offer one single point of contact among MS to help taxpayers in their various formalities starting as from the setting-up of the PE (and including the determination of whether they have a taxable presence qualifying as a PE in the concerned country, as mentioned above).

Otherwise, we fear that the potential reduction of the compliance burden through the HOT proposal would be fairly limited (i.e., only corporate tax returns) given the number of other remaining legal, regulatory and tax obligations faced by SMEs developing their activities through PEs within the EU that would have to be fulfilled locally.

⁵ [Directive 2013/34/EU](#) of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EE

Need to ensure support in digitalisation and automation of MS

Given that this Proposal largely relies on the interaction between competent authorities in the EU, it may be useful to test the rules in a pilot mode first. This would allow to draw the benefits and address the difficulties that will come up for businesses and tax administrations before finalising the Proposal.

Besides, the successful implementation of such Proposal is mainly based on the capacity of MS to properly treat the requests for option and the respective tax returns and tax assessments of the SMEs in a timely manner.

Therefore, it is key that the EU Commission invests in a digitalised and centralised platform as well as in solutions that would offer standardised reporting requirements between MS. It would also be useful in this area to leverage on the EU VAT digitalisation process. This would help ensuring a smoother implementation of the Proposal at EU level, especially for smaller countries for which such reporting process might be more difficult to implement due to more limited capacity.

Need to define an accelerated and binding procedure for disputes resolution between MS

We fear that the current Proposal will increase the risk of disputes in relation to the attribution of the profits to PEs since even if the host MS will initially be bound by the rules of the head office MS, it will then have the possibility to contest the tax assessment made (according to article 11 of the Proposal).

However, the Proposal does not foresee a specific procedure to resolve possible disputes between MS in relation to the attribution of profits to the PE. Indeed, we understand that any dispute between the head office MS and the host MS will have to follow the rules sets by double tax treaties or by the Directive on dispute resolutions.

Therefore, we believe essential that this HOT initiative foresees an accelerated, binding, and clear procedure to solve disputes between MS regarding the attribution of profits to PEs. This procedure could also include the resolution of conflicts deriving from the recognition of a PE.

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About UEL:

UEL (Union des Entreprises Luxembourgeoises) is the Luxembourg Employers' Association. UEL represents the Luxembourg private-sector businesses, except for the primary sector, and includes the Grand Duchy's professional chambers and employer federations.

UEL works for a sustainable and prosperous economy for Luxembourg, its inhabitants and those who work there. It endeavors to provide an economy that is attractive to both investors and talented individuals.

To accomplish its mission, UEL facilitates working groups and discussions with its member organisations on major inter-branch topics. It is thereby able to present joint positions to the public authorities and social partners on these topics which they can then review together.

The initiatives launched by UEL are based on the values of the social market economy, sustainable development, business ethics, good governance and dialogue.