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PROPOSAL

From:	Secretary-General of the European Commission, signed by Ms Martine DEPREZ, Director
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To:	Ms Thérèse BLANCHET, Secretary-General of the Council of the European Union
No. Cion doc.:	SWD(2023) 303 final
Subject:	COMMISSION STAFF WORKING DOCUMENT EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT Accompanying the document Proposal for a Council Directive establishing a Head Office Tax system for small and medium-sized enterprises, and amending Directive 2011/16/EU

Delegations will find attached document SWD(2023) 303 final.

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COMMISSION STAFF WORKING DOCUMENT
EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT

Accompanying the document

Proposal for a Council Directive

**establishing a Head Office Tax system for small and medium-sized enterprises,
and amending Directive 2011/16/EU**

{COM(2023) 528 final} - {SEC(2023) 308 final} - {SWD(2023) 301 final} -
{SWD(2023) 302 final}

Executive Summary
Impact assessment report accompanying 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
A. Need for Action
What is the problem and why is it a problem at EU level?
<p>As the EU celebrates 30 years of the internal market, businesses are still faced with different national corporate income tax systems. Beyond tax rates and incentives, each national system has divergent features. Businesses operating across the EU are faced with different sets of national tax obligations as soon as they expand and become taxable in another Member State.</p> <p>Such tax complexity has consequences for micro, small and medium-sized enterprises (SMEs) that operate or wish to operate across borders in the internal market. Compliance with new tax obligations comes with fixed costs and therefore creates a higher burden for SMEs with less resources. This can represent a barrier for SMEs to expand their activities abroad and takes particular relevance in the inception stage of expansion, when activities abroad are still ancillary to the primary business operations in the state of origin. Due to this complexity, SMEs face an uneven level playing field compared to larger cross-border businesses and purely domestic companies, when they enter new markets.</p> <p>These issues are particularly important at EU level because the EU has a highly integrated internal market. While in many other areas, there is significant progress in EU law to ensure that businesses can operate in the internal market under common standards, disparate corporate tax requirements remain an obstacle. In an increasingly digitalised and integrated European economy, where many businesses are active across borders, the internal market cannot achieve its full potential without addressing these problems at EU level.</p>
What should be achieved?
<p>The general objectives of the initiative are: (i) to ensure the good functioning of the internal market; and (ii) to stimulate growth and investment in the EU. To achieve such general objectives, the following specific objectives should be attained: (i) reduce tax compliance costs for SMEs with a taxable presence abroad; (ii) to encourage cross-border expansion of SMEs; and (iii) to ensure a level playing field for the participation of SMEs in the internal market.</p>
What is the value added of action at the EU level (subsidiarity)?
<p>The problems that the initiative will address are common to all Member States and cannot be effectively addressed by disparate actions at national level. As the problems result from the fragmentation and diversity of national systems, national uncoordinated measures might have undesirable implications, by adding further complexity. In this context, only an EU-wide initiative providing for a common set of rules would be effective. Since the problems are primarily of a cross-border nature, they can only be tackled by laying down legislation at EU level. This initiative, when undertaken through EU law, therefore includes elements which add value in line with the subsidiarity principle. A common approach for all Member States would have the highest chances of achieving the intended objectives.</p>
B. Solutions
What are the various options to achieve the objectives? Is there a preferred option or not? If not, why?
<p>The objectives can be achieved through an initiative designed for SMEs in the form of a Directive that provides tax simplification for SMEs with limited presence in other Member States. This initiative is analysed in the impact assessment report.</p> <p>The initiative is addressed to SMEs which have a taxable presence in one or more Member States, in the form of one or more permanent establishment (PE) or subsidiary. It is aimed to provide simplification to calculate the tax liability of such PEs or subsidiaries and to comply with the administrative requirements. This is achieved by giving eligible SMEs the possibility of computing the taxable base of their permanent establishments or subsidiaries in other</p>

Member States in accordance with the tax rules of the head office, or the 'Head Office Taxation' ('HOT') rules. The report assesses two options for this approach. The system would be the same under both options, but the scope differs. **Option 1** would only include standalone SMEs with permanent establishments in other Member States. **Option 2** would also cover SMEs with subsidiaries in other Member States. The second option would in other words also cover groups of companies that are SMEs, or SME groups.

The preferred option is option 1. The option is most targeted to supporting SMEs in their initial phase of international activity, to encouraging SMEs to start going abroad, by continuing to apply the tax rules with which they are already familiar. The impact assessment concludes that this option is therefore both effective and efficient in achieving the specific objectives of the initiative, while also remaining proportionate with the potential costs of implementation and the tax sovereignty of Member States over their resident taxpayers. The option also appears most coherent with other EU policies, considering that the Commission announced an initiative specifically designed to provide simplification for the tax base of groups of companies.

C. Impacts of the preferred option

What are the benefits of the preferred option?

Under the preferred option, less SMEs may be eligible to opt in, but (under both options) the exact number of SMEs that will opt in and apply the HOT rules is unknown, as the simplification introduced by the initiative will be fully optional. To estimate the benefits for SMEs, the impact assessment thus provides a possible range with low- and high-end estimates (covering both options). Accordingly, it is estimated that the availability of the simplification has the **potential to reduce current tax compliance costs for SMEs** by between EUR 1.3 (low-end) and 3.4 billion (high-end) yearly. The low-end assumes, as an illustrative example, that the initiative reduces CIT compliance costs by 16% and that 5% of domestic SMEs will start operating cross-border, while the high-end estimate is calculated under the assumption that the initiative reduces CIT compliance costs by 32% and that 10% of domestic SMEs will start operating cross-border.

Taking the same low- and high-end assumptions on domestic SMEs crossing borders (5% and 10%), the impact assessment also estimates the **potential increase of GDP and tax revenues in the EU**. This macro-economic impact is calculated under the assumption that, as explained in the report, businesses experience a productivity boost as a result of competing across borders, assumed at 4% for the low-end estimate and at 15% for the high-end estimate. Accordingly, the sensitivity analysis yields an EU GDP increase of between EUR 19 billion (i.e., +0.08%) and EUR 61 billion (i.e., +0.7%) per year, and between +0.12% and +1% tax revenue increase in the EU in the long term, relative to the status quo. Alternative scenarios are possible under different assumptions.

The impact assessment also outlines potential benefits for tax administrations.

What are the costs of the preferred option?

Costs cannot be estimated with any precision because the initiative does not have a precedent that we can refer to. Furthermore, there is no dedicated data that one can reliably use to produce very concrete estimates. The impact assessment report attempts to describe some of the possible costs.

Opting-in SMEs will be able to apply tax rules that they are already familiar with and to deal with all their tax obligations in one place (one-stop-shop). As such, SMEs will file a new tax return, the 'HOT' tax return, and tax administrations must implement a system for filing and exchanging the returns and for assessing, collecting and transferring taxes of the head office's permanent establishments abroad. This should involve an adjustment and administrative cost for SMEs and tax administrations which is substantially lower than the benefits, as explained in the report. In total, estimated costs for all SMEs opting into the HOT system range between an initial EUR 332 million plus annually EUR 60 million (low-end) and an initial EUR 428 million plus annually EUR 78 million (high-end). The total cost for all tax administrations to

implement the preferred option across the EU is estimated at about an initial EUR 20 million plus annually EUR 4 million.

What are the impacts on SMEs and competitiveness?

SMEs: Standalone SME entities with permanent establishments (but not subsidiaries) in one or more Member State will be entitled to apply the simplification rules, which will effectively mean that they can expand abroad and still compute their tax base in accordance with their own national rules. SME groups (i.e., with subsidiaries) would be covered by another initiative, with the possibility to opt in provided that they file consolidated financial accounting statements. As such, SMEs would be supported both in their early stages of cross-border development and when they stabilise or further expand their cross-border activities. Considering that the rules will remain optional for SMEs, we do not estimate adverse effects. Rather, SMEs will enjoy the benefit of choosing the simplest and most cost-efficient solution based on their individual needs.

Competitiveness: The initiative is expected to have a positive impact on cost and price competitiveness. The HOT rules can reduce compliance costs for SMEs operating in all sectors of the internal market and support SMEs in order to fully participate in the internal market. The initiative facilitates increased cross-border activity and improves the international competitiveness of EU businesses.

Will there be other significant impacts?

The impact assessment also considered whether the initiative may have environmental or social impacts, or an impact on fundamental rights. No particular and direct environmental impact is expected. It is also not expected that there would be a significant social impact, although freed resources may positively influence employment. The initiative should also not have an effect on fundamental rights, which are guaranteed, and personal data will be protected.

Proportionality?

The preferred option does not go beyond what is necessary to achieve the objectives and focuses on elements where the added value of EU action goes beyond what can be achieved by Member States alone.

D. Follow up

When will the policy be reviewed?

An evaluation of the initiative should assess the extent to which the outlined objectives have been met and will take place **five years after the Directive starts to apply**. It will also analyse the extent to which the expected simplifications for the targeted stakeholders have materialised and assess the related administrative and regulatory burden. The Commission will present the evaluation results in the form of a report. The proposal will include a review clause allowing the Commission to amend the Directive according to the results of the evaluation.