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**COMMISSION STAFF WORKING DOCUMENT**

**IMPACT ASSESSMENT REPORT**

*Accompanying the document*

**Proposal for a COUNCIL DIRECTIVE**

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

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## 1. INTRODUCTION: POLITICAL AND LEGAL CONTEXT

This initiative aims to reduce tax complexity and its consequences faced by micro, small and medium-sized enterprises (SMEs)<sup>1</sup> in the EU. Its rationale is closely linked to the importance of SMEs for the internal market. SMEs have been the backbone of Europe's long history of economic development and innovation,<sup>2</sup> as European SMEs represent a very large share of all businesses and provide two thirds of jobs in the EU.<sup>3</sup> In the 2022 State of the Union Address, Commission President Ursula von der Leyen acknowledged the importance of making it easier for SMEs to do business in the internal market and announced an "SME Relief Package",<sup>4</sup> saying that, "*We must remove the obstacles that still hold our small companies back*".

In this context, one of the actions linked to the "SME Relief Package" is a proposal for a Council Directive aimed at facilitating SMEs to expand abroad and fully participate in the internal market through simplification in the area of taxation. The related ongoing initiatives are the replacement of the existing Late Payment Directive<sup>5</sup> with a regulation introducing binding maximum payment terms, the implementation reports of the Single Digital Gateway<sup>6</sup> and the Platforms to Business Regulation<sup>7</sup>, among others.

In the field of taxation, the initiative assessed here builds on the vision set by the Commission in its 2021 Communication "Business Taxation for the 21st Century",<sup>8</sup> which in the face of current challenges and future mega-trends puts forward the twin priorities for business taxation: i) enabling fair and sustainable growth, including by supporting wider EU policies such as the European Green Deal, the Commission's digital agenda, the New Industrial Strategy for Europe and the Capital Markets Union, and in line with the principles of the European Pillar of Social Rights; and ii) ensuring the effective collection of tax revenue which is vital to fund quality public services and is a precondition for a fair sharing of the tax burden between taxpayers. On SMEs, the Communication indicates that reducing compliance costs for businesses, facilitating cross-border investment, and providing the right environment for SMEs and larger enterprises alike is important for SMEs to thrive in a green and digital Europe. The initiative complements another proposal put forward in that Communication: a new framework for income taxation for businesses in Europe

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<sup>1</sup> As defined in Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. SMEs are defined at group level, not at entity level, meaning that when a company is part of a group, it cannot be considered an SME in itself. The thresholds should be calculated at group level.

<sup>2</sup> Productivity in SMEs and large firms, OECD, 2021, <https://www.oecd-ilibrary.org/sites/54337c24-en/index.html?itemId=/content/component/54337c24-en>.

<sup>3</sup> SME Performance Review 2023, [https://single-market-economy.ec.europa.eu/smes/sme-strategy/sme-performance-review\\_en](https://single-market-economy.ec.europa.eu/smes/sme-strategy/sme-performance-review_en).

<sup>4</sup> Statement of European Commissioner Thierry Breton on a "Relief Package" to give our SMEs a lifeline in troubled waters, 19 September 2022, [https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT\\_22\\_5653](https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_22_5653).

<sup>5</sup> Directive 2011/7/EU of the European Parliament and of the Council of 16 February 2011 on combating late payment in commercial transactions.

<sup>6</sup> Regulation (EU) 2018/1724 of the European Parliament and of the Council of 2 October 2018 establishing a single digital gateway to provide access to information, to procedures and to assistance and problem-solving services and amending Regulation (EU) No 1024/2012.

<sup>7</sup> Regulation (EU) 2019/1150 of the European Parliament and of the Council of 20 June 2019 on promoting fairness and transparency for business users of online intermediation services.

<sup>8</sup> See Commission Communication COM(2021) 251 final [https://taxation-customs.ec.europa.eu/system/files/2021-05/communication\\_on\\_business\\_taxation\\_for\\_the\\_21st\\_century.pdf](https://taxation-customs.ec.europa.eu/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf)

(Business in Europe: Framework for Income Taxation, or BEFIT), which is to define a single corporate tax rulebook for the EU, based on the key features of a common tax base.

The European Parliament in its Resolution of 13 July 2023<sup>9</sup> welcomed the Commission President's announcement of a proposal for a single set of tax rules for doing business in Europe, BEFIT, and called on the Commission to make sure that the specific demands of SMEs are met, by keeping BEFIT always optional for SMEs, especially those not doing cross-border business.

In addition, this initiative relates to the 2020 "Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy" which is a set of 25 initiatives to make taxation fairer, simpler and more adapted to modern technologies. One of the areas is that to reduce tax obstacles and unnecessary administrative burdens for businesses in the internal market as tax simplification can improve the business environment, enhance business competitiveness and contribute to economic growth. In this context, the initiative assessed here can be seen as a complement to the 2021 Value Added Tax (VAT) E-Commerce initiative, which allows online sellers, including online marketplaces and platforms to register in one EU Member State and this will be valid for the declaration and payment of VAT on all distance sales of goods and cross-border supplies of services to customers within the EU. The aim of the e-commerce initiative was to ensure that businesses can see a reduction in red tape of up to 95% notably by registering with a new one-stop-shop. The initiative assessed here is also complementary to the 2022 Commission proposal regarding VAT rules for the digital age (ViDA)<sup>10</sup> which considers measures to modernise and make the EU's VAT system work better for businesses.

Currently, SMEs are faced with different sets of national tax obligations as soon as they expand and become taxable into another Member State. This complexity represents a barrier for SMEs to expand their activities abroad and takes particular relevance in the inception stage of expansion, when activities abroad are still auxiliary to the primary business operations in the state of origin. This is for example shown in the Commission's Communication on barriers to the internal market,<sup>11</sup> where national rules and procedures in the area of taxation are consistently highlighted by businesses as one of the biggest obstacles they face.

It could be beneficial for these SMEs to be able to continue to only apply the tax rules that they are familiar with to calculate their taxable results (i.e., profits or losses) in the new Member States. If and when SMEs can opt for this, the compliance costs that can arise from dealing with diverse tax rules and different administrations would likely be mitigated and this could support SMEs taking business decisions that suit them best in terms of investment and growth.

Such a simplification mechanism would be aimed specifically at SMEs with cross-border taxable presence, and in particular, to support SMEs in their early stages of cross-border development. The aim is that these SMEs can benefit from applying only one set of tax rules when calculating their tax results as well as a one-stop-shop. This means they would only have to interact with one tax administration through the entire tax filing and collection process. The options for possible simplification are set out and assessed in this impact assessment report.

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<sup>9</sup> European Parliament resolution of 13 July 2023 on the state of the SME Union, P9\_TA(2023)0294

<sup>10</sup> Proposal for a Council Directive amending Directive 2006/112/EC as regards VAT rules for the digital age. COM(2022) 701 final. Available [here](#).

<sup>11</sup> COM(2020) 93 final <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52020DC0093>

## 2. PROBLEM DEFINITION

### 2.1. What are the problems?

The current systems of business taxation in the EU give rise to high tax complexity, with different rules applying in each Member State. Each jurisdiction designs its own rules according to national or regional circumstances and preferences. As governments adapt to new realities and to the emergence of new business models, individual Member States' responses have resulted in increasingly fragmented tax systems in the internal market. As a result, tax compliance with tax obligations across the EU has become a very complex exercise. Recent research, including the Tax Complexity Index, indicates that tax complexity has increased significantly in the past years.<sup>12</sup> The resulting tax liability computations and the required resources to comply with tax obligations tend to vary from one Member State to another.

All businesses that operate in the internal market face important consequences arising from these diverging national tax systems. Smaller businesses in particular may have difficulties crossing the border. Companies become taxable in more than one Member State as soon as they have a permanent establishment (PE) or a subsidiary in another Member State.<sup>13</sup> Compliance with such tax obligations comes with fixed costs (e.g., administrative, legal, consulting and time costs). This creates a high burden for SMEs which is proportionately larger than that of large groups of companies, which can leverage economies of scale. Such tax compliance costs can be particularly relevant in the inception stage of expansion of SMEs, when the extent of activities carried out abroad would only be complementary to the main business operations in the state of origin.

Tax complexity therefore translates into specific consequences for SMEs, in particular in their early development. As displayed in Figure 1, it results in disproportionately higher compliance costs, presents a barrier to potential cross-border expansions, and creates an uneven level playing field between smaller and larger businesses operating across borders and between SMEs with a permanent establishment or subsidiaries in foreign markets and between purely domestic companies.

These consequences for SMEs impede the proper functioning of the internal market and hamper prospects for growth and investment by a large number of businesses in the EU. Hence, the problem that this initiative aims to address is tax complexity and specifically the ensuing costs and consequences for SMEs.

However, businesses should be able to flourish in the internal market beyond their SME status and tax complexity also has important consequences for larger businesses. For this reason, the Commission is also working on other initiatives. In the above Communication on Business Taxation for the 21<sup>st</sup> Century, the Commission announced that it will table a legislative proposal

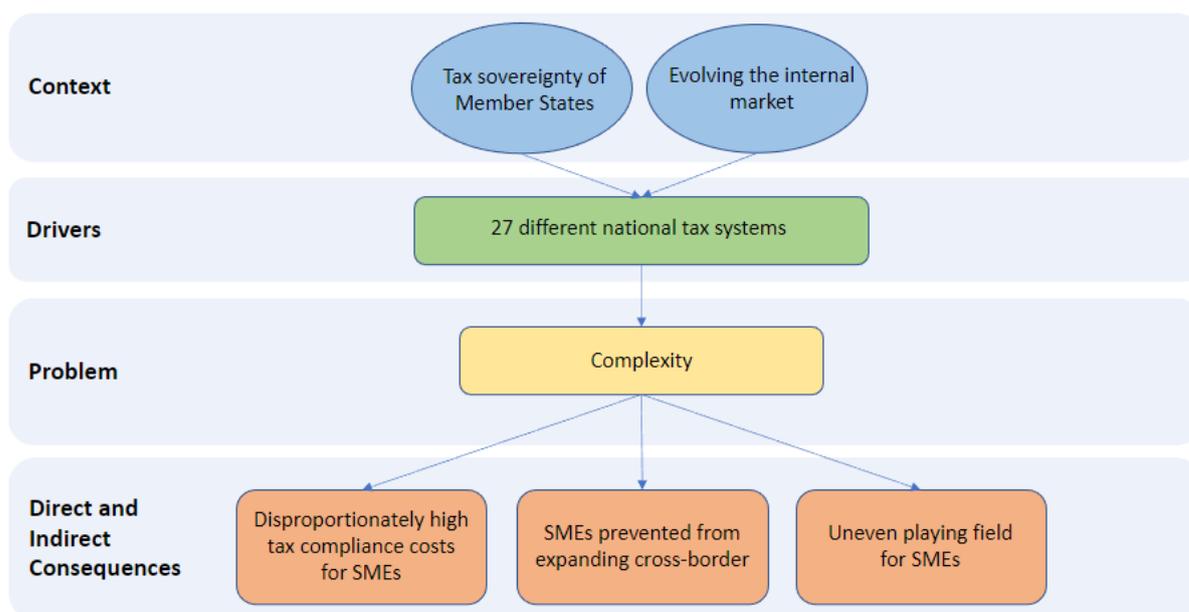
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<sup>12</sup> See for example, Hoppe, Schanz, Sturm, Sureth-Sloane (2021): The Tax Complexity Index – A Survey-Based Country Measure on Tax Code and Framework Complexity, *European Accounting Review*, DOI: [10.1080/09638180.2020.1852095](https://doi.org/10.1080/09638180.2020.1852095).

<sup>13</sup> According to the OECD tax treaty model (article 5) the permanent establishment is 'a fixed place of business by means of which a company conducts all or a part of its business'. The notion of a permanent establishment includes, among other thing, for example, a management head office, a branch, an office. Contrary to subsidiary, a PE does not have its own legal personality.

which will be designed specifically for the tax base of groups of companies. This proposal is known as ‘Business in Europe: Framework for Income Taxation’, or ‘BEFIT’, and will also aim to simplify tax rules and reduce compliance costs. In addition, the Commission also envisages a common EU approach to transfer pricing, which would provide groups of companies with more predictability and simplification for their intra-group transactions in the EU. The impacts of these initiatives are not assessed in this report but are also part of a broader EU approach to address the problem of tax complexity.

Figure 1 – Problem Tree



In addition, the problem of tax complexity does not only have consequences for SMEs in the field of corporate taxation. More broadly, EU policies aim to simply tax rules and reduce tax compliance costs. The ViDA proposal addresses tax complexity in the area of value added taxes and will also support SMEs in this regard. This initiative is complementary with this approach and the problem addressed here is thus limited to corporate tax complexity.

## 2.2. What are the problem drivers?

### Different national tax systems

Corporate income taxation in the EU is characterised by 27 different corporate income tax systems and 27 distinct tax administrations. Each of these systems provides detailed and possibly different specifications to compute the national corporate income tax base of SMEs that are established in the respective Member State. An SME that operates in other Member States by way of permanent establishments (PEs) or subsidiaries must therefore know different national tax laws before filing different tax returns in each of the Member States where it operates. In addition, requirements and procedures for filing corporate income tax returns vary across Member States. By way of example, as shown in the Annual Report on Taxation 2023,<sup>28</sup> statutory tax rates differ substantially among Member States from 10 % to 31.5%. The model-based effective tax rates which consider, amongst

other things, tax support schemes put forward by governments, vary from 9% to 29%. The same Report shows how various tax incentives vary across countries.

To give an overview, all national tax systems have one common aim, i.e., to define the rules to arrive at the taxable results (profit or loss) for each taxpayer. Gross income (revenues) is generally taken as the starting point, on which tax laws allow certain expenses to be deducted or certain income to be exempted. More specifically this includes, for instance, rules for tax depreciation and amortisation of a company's assets, inventory costing, the deductibility of previous (or future) losses, interests, dividends, provisions, bad debts, fines, illegal payments, foreign taxes, the availability of relief in defined cases, or rules for business reorganisations. By way of example, depreciation rates can vary significantly across countries by type of asset: e.g., just for fixed tangible assets it ranges from 2 years to 10 years and some countries use the so-called useful life with minima and sometimes maxima, while others use accelerated methods.

In addition, for cross-border businesses, which have income and expenses in multiple countries, each country also has to apply a method to determine whether the business should be taxable there, and if so, which part of the overall income will be taxed, and whether foreign expenses can be deducted.

In that respect, a company can become taxable in Member States other than the Member State of its head office in multiple ways. Firms can operate cross-border with or without establishing a subsidiary in the other Member State. Even when there is no subsidiary, a company's operations become taxable when they are considered a PE for tax purposes. The fundamental difference between expanding abroad through a PE or by way of a subsidiary is that the former remains an extension of the legal personality of the head office beyond the origin Member State, while subsidiaries are separate legal entities incorporated under the company law of another Member State.

As such, when a Member State taxes a PE, it taxes a non-resident company (the head office), while when that Member State taxes a subsidiary incorporated under its own company law, it deals with a domestic (resident) taxpayer. In most cases when a country taxes a PE, there is a relief mechanism (exemption or tax credit) in the jurisdiction of the head office that takes the tax due by PEs into account against any tax due in the hands of the head office. This treatment, however, depends on the specific rules of each Member State. For SMEs, this can be a complex and expensive exercise.

Moreover, mismatches in the interaction between different national tax systems, when dealing with cross-border businesses, can result in tax uncertainty, avoidance or double or over-taxation. Countries have adopted a range of measures to address these issues, such as bilateral treaties, exchange of information, anti-abuse measures, and dispute prevention and resolution provisions. Despite such efforts, results of the public consultation suggest that a fundamental concern regards cross-border inconsistencies compared to the consistency of tax regimes for purely domestic situations.

In sum, although each of the national systems may feature similar elements for calculating the tax base, the legal qualifications and practical applications can differ widely. National rules have had different trajectories, have been subject to frequent changes to address variable political objectives, and although bilateral tax treaties and anti-abuse measures are often comparable and based on model rules, they have resulted in a multitude of rules that differ for each country. Hence, businesses that operate in a cross-border environment have to comply with a fragmented patchwork

of different national requirements. While this affects all businesses that operate in the internal market, such complexity can in particular lead to tax compliance costs that are disproportionately higher for SMEs, preventing them from expanding abroad, and it affects the level playing field compared to larger cross-border businesses or purely domestic companies.

### **2.3. What are the consequences of the problem?**

There are several negative direct and indirect consequences for SMEs with activities abroad arising from tax complexity and that act as a barrier to SMEs wanting to expand their activities in the internal market.

#### *2.3.1. Tax compliance costs disproportionately affect SMEs*

The variety of features that permeate national tax systems, the discrepancies in the application and interpretation of such features, as well as differences in general administrative procedures across Member States have an impact on the tax compliance burden for companies operating in other Member States.

A taxpayer has to bear an overall burden from the tax system, which consists of (i) the actual amount of tax due, plus (ii) the costs incurred to comply with the applicable tax regulations (e.g., costs associated with legal and accounting advice, time to file tax returns which multiply with the number of countries where the company has its activity). From the economic perspective of a taxpayer, administrative costs related to tax compliance can be regarded as an efficiency loss and a waste of economic resources. This is because administrative tax compliance costs reduce the profits of businesses and increase the costs for tax administrations without leading to higher tax revenues.

Complex tax compliance also creates broader economic costs and inefficiencies that do not immediately materialise as expenses: legal uncertainty and non-transparent systems can be significant obstacles to investment and thus hinder economic growth. Tax compliance costs can, therefore, be considered as an inherent waste of resources and a ‘deadweight loss’ and undesirable for the entire society.

Even if one looks only at the directly-related expenses, tax compliance costs for businesses are found to be high. A comprehensive, survey-based study presenting extensive analysis of the administrative costs to comply with tax obligations has been carried out on behalf of the European Commission in 2022.<sup>14</sup> This study is explained in detail in Annex 4. It estimates the administrative burden<sup>15</sup> of tax compliance for both small and large businesses in Member States and the United Kingdom. On average, businesses incur an annual cost in meeting their tax compliance obligations that amounts to 1.9% of their turnover. Businesses in these 28 countries spend an estimated annual amount of around EUR 204 billion to comply with their tax obligations (for all types of taxes).

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<sup>14</sup> European Commission, Tax Compliance costs for SMEs: An update and complement” Final Report by VVA and KPMG, Luxembourg: Publications Office of the European Union, 2022.

<sup>15</sup> The administrative costs consist of two different cost components: the business-as-usual costs and administrative burdens. While the business-as-usual costs correspond to the costs resulting from collecting and processing information that would even be done in the absence of any legislation, administrative burdens stem from the part of the process which is done solely because of a legal obligation.

Furthermore, tax compliance costs have not declined over time. Total enterprise tax compliance costs increase significantly (i.e., 114%) from 2014 to 2019.

Importantly, these compliance costs are regressive when comparing small and large businesses. **The relative burden of tax compliance is disproportionately higher for small businesses.**<sup>16</sup> The study above shows that SMEs spend approximately 2.5% of their turnover on compliance with their tax obligations (e.g., CIT, VAT, and income taxes) while large enterprises spend 0.7%.

The study looks specifically at the cost of compliance with specific types of taxes, including corporate income taxation (CIT). When looking at such costs, the study covers a population of some 16 million SMEs in the EU, of which 14.5 million enterprises do not (yet) engage in cross-border activities.<sup>17</sup> The true number is probably higher.<sup>18</sup> Based on the firm-level data from the study, **total CIT-related compliance costs in the EU could amount to EUR 54 billion, of which very small enterprises with less than 10 employees bear 90%**. This means that, while the overall amount may not seem very high as a share of GDP (0.004% of the EU GDP), the cost may be significant for individual companies and especially for SMEs and act as a barrier to expand their activity.

*Table 1: CIT-related compliance costs: who pays? Cost by firm size*

Firm size: employment	Total CIT compliance cost, EU-27 (bn EUR)	.. In %
From 0 to 9 persons employed	48.4	90%
From 10 to 19 persons employed	2.1	4%
From 20 to 49 persons employed	2.7	5%
From 50 to 249 persons employed	0.6	1%
250 persons employed or more	0.1	0%
Firm size: firm's turnover		
<1 million EUR	39.0	72%
1-10 million EUR	12.4	23%
10-49 million EUR	1.4	3%
50-249 million EUR	1.0	2%
250-749 million EUR	0.0	0%
>750 million EUR	0.0	0%
Total	53.9	

TAXUD calculations based on VVA/KMPG for European Commission (2022). For more details see Annex 4 and Chapter 6.

**Tax compliance costs are positively correlated with cross-border activities.** This is because in such a context, two or more different sets of national tax rules would have to be applied in addition to possible common EU and international norms. To demonstrate this effect, a multivariate

<sup>16</sup> European Commission, *Tax Compliance Costs for SMEs, An Update and a Complement: Final Report*, (2022), available at: <https://op.europa.eu/en/publication-detail/-/publication/70a486a9-b61d-11ec-b6f4-01aa75ed71a1/language-en>.

<sup>17</sup> Structural information from Eurostat's Structural Business Statistics is used to project (gross up) the sample from the KMPG survey.

<sup>18</sup> In the study, cross-border activities are defined as "all activities which involve the selling of goods, services or intangibles to a country other than the enterprise's home country". Foreign direct investment is thus not covered by that definition.

regression analysis was carried out on the above-mentioned survey's firm-level data. This is outlined in Annex 4. It shows that, everything else being equal,<sup>19</sup> **firms crossing borders will have significantly higher CIT-related tax compliance costs compared to purely domestic companies.**

The data analysis conducted here also shows that compliance costs strongly interact with the availability of a 'simplified tax regime'. Simplified tax regimes are tax rules which are less complicated and easier to comply with, relative to regular national CIT rules. Estimates from data analysis presented in the aforementioned study and views from SMEs' representatives indicate that cross-border operating firms could reduce their CIT-related compliance costs significantly if they are subject to a simplified tax framework. A regression analysis based on the survey data above suggests that compliance costs of cross-border operating firms that have access to a simplified framework can be one third below the cost of those firms which are not subject to simplified frameworks, all other firm characteristics being the same. This suggests that simplified tax rules therefore offer a significant advantage for firms operating in more than one jurisdiction.

A 2023 study analysis requested by the FISC subcommittee of the European Parliament<sup>20</sup> concluded that tax compliance costs are large enough to be a concern for businesses and are disproportionately borne by SMEs. The study indicates that by burdening companies and discouraging investment, tax compliance costs are an obstacle to economic growth.

### *2.3.2. SMEs prevented from expanding cross-border*

The risk of high tax compliance burdens in cross-border scenarios can therefore act as a barrier for the expansion of businesses across borders in the internal market. Businesses may for instance decide to concentrate their investment in one jurisdiction only, in order to avoid dealing with more than one set of administrative or regulatory rules including tax rules, while economically, it could be financially interesting to spread its operations.

This may be particularly important for SMEs. Indeed, 55% of EU SMEs surveyed said that regulatory obstacles or administrative burden were among the biggest problems they face (Eurobarometer 486).<sup>21</sup> Different tax obligations apply in each Member State, and compliance with those obligations comes with fixed costs, making it more expensive for SMEs than for larger enterprises,<sup>22</sup> as seen before.

This creates a barrier that prevents SMEs from developing their business cross-border. Given the role of younger firms in spurring growth, innovation and employment, such barriers to the activities of SMEs may therefore impact negatively on a country's competitiveness,<sup>23</sup> and on the EU's competitiveness as whole.

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<sup>19</sup> The analysis controls for different firm sizes and differences firms' country- and sector-related specificities.

<sup>20</sup> [FISC subcommittee SME tax compliance costs - IPOL STU\(2023\)642353\\_EN.pdf](#)

<sup>21</sup> See [Eurobarometer – Public opinion in the European Union \(europa.eu\)](#)

<sup>22</sup> Marchese, M. (2021). Preferential tax regimes for MSMEs. ILO Working Paper 33 - [https://www.ilo.org/wcmsp5/groups/public/---ed\\_emp/---emp\\_ent/---ifp\\_seed/documents/publication/wcms\\_803925.pdf](https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_803925.pdf)

<sup>23</sup> See for example [FISC subcommittee SME tax compliance costs - IPOL STU\(2023\)642353\\_EN.pdf](#)

### *2.3.3. Uneven playing field for SMEs*

A related consequence of complexity that this proposal aims to tackle is the uneven playing field. SMEs may be at a comparative disadvantage with respect to MNEs when they enter a new market, as a result of the disproportionately higher costs they face (see above, 2.5% vs. 0.7% of their turnover on tax compliance). This difference could be explained by economies of scale that large enterprise groups in particular are able to leverage.<sup>24</sup> As each national tax system lays down disparate administrative requirements for compliance with different interactions across Member States, this places a higher relative burden on SMEs, which have less resources than larger businesses already operating across the EU. An additional point is that SMEs with a PE or subsidiaries in foreign markets may experience a competitive disadvantage, from the point of view of tax compliance costs, when competing with purely national companies. These differences lead to an uneven playing field for businesses across the EU.

#### **2.4. How will the problem evolve?**

If no action is taken at the level of the EU to bring more simplification in the tax rules, and notably those regarding the calculation of the tax base for the SME with taxable presence abroad, the situation described above will persist. High tax compliance costs will continue to be an economic deadweight loss and can discourage expansion of SMEs within the internal market. Faced with an uneven playing field, SMEs may not exploit the full potential of the internal market, which affects competitiveness in and of the EU.

### **3. WHY SHOULD THE EU ACT?**

#### **3.1. Legal basis**

This proposal falls within the remit of Article 115 of the Treaty on the Functioning of the EU (TFEU). The rules of the proposal aim to approximate the laws, regulations or administrative practices of the Member States as 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.

The current initiative introduces, through a directive, as prescribed in Article 115 TFEU, a new framework for taxation in the EU with focus on SMEs which operate in another Member State. It envisages action to facilitate the cross-border expansion of SMEs and is therefore also linked to the enhancement of the internal market.

#### **3.2. Subsidiarity: Necessity of EU action**

In accordance with the subsidiarity principle laid down in Article 5(3) TFEU, action at EU level should be taken only when the aims envisaged cannot be achieved sufficiently by Member States acting alone and when in addition, by reasons of the scale or effects, the proposed action can be

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<sup>24</sup> European Commission. (2022). Tax compliance costs for SMEs. An update and a complement : final report <https://op.europa.eu/en/publication-detail/-/publication/70a486a9-b61d-11ec-b6f4-01aa75ed71a1>

better achieved by the EU. This initiative is in line with the principle of subsidiarity laid down in Article 5(3) TFEU for the reasons set out below.

**The problems are common to all Member States.** SMEs can increasingly operate across borders in the internal market, but in the current context they have to deal with 27 different corporate tax systems. This multiplicity of rules results in fragmentation and presents a serious impediment to cross-border business activity in the internal market. This is particularly striking for small businesses crossing or wishing to cross the border as they will be faced with disproportionately high tax compliance costs even if in the internal market, other barriers have been removed.

This cannot be effectively addressed by Member States directly. Complexity and the derived consequences are the result of having different tax systems in the first place, which results from individual national action. Therefore, **action at Member State level would likely continue to produce insufficient and uncoordinated effects.** Similarly, while better cooperation between Member States without EU action has resulted in several beneficial outcomes, this approach has mainly been bilateral, is limited, and has not necessarily resulted in less complexity for SMEs.

In this context, **only an EU-wide initiative providing for simplification can be effective.** The complexity and its consequences would be significantly reduced if there were a simplification framework for SMEs, allowing them to apply one set of corporate tax rules when they wish to expand abroad. Such a simplification can only effectively work on the basis of mutual recognition between the origin Member State and the Member States into which the company expands. Instead of filing in each Member State where an SME has a taxable presence, SMEs would be able to comply with all requirements through their head office and only in the Member State of the head office (one-stop-shop). If Member States would establish such a system unilaterally, bilaterally or multilaterally, and not at EU level, it would not effectively reduce complexity, as the approach and filing obligations would depend on a patchwork of agreements between Member States.

This initiative is therefore in line with the subsidiarity principle, considering that individual uncoordinated action by the Member States would only add to the current fragmentation of the legal framework for corporate taxation and fail to achieve the intended results notably from an internal market perspective. A common approach for all Member States would have the highest chances of addressing the problem and its consequences and of achieving the intended objectives.

### **3.3. Subsidiarity: Added value of EU action**

Action at the EU level would bring significant benefits to both businesses and tax administrations. The scope and scale of the initiative is **targeted** to the particular situation where SMEs would have taxable presence in other Member States and in particular during their initial phase of expansion. This targeted scope, combined with anti-abuse rules, will ensure that the proposed simplification can only be applied by businesses when there is clear added value.

What is more, in these cases, the initiative **provides SMEs with an opportunity to use one single set of tax rules** to compute their taxable results abroad and thereby reduce their compliance costs, but **without prescribing any substantive national tax rules of the Member States.** The initiative only designates which national tax rules should be used for the computation of the taxable results and relies on a mutual recognition among the Member States of each other's taxation rules. Tax rate and enforcement policies remain fully with Member States.

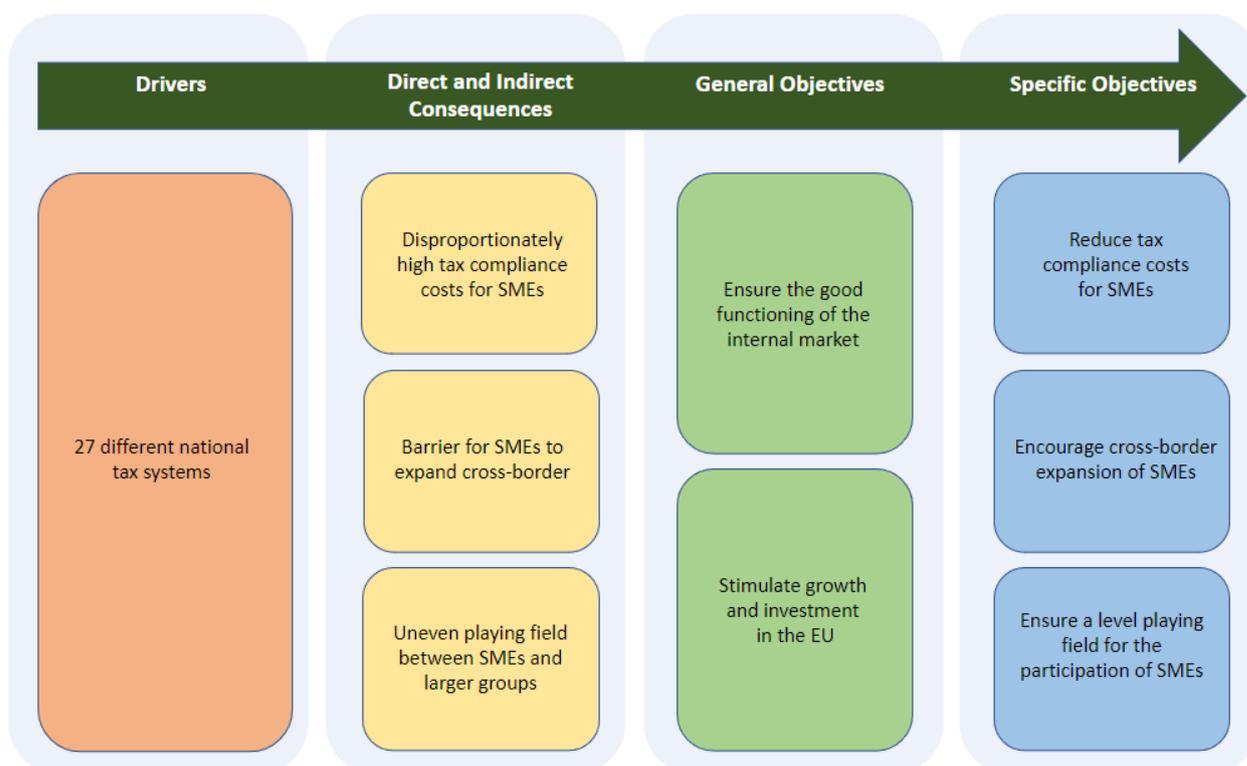
Moreover, the initiative assessed here goes for **voluntary application of the proposal by SMEs** (rather than mandatory application – see Chapter 5). This will bring a definite advantage for SMEs because SMEs have less resources to cope with foreign tax systems and SMEs themselves are best placed to decide whether, in their specific case, such a mechanism can help them reduce compliance costs and support their expansion. As such, the common rules will have added value and are balanced.

Indeed, **this initiative will also support investment and capital mobility in the EU**. By simplifying tax rules, it will eliminate tax regulatory obstacles and SMEs operating in different Member States will be able to make an improved use of their freedom of establishment and free movement of capital.

#### 4. OBJECTIVES: WHAT IS TO BE ACHIEVED?

This section outlines the general and specific objectives that the initiative pursues. The ‘Intervention Logic’ in Figure 2 presents these objectives jointly with the problem drivers and problems that the initiative aims to address.

Figure 2 – Intervention Logic



##### 4.1. General objectives

The primary objective of the initiative is to simplify tax rules for business in EU by reducing compliance costs, in particular for SMEs. This will **ensure the good functioning of the internal market**. While in many other areas, there is significant progress in EU law to ensure that businesses are not hampered by obstacles in the internal market, the proliferation of different corporate tax systems can still hinder SMEs activities across the EU and affect the level playing

field. By providing an option for simplification that reduces these obstacles for the computation of the tax base, the initiative will improve the functioning of the internal market.

The proposal further aims to **stimulate growth and investment in the EU** by reducing the number of national sets of tax rules that SMEs must comply with to be able to expand and invest across borders in the internal market. Useful simplification will make the environment for doing business in the internal market more attractive and will untap opportunities.<sup>25</sup> In providing SMEs with the option to continue to comply with the same tax obligations during their early stages of development, the proposal ensures that their business and growth decisions are not distorted. Additional resources may also be freed by reducing deadweight costs, and can be directed to economic activity, investment and growth.

#### 4.2. Specific objectives

The specific objectives of this initiative contribute to achieving the general objectives. The specific objectives link directly to the problem and its consequences, as identified in Chapter 2. The specific objectives therefore focus on SMEs, while tax complexity and its broader consequences will also be addressed by other EU initiatives with complementary objectives, such as BEFIT.

The first specific objective is **to reduce tax compliance costs for SMEs with a taxable presence abroad**. As the proposal will provide SMEs operating in the EU with a simplified set of tax rules, compared to the current environment, less resources should be required for businesses to comply with tax regulations.

Secondly, the initiative aims **to encourage cross-border expansion of SMEs**. This specific objective can be achieved for SMEs through this proposal as it will provide simplification for SMEs wishing to expand across borders and is targeted at supporting them in their early stages of cross-border expansion. In this way, the SMEs within the scope will not face a cliff effect, i.e., a sudden increase in the compliance and other burdens when expanding their operations cross-border. SMEs which have crossed the border and wish to stabilise their cross-border operations, are as such not the focus of this initiative. It is however important that these SMEs are also supported in their further development by a coherent EU approach. This is the objective of other initiatives that the Commission will put forward.

Thirdly, the simplification should **ensure a level playing field for the participation of SMEs in the internal market**. SMEs are the backbone of the EU economy and drive innovation. It is crucial that they can grow and scale up, and that possible barriers to their competitiveness and resilience are mitigated so they can fully participate in and benefit from the internal market. As with access to financing and market access, it is key to reduce regulatory burdens that come with a fixed cost and that therefore put SMEs at a disadvantage compared to larger businesses when they enter new markets, on the one hand, and at a disadvantage with purely domestic actors, on the other hand. Levelling the playing field can also contribute to reinforcing the EU's overall competitiveness.

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<sup>25</sup> As explained in Annex 3, the objectives of the initiatives also relate to the Sustainable Development Goals (SDGs). Notably, the general objective to stimulate growth and investment should translate into a positive impact on SDGs no. 8 and 9.

## 5. WHAT ARE THE AVAILABLE POLICY OPTIONS?

Based on the above problems and objectives, three policy options have been identified. The status quo can be maintained (baseline option), or the initiative can provide voluntary simplification for SMEs by allowing them to apply only one set of national tax rules when they expand across borders. This simplification could either be available for only standalone SMEs with permanent establishments in other Member States (option 1), or for all SMEs with cross-border taxable presence, including both permanent establishments and subsidiaries (option 2). Mandatory application of the simplification was also considered but discarded early on.

### **Baseline: no policy change**

The baseline scenario is to keep the existing policy framework. This means that the EU continues to have 27 different corporate tax systems and no administrative simplification is offered to SMEs with taxable presence in another Member State. This would result in continued barriers to the good functioning of the internal market, as SMEs will continue to be faced with disproportionately higher compliance costs, and face an uneven level playing field which can hinder their growth and competitiveness.

### **Policy options: Simplification for SMEs by allowing one set of national tax rules for computing their taxable results**

As explained in detail above, today, SMEs with taxable presence in other Member States (either through PEs or subsidiaries) are subject to more than one set of national tax rules and must file multiple tax returns in line with the tax rules specific for each Member State. As explained above in section 2.2, not only national tax rate policies differ; each Member State also has differing rules to calculate the taxable result of businesses. A proposal for simplification can maintain these existing, national tax systems and design rules but allow expanding SMEs to continue to apply the tax rules of the Member State of their head office or headquarter also for the purpose of determining their taxable result in other Member States.

This concept is not new. In a 2005 Communication,<sup>26</sup> the European Commission presented a ‘Home State Taxation’ system as a possible solution to the compliance costs and other company tax difficulties of SMEs. The concept was based on voluntary mutual recognition of tax rules by Member States in order to compute the taxable profits of SMEs active in more than one Member State according to the national tax rules of one Member State.

The initiative assessed here also proposes a simplification for SMEs by allowing them to compute the taxable results of their PEs or subsidiaries based on **only the national tax rules of the Member State of the head office (for PEs) or of the headquarters (for subsidiaries), the ‘Head Office Taxation’ (‘HOT’) rules**. The SME would as such apply these rules to all its operations in the EU and would include this information in a single tax return, the **‘Head Office Taxation’ (‘HOT’) tax return**. This allows SMEs to comply with their tax obligations through a one-stop-shop. The HOT

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<sup>26</sup> COM (2005) 702: Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee - Tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market - outline of a possible Home State Taxation pilot scheme [...] {SEC(2005)1785}

tax return would be filed with **only the tax administration of the Member State of the head office or headquarter**.

That tax administration would have to share with the respective Member State tax administrations of the PEs or subsidiaries that the SME has opted for the HOT rules, so that these administrations are aware that the SME will not file a tax return with them. The HOT tax return would also be shared by that tax administration of the head office or headquarter with the other concerned tax administrations, to ensure full transparency and overview. This could be best achieved by enabling automatic exchange of information between Member State tax administrations in the framework of the Directive on Administrative Cooperation (DAC)<sup>27</sup>.

The tax administration of the head office or headquarter would also be responsible for preparing a tax assessment for not only the head office or headquarter but also each PE or subsidiary, after applying the tax rate of the respective Member State. The tax administration of the head office or headquarter would also share these draft assessments with the Member States of the PEs and subsidiaries for review, in the framework of the DAC.

To ensure that each tax administration fully retains its competence, the tax administrations of the other Member States would have to accept this draft tax assessment and may also request joint audits. These joint audits would be based on the framework foreseen in the DAC, but it would be mandatory for Member States to accept requests in application of the HOT rules. Taken together with the required updates to be able to exchange the information as mentioned above (the SMEs' election to apply the HOT rules, the HOT tax returns, and the draft tax assessments), this means the proposal would amend the DAC.

The tax administration of the head office or headquarter would also be responsible for collecting the taxes due and to transfer the collected revenues to the respective Member States.

Such solution would be limited to the taxation rules for the computation of the taxable result of PEs or subsidiaries and would not touch upon the social security rules applied in the Member State of the PE or subsidiary, nor would it affect the existing bilateral conventions on the avoidance of double taxation.

The above features would have to be similar for both proposed policy options. The options differ in scope and more specifically on whether the simplification should be provided for only standalone SMEs with PEs in other Member States, or also for SME groups with subsidiaries in other Member States.

### **Option 1: Optional simplification for SMEs with PE(s) (but no subsidiaries) in (an)other Member State(s)**

A first option would be to include in the scope of the proposal **only standalone SMEs with permanent establishments in other Member States** and exclude SMEs with subsidiaries in other Member States. SMEs in scope of this option are those who have or wish to have a taxable presence in one or more Member State through PEs. Without the proposal, each PE would be subject to tax

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<sup>27</sup> Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 64, 11.3.2011, p. 1–12.

in the respective Member State in accordance with the domestic tax base rules of that Member State.

This option proposes that the taxable results of each PE of the SME would, instead, be calculated according to the applicable rules of the Member State of the head office, i.e., the HOT rules as explained above. This means that these SMEs would be able to apply these rules to all their PEs in the EU and can make use of a one-stop-shop that allows them to continue to only file one tax return with the same tax administration, i.e., of the Member State of the head office.

SMEs would have to be eligible and need to explicitly opt in. To determine whether an SME is eligible to opt in, the proposal would have to include **eligibility requirements** that ensure a clear delineation of the scope, i.e., that only genuine standalone SMEs with PEs in other Member States can opt in. To this effect, it would of course be required that the SME does not have a subsidiary in another Member States, but also that the joint turnover of the PEs does at least not double the turnover of the head office, and that the head office has been resident in its Member State for at least two years.

In addition, to prevent that the voluntary scope of the proposal would be used for circumvention, the rules would be coupled with the **requirement that an opting-in SME applies the rules of the Member State of the head office for a minimum period of time**, for example five years. SMEs will be entitled to renew their choice every five years without limit as long as they continue to meet the above eligibility requirements.

The proposal must also ensure that the new rules cannot be used for abusive tax planning practices. The proposal would thus have to include **termination provisions** that allow Member States to disapply the HOT rules, when this is no longer appropriate, such as for instance, when the SME deliberately transfers the head office to another Member State for tax purposes.

### **Option 2: Optional simplification for all SMEs with taxable presence (PEs and/or subsidiaries) in (an)other Member State(s)**

An alternative option would be to allow eligible SMEs to apply the same set of applicable rules to compute the taxable results of both PEs and **subsidiaries**. Similarly, this would then be computed using the rules that are applicable in the Member State of its head office or headquarter and there would be a one-stop-shop, as explained above. The main difference would be that the scope of the proposal is **extended to also include groups of companies**.

Hence, the analysis of the technical elements is the same as under the first option, but the implications are different. This is because subsidiaries are separate legal persons established under the laws of another Member State, whilst PEs are legally the same legal entity as the head office company. PEs do not have a separate legal entity and are only physically carried out in another location. Eligibility and termination criteria would also be present much as above but adjusted to the new scope notably to now include subsidiaries. The rules on turnover would thus be the same or similar, as appropriate, and the head office residency rule would naturally relate to the headquarter. The second option would also need to ensure similar rules for the minimum period of application of the rules. Termination rules to avoid abuses would also be similar but specific to SME groups.

### **Discarded option: Mandatory application**

Beyond the above two options, a mandatory application of the simplification rules was discarded. It would risk leading to discriminatory tax treatment against PEs or subsidiaries in the cases that the tax base in the Member State of the head office were wider, compared to that of the Member State of the PE or subsidiary. As a result, foreign-held taxpayers would be unequally treated, compared to domestic taxpayers in regard to the freedom of establishment. The situation is different if the system is designed as optional. In such case, if an unfavourable tax treatment occurred, it would be the outcome of an option chosen by the taxpayer and not imposed by EU rules.

## 6. WHAT ARE THE IMPACTS OF THE POLICY OPTIONS?

### 6.1. Scope: how many SMEs could be affected?

As explained, the scope of the proposal depends on the chosen policy option. In addition, since the proposal would be optional for SMEs, it is not possible to establish the number of companies that will choose to apply the new rules with precision.

Under the **first option**, the scope would be limited to standalone SME companies with permanent establishments in one or more other Member State(s). These SMEs only have one set of financial accounts and have no legal personality established under the law of the other Member State(s).

Under the **second option**, SMEs with subsidiaries in one or more other Member State(s) would also be eligible to opt in. This therefore includes groups of companies. Orbis company data provided by Bureau van Dijk<sup>28</sup> suggests that many subsidiaries are located in a different Member State than their headquarter. Note in that respect that, as set out in Chapter 7 below on the coherence with other EU policies, the Commission is also envisaging a separate initiative aimed at simplification for groups of companies. Groups that prepare consolidated financial statements could also be eligible to opt into such initiative. As such, in case two different sets of EU simplification are available for SMEs and groups of companies, this would influence how many companies are affected.

### 6.2. Impact of the policy options

Quantifying the effects of a voluntary approach is difficult. The analysis below provides an estimation of the possible benefits and costs of implementing the HOT system and the one-stop-shop for SMEs. For the benefits, the analysis looks at both the direct pecuniary savings for tax compliance costs of businesses, and the broader macro-economic impact thereof. Given the uncertain number of SMEs that would be affected, the analysis will be based on various illustrative examples and provides ranges with high-end- and low-end estimates.

For the **benefits**, the **starting point is an estimate of today's CIT-related tax compliance costs borne by SMEs in the EU**. As indicated in Chapter 2 and explained in more detail in Annex 4, these costs could today amount to an estimated **EUR 54 billion**,<sup>29</sup> representing a significant **0.4%**

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<sup>28</sup> Orbis is a global company database comprising information about more than 400 million companies and notably private companies worldwide. It is produced by Bureau van Dijk. The system operates a 10-year window for listed companies and a 5-year window for all other companies. See [Orbis \(bvdinfo.com\)](https://www.bvdinfo.com)

<sup>29</sup> The information is extracted from firm-level (micro) data stemming from the VVA/KMPG survey on compliance cost for SME. This survey was done for the European Commission (2022).

**share of the EU’s GDP.** The amount includes the cost of both purely domestic and cross-border operating firms. The below **section 6.2.1** looks at how the initiative could reduce these costs. This analysis only includes the direct pecuniary costs related to complying with existing tax rules and does not include macro-economic costs of investment gaps that may result from these expenses, nor does it take account of foregone cross-border expansion as a result of today’s complicated EU-wide network of different national tax rules. Hence, **section 6.2.2** also models second-round macro-economic effects, i.e., what if SMEs used the freed resources for productive actions and what if more SMEs go for cross-border activities. **Section 6.2.3** considers the benefits for tax administrations.

**Section 6.2.4** sets out a comprehensive estimation of the **costs** of implementation for businesses and tax administrations, to the extent possible. Finally, **Section 6.2.5** considers additional impacts such as on the environment, employment, fundamental rights, or competitiveness.

### 6.2.1. Impact on direct corporate income tax compliance costs

Using firm-level micro data of the above-mentioned survey-study in Chapter 2, one can estimate how the current CIT-related compliance costs are distributed across businesses with respect to their size and whether they operate cross-border. Details can be found in **Annex 4**. It confirms that the bulk of CIT-related compliance costs is borne by SMEs. Moreover, the study captures only a limited number of companies operating in a state other than their home state (N.B. cross-border activities in the definition of the study consider selling across borders). Today, EUR 6 billion CIT-related compliance costs out of the EUR 54 billion are borne by SMEs operating across the border.

This amount probably underestimates true compliance costs of internationally active companies. In addition to the potential savings associated with reducing purely pecuniary costs of tax compliance for firms already involved in international business, the potential cost savings for today’s purely domestic firms that may feel motivated to expand their cross-border activity (via the simplification proposal) can be even more significant.

*Table 2: Number of firms, absolute and average CIT compliance costs (CC), cross-tabulated by firm size and cross-border activity, 2019*

		Operating cross-country?		
		no	yes	Total
SME	CIT CC (bn EUR)	46.9	5.9	52.8
	.. per enterprise	3,223	3,308	3,232
	Number of enterprises	14,566,027	1,784,673	16,350,700
Larger Enterpr.	CIT CC (bn EUR)	0.8	0.3	1.0
	CIT CC per enterprise	9,929	8,266	9,436
	Number of enterprises	77,939	32,824	110,763
Total	CIT compl. Costs (bn EUR)	47.7	6.2	53.9
	.. per enterprise	3,259	3,398	3,274
	Number of enterprises	14,643,966	1,817,497	16,461,463

Source: Commission services, based on data from VVA/KMPG (2022).

**Calculating a high-end estimate:** Using a regression analysis, Annex 4 shows that the availability of a simplified tax system has the potential of reducing current CIT-related compliance costs per firm by 32% for cross-border operating firms. Therefore, if we apply cost savings of 32% to the

firms in the sample that are already operating across the border, we can estimate overall potential savings of EUR 1.9 billion for these firms.<sup>30</sup> Moreover, a certain percentage of enterprises which are so far *not* operating cross-border would be incentivised to do so as this regulatory barrier and the associated costs would be mitigated. They would also benefit from the 32% reduction on potential compliance costs when initiating their cross-border activity. As explained in Annex 4, if, as a purely illustrative example, 10% of the so-far domestic SMEs (i.e., 14.6 million firms, see first row of Table 2) started operating cross-border those would correspond to savings of an additional amount of CIT-related compliance costs of EUR 1.5 billion when conducting cross-border activities. Total savings could amount to **EUR 3.4 billion per year**.<sup>31</sup>

The 10%-assumption is an illustrative scenario showing the magnitude of potential cost savings. The assumption is applied in the absence of any reliable information about cross-border investment behaviour following the initiative. If we keep assuming 32% savings on compliance costs, but only 5% of the so-far domestic firms starting to operate cross-border (i.e., 364 000 firms), then total savings could amount to about **EUR 2.3 billion**.

**Calculating a low-end estimate:** The number of eligible SMEs will depend on the policy option and the new rules would be optional for eligible SMEs. This means that it is difficult to predict the exact number of companies that will opt-in. Also, the 32% is proxy and as such it is possible that the reduction in tax compliance costs via this mechanism would be lower than the one used as a proxy. Therefore, a more cautious estimate – i.e., a lower-end estimate – is also warranted, assuming a lower cost reduction and that fewer SMEs will develop cross-border operations. We can consider that having access to simplification reduces tax compliance costs by 16% (instead of 32%). Moreover, one can also assume that only 5% of the so-far domestic SMEs opt in (instead of 10%). This would result in savings of about EUR 0.9 billion for those already operating across the border and EUR 0.4 billion for those starting to cross borders. Total savings would then amount to **EUR 1.3 billion per year**. Furthermore, if we were to assume that only 1.25% of the so-far domestic SME (instead of 5%) would start operating cross-border, then total savings would amount to EUR 1 billion per year if firms save 16% compliance costs.

These calculations show us the potential in savings that could be generated for SMEs with cross-border activity or wanting to expand their activity across the border in the internal market. They provide an estimated range for the potential savings that the proposal could achieve through the two options. They show a potentially significant positive impact of the proposal.

Note that the granularity of the available data from the survey on SMEs does not allow to calculate with precision how much savings option 1 (voluntary simplification only for those with PEs) or option 2 (voluntary simplification for SMEs with PEs and subsidiaries) would generate. The survey data does not distinguish between cross-border activity via a PE or a subsidiary. A look at Orbis data suggests that the sample would be larger for option 2 than for option 1, with the caveat that

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<sup>30</sup> Note that to avoid a possible double counting with the impact assessment on BEFIT, we have reduced the number of SMEs with cross-border operations by 5373 times 2 (assuming each SME group has on average one subsidiary) which can be seen as the proxy for the number of MNEs with a turnover of less than EUR 50 million and therefore considered SME groups. The overall rounded amount does not change even if we consider that SMEs have two subsidiaries on average and we reduce the sample by 16,119.

<sup>31</sup> These estimates are based on information from the VVA/KMPG survey to above and in Annex 4. For several reasons, the true pecuniary savings on CIT compliance costs could be higher. Those reasons are explained in Annex 3.

Orbis data is not specific to SMEs. Potential tax compliance cost savings in option 2 would therefore be expected to be higher in total, while at firm level, the benefits may not be higher on average. Some of these SMEs with subsidiaries may already be larger in size. They may benefit from economies of scale, and, just as with larger MNEs, they may be able to wear off such tax compliance costs more easily.

#### 6.2.2. *Macro-economic impact of companies crossing borders within the EU and using freed resources for investment*

As mentioned, complex tax laws can create barriers to cross-border expansion, thus depriving SMEs from fully participating the internal market. Indeed, the impact of potential new cross-border activities motivated by the initiative is a multiple of the savings on the purely pecuniary amounts paid on CIT-related compliance. Accordingly, this section looks at second-round effects using a more comprehensive model-based analysis.

The current complicated set of CIT requirements may dissuade domestically operating SMEs from expanding into other Member States, even in case of small geographic distances. Simplification through the new initiative may be an incentive to extend their business to other Member States, and thereby further accelerate EU-wide productivity, growth and the strengthening of EU competitiveness (see also Annex 4).

To assess the macro-economic impact, we use **the Joint Research Centre's Cortax Model**, a general-equilibrium tool with a focus on taxation. **A simulation with Cortax looks at the effect of the simplification of the HOT system on GDP via productivity effects** (see Annex 4 for more details). As a result of the proposed HOT rules, more purely domestic SMEs will be expected to cross borders and start operating in other Member States. There is strong empirical evidence that international companies are more productive than their non-multinational counterparts,<sup>32</sup> implying the potential of a significant productivity boost for those going international (i.e., those that will start to operate cross-border). We look at what happens as a result of assuming a high productivity boost of 15% and a low productivity boost of about 4%. There is empirical evidence for both assumptions.<sup>33</sup>

As it is impossible to predict the number of companies that may decide to expand cross-border, we look at the above-introduced assumption that considers that 10% of currently domestic SMEs would expand their business into another Member State. From Table 2, one can deduce that this assumption could bring the share of cross-border operating SMEs from today's (estimated) 11% to 20%, which would represent an optimistic scenario.<sup>34</sup> Applying the assumption of a high productivity boost of 15% would lead to an overall increase in GDP of +0.7% in the long term, with a corresponding increase in total tax revenue of around +1%, relative to the status quo. **We can see this as the high-end estimate in terms of growth impact via productivity.** To put this in

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<sup>32</sup> For example, in the context of exporting vs. non-exporting firms: Bernard A. B., Jensen J. B., *Exceptional exporter performance: cause, effect, or both?* Journal of International Economics 47 (1999), pp. 1–25.

<sup>33</sup> According to the 2020 CompNet Firm Productivity Report, the current exporters' labour productivity premium could be around 15% on average (p. 38). Other studies show a lower productivity boost of around 4% (see e.g., de Loecker, 2013).

<sup>34</sup> This information is extracted from firm-level (micro) data stemming from the VVA/KMPG survey on compliance cost for SME, European Commission (2022).

perspective, consider that these 1% of the EU's total tax revenue corresponds to 0.39% of EU GDP, or EUR 61 billion per year – more than the amount of today's compliance costs altogether. As a **low-end estimate**, if we were to use a 4% productivity boost on the 5% of currently domestic SMEs that would expand their business into another Member State, we would see an increase in EU GDP of around +0.08% while tax revenue would increase by +0.12% (some EUR 19 billion).

Since the final effects also largely depend on the number of firms extending their businesses abroad thanks to the simplification, the following scenarios have been estimated, as indicative examples.

Keeping the **high-end estimate of 15% productivity gains** for international firms, the increase on EU GDP could range from +0.90 to +0.16% if 12.5% and 2.5% of so-far domestic firms go international, respectively. In the same vein, the EU tax revenues will increase by a range from +1.32% to +0.24%.

For the **low-end estimate** of a productivity premium for going international of only **4%**, the increase on EU GDP could range from +0.21 to + 0.04% if 12.5% and 2.5% of so-far domestic firms go international, respectively. In the same vein, tax revenues in the EU will increase by a range from +0.32% to +0.06%.

Moreover, these estimates do not include some **other positive macro-economic second-round effects**. Due to simplified tax compliance, resources so far bound to tax compliance-related activities will become available for productivity-enhancing investment. Annex 4 outlines the results of a simulation with a labour market model in which it is assumed that companies use the additional resources to step up investment in the formation of human capital (company-sponsored training). It is shown that every euro redirected to be spent on investment in human capital because of savings on tax compliance costs could return up to three euros.

**When comparing the two options**, the second option can be expected to generate higher savings in total than the first option, given that the second option would be open to more SMEs. In addition, the increase in cross-border operations may be higher, and as a result, this could also lead to more productive investment, generating a higher positive macro-economic impact in total. Note that all these are estimates on the basis of model analysis and as such need to be taken with caution.

### *6.2.3. Benefits for tax administrations*

While the initiative is aimed at reducing compliance costs for SMEs crossing borders in the internal market, it will also impact tax administrations and brings clear advantages. Firstly, the introduction of HOT tax returns will reduce the total amount of tax return filings at EU level. The costs for tax administrations in accommodating and exchanging the HOT tax returns are discussed in section 6.2.4 below but, in any case, for each HOT tax return there will be at least one filing less in another Member State. Although the tax administrations of these other Member States would still have to dedicate some resources to receiving the HOT tax return and accordingly reviewing the proposed tax assessment for approval, the initiative can therefore be expected to free up resources for tax administrations.

Currently, the complexity and lack of transparency also creates opportunities for irregularities and fraud. Businesses with PEs in several Member States may exploit such possibilities, for instance, because their operations are controlled by different administrations. If SMEs would interact with only one Member State tax administration for all their activities in the EU, the risk for irregularities

and fraud due to mismatches or lack of overview will be considerably reduced. Hence, the HOT system should facilitate anti-fraud policies and should contribute to the tax administrations' efforts to reduce the tax gap for corporate income taxation.

#### *6.2.4. Costs for SMEs and tax administrations*

The analysis above has shown the impact from a benefit point of view, including in terms of potential cost savings in complying with tax requirements, improved cross-border activity for SMEs, and its macro-economic impact. These overall benefits are now compared with possible costs that SMEs and tax administrations may incur.

Such compliance costs<sup>35</sup> could be *adjustment costs*, which encompass, for example, investments and expenses linked to the requirements contained in a legal rule, and *administrative costs* as a result of administrative activities performed to comply with administrative obligations included in legal rules.

These costs cannot be estimated with precision because the initiative does not have a precedent and there is no dedicated data that one can reliably use to produce precise estimates. Below, we attempt to describe some of the possible costs, noting that these are likely to be relatively small when compared to the potentially large savings derived from simplification and the macro-economic impact of simplification.

#### *SMEs*

SMEs that wish to opt in and apply the HOT rules would be required to notify this. As explained above, opting-in SMEs would need to prepare a specific tax return, the 'HOT tax return', which will include information for all their permanent establishments and/or subsidiaries, and file this in the Member State of their head office or headquarter.

This one-stop-shop with one single tax return is expected to significantly reduce tax compliance costs for SMEs as discussed above, but there will also be some costs: a) some initial adjustment cost for IT updates/investments and limited costs for getting familiar with the HOT procedure; and b) additional (recurrent) administrative cost to collect the relevant information and to file them in the new HOT tax return, though companies would always have to submit a tax return.

No other additional costs are expected for those joining the optional simplification framework. SMEs with cross-border presence already have all information concerning their subsidiaries and PEs, and they will compute such tax result by continuing to apply the same set of corporate tax rules that they are already familiar with.

#### *Tax administrations*

Concerning tax administrations, a holistic picture is hard to obtain. There are differences in capacity and expertise between Member States, and the additional workload will depend on the number of SMEs that have their head office in the Member State and that opt into the system.

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<sup>35</sup> To not be confused with the tax compliance cost, that refers to the cost to comply with the national tax requirements.

Tax administrations would not be required to apply a whole new set of tax rules but would need to integrate new features in their existing systems. They need to implement a procedure for SMEs to opt in and cross-check that they are eligible. They also need to accommodate the filing of the HOT tax returns so that it that now also includes tax-related information for all permanent establishments and/or subsidiaries of the SME. The tax administrations of the head office would now also need to prepare the tax assessments and collect tax revenues accordingly for the whole SME. This would require knowledge of the tax rates of other Member States. The implementation will therefore require an initial investment from tax administrations, although useful elements may already be in place, for instance because foreign permanent establishments are most likely already taken into account in tax returns. In general, information regarding eligibility requirements is also available to tax administrations so that any related administrative costs associated would be very limited.

Tax assessments must also be communicated by the Member State of the head office with the other concerned Member States for review and Member States can request joint audits. This will likely require some resources and increase interactions between Member States. While existing systems for the exchange of information such as for the DAC, are already in place and widely used, this will need to be upgraded. Finally, the tax administration of the head office would also be tasked with transferring the collected tax revenues to the Member States of the permanent establishments and/or subsidiaries. This will also require Member States to have a system in place.

Otherwise, the same tax rules which the SMEs already apply for their head office would now also be applied to their permanent establishments and/or subsidiaries. These would be the domestic rules which the tax administration already knows and applies, and there would already be personnel dealing with the head office itself. It should therefore require limited additional resources, and, at the same time, less staff would be dealing with permanent establishments (as those would be dealt with by other Member States of the respective head offices).

Furthermore, the infrastructure for exchanging information is already in place as Member States engage in exchanges of information, including automatic exchanges, in a variety of fields under the DAC.

### *Quantification of costs*

Based on the above, the required adjustments for tax administrations and SMEs should be limited and will likely be linked to the phasing-in of IT solutions or upgrading of existing systems, but the absence of any comparable precedent leaves little room for solid cost-estimation based on historical data. What is more, the nature of the initiatives is cost reduction through simplification. Costs linked to its introduction are therefore mostly transitional in nature when both tax administrations and some SMEs will have to adjust to the new rules.

### SMEs

To estimate the costs for businesses to comply with the HOT rules and submit HOT tax returns, **a point of orientation may be the supporting study to the impact assessment report of the ViDA proposal** (hereafter: ViDA IA<sup>36</sup> and ViDA study<sup>37</sup>). This proposal includes a new EU-wide digital

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<sup>36</sup> Impact assessment report - SWD(2022)393. Available [here](#).

reporting requirement (DRR) for VAT in order to standardise the information to be submitted by taxable persons on their transactions. While the nature of ViDA is different, there are similarities to the envisaged initiative. In both cases, there are administrative costs of implementation and costs linked to running a more standardised system that enables the exchange of information between businesses and authorities.

The ViDA study outlines implementation and recurrent costs required for DRRs. **Implementation one-off costs** include acquiring physical and intangible capital and know-how. **Recurrent costs** mainly cover recurrent expenses for personnel running the system (i.e., filling-in the reports). Already today, there are a number of different DRR systems in the EU. Among those, **SAF-T** (Standard Audit File for Tax) is a file containing reliable accounting data exportable from an original accounting system, for a specific time period and easily readable due to its standardisation of layout and format that can be used by authority staff for compliance checking purposes. One of its possible uses is the reporting of transaction data. Therefore, while of course not tailored to the envisaged initiative, **SAF-T can be compared to what is needed**, i.e., the exchange of information based on a standardised file that can be read by businesses and authorities across the EU.

SAF-T today is in place in Lithuania, Poland and Portugal.<sup>38</sup> Based on the existing evidence, the ViDA study has come up with an estimation of the implementation costs (one-off costs) and recurrent costs imposed by the application of SAF-T per company and year. In the ViDA study, the (annualised) one-off costs for all SMEs (3,2 million SMEs) are estimated at EUR 0.57 billion per year, and the recurrent costs at EUR 0.31 billion per year. Yearly costs per firm are on average about EUR 176 one-off (annualised over three years, i.e., expenses of EUR 528 per firm) and EUR 96 recurrent.<sup>39</sup>

However, compared to the ViDA proposal, the HOT tax return may not be so different from what SMEs and tax administrations currently have to file and process for their corporate tax returns (the so-called business-as-usual). The tax results of PE and/or subsidiaries would need to be added to the information that the head office already reports today for its own tax results. As said, there may be some initial adjustment costs regarding the adjustment of the layout of the tax return, for example, and then recurrent administrative costs. Note though that many Member States already require head offices to include tax information on PEs in their tax returns, as they receive tax credits for taxes paid by the PEs abroad. Also, as said, the information regarding eligibility requirements is available. The additional compliance costs stemming from the present initiative are therefore significantly lower than for the DRR in the ViDA proposal. In addition, the frequency of reporting corporate tax information to tax authorities under this initiative will be lower than for transaction-based information exchanges for VAT purposes.

This means that, while the two are similar, a direct comparison with the cost estimates for ViDA may overestimate the implementation costs of this initiative. For this reason, if we were to consider that only one fourth of the costs estimated in relation to SAF-T would be required for the HOT tax

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<sup>37</sup> European Commission, Directorate-General for Taxation and Customs Union, Luchetta, G., Giannotti, E., Dale, S. et al., *VAT in the digital age – Final report. Volume 1, Digital reporting requirements*, Publications Office of the European Union, 2022, <https://data.europa.eu/doi/10.2778/541384>.

<sup>38</sup> ViDA IA, p. 14.

<sup>39</sup> ViDA Study, p. 43.

return, the costs per firm would be an annualised one-off of EUR 44, i.e., setup expense of EUR 132 annualised over three years, plus EUR 24 recurrent costs per year.

Taking these costs per firm as a reference, one can multiply them by the number of firms potentially affected by the present initiative. Those are taken from the analysis presented in Table 2 above, namely: 1.8 million SMEs with taxable cross-border presence already today; and around 1.5 million SMEs which may start cross-border operations due to the major simplifications of the HOT rules, if 10% of so-far domestic SMEs (i.e., 10% of 14.5 million SMEs – high-end estimate) would make that decision. Correspondingly, if only 5% make that decision (low-end estimate), there will be only 0.75 million additional SMEs operating cross-border. As above, these are illustrative examples.

Multiplying these amounts of SMEs by costs per firm and year results in the following respective estimates for costs of implementing and running a system for the HOT rules. For the **high-end estimate**, there are one-off costs of EUR 428 million and recurrent costs of around EUR 78 million per year. For the **low-end estimate**, there are one-off costs of EUR 332 million and recurrent costs of around EUR 60 million per year.

In addition, eligible SMEs are offered the opportunity to opt into the system but are not required to do so. Depending on the number of SMEs opting in, the number of firms for which the costs related to the HOT system would apply could thus be even lower.

#### Tax administrations

For tax administrations, the annual costs for implementing and running the HOT system are estimated to be much lower than for businesses. To estimate these costs, a difference could be made based on whether the tax administrations only need to put in place a new system for resident, standalone SMEs with permanent establishments in other Member States (option 1), or also for subsidiaries which are resident companies of another Member State (option 2).

For this purpose, the same high- and low-end estimates are not used, because while the workload would also depend on the number of eligible SMEs that voluntarily opt in, this would always result in a net decrease of tax return filings across the EU and should therefore not be a main cost driver for tax administrations. Instead, both options could be assessed based on their comparison with the implementation of DRR in the ViDA proposal.

Indeed, while the initial IT investment for setting-up the DRR system may be more complex, the costs linked to the exchange of information between Member States could be comparable. Moreover, the tax administration of the head office will be in charge of preparing the tax assessments, communicating to the concerned Member States for review, and transferring the collected tax revenues. This will also require Member States to have an ad-hoc system in place. Finally, any of these Member States can request joint audits.

The HOT system therefore seems comparable to some extent, but comparing the two options, the recurrent cost for tax administrations for option 1 is expected to be significantly lower than for option 2, as the level of legal complexity is lower and the sample of firms smaller. Moreover, many national tax returns of head offices already include tax information on permanent establishments, in order to take taxes paid into account. This is not the case for subsidiaries, and as such, the HOT tax return would involve less administrative changes for permanent establishments compared to the

current situation and to option 2. The administrative costs are therefore expected to be lower under option 1 than under option 2.

Consequently, taking the estimates for introducing DRR in the ViDA proposal as a proxy for option 2 of the present initiative, where SMEs with PE and/or subsidiaries can opt-in, the costs would be an estimated one-off cost of EUR 1.5 million per Member State and recurrent costs of EUR 0.3 million per year and Member State, based on a consultation amongst tax administrations where SAF-T is in place.<sup>40</sup> For all 27 Member States, that translates to a total of EUR 41 million one-off and recurrent costs of EUR 8 million per year. If we approximate costs for option 1 as half of those incurred if subsidiaries were included in the scope, that would imply a total of EUR 20.5 million one-off and recurrent costs of EUR 4 million per year for all 27 Member States. As above, this assumption is an illustrative example.

#### *6.2.5. Additional impacts*

No particular and direct **environmental impact** is expected. Indirectly, one could perhaps consider that the resources freed from tax compliance costs could be used by companies to invest in more environmentally sustainable production methods if companies wished.

Regarding **employment and social impacts**, resources freed from tax compliance costs could be used in productive activities. These in turn could mean hiring new staff and/or training new staff. Alternatively, companies could choose to use the extra resources, in order to pay higher wages. In both cases, this could have a potential positive employment and social impact. Additional resources, either as savings or generated via investment could also be distributed among shareholders. It is however difficult to estimate such impacts with precision since they would depend on the decision of each company on how to use its additional spare resources.

**Fundamental rights** are not expected to be affected. The initiative would contribute to levelling the playing field and removing cross-border barriers. While it is not implied that the problems identified in Chapter 2 lead to any discrimination or unjustified restriction, this could be beneficial for equal treatment and the freedom to conduct a business. Given that SMEs are more often family businesses or led by women when compared to MNEs, the initiative may also contribute indirectly to family life, equality, and fairness. The proposal will also ensure that the protection of personal data is guaranteed.

The impacts on **competition** have also been taken into account, as described, for instance, in the competitiveness check in Annex 5. Such impact may depend on the options for the scope. Both options do not consider differences in size and activities but look at the legal structure of the SME. Including SMEs that have subsidiaries in other Member States may result in more cost savings, as more SMEs could benefit from the simplification, but as explained also in Chapter 7, this may be less effective in levelling the playing field and providing a coherent approach with other policies. Such SME groups may also benefit from an initiative designed for groups of companies, which creates an overlap. It would also imply that companies (subsidiaries) that are established under the law of one Member State would be taxed according to the tax laws of another Member State. In the

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<sup>40</sup> ViDA Study, p. 33.

case of permanent establishments, however, the entity is taxed by both Member States but only has legal personality in the Member States of its head office.

## 7. HOW DO THE OPTIONS COMPARE?

In this chapter, the options are compared against the criteria of effectiveness, efficiency, proportionality, and their coherence with other EU policies and initiatives. The below tables indicate to what extent each of the options perform well against these criteria based on the following scaling: from (0) irrelevant/no change, (+) limited contribution, (++) partial contribution, and (+++) substantial contribution.

### 7.1.1 Effectiveness

The effectiveness of the policy options is tested against the specific objectives of the initiative to reduce tax compliance costs for SMEs, encourage cross-border expansion, and ensure a level playing field for the participation of SMEs in the internal market. These objectives contribute in turn to the two general objectives to ensure the good functioning of the internal market and to stimulate growth and investment in the EU (Chapter 4).

#### *Option 1*

For SMEs that may have cross-border activities or are planning to expand across the border and may have been held back by the perspective of high compliance costs, the HOT rules for standalone SMES with a PE would broadly address the objectives. The rules are optional and therefore, can be used by those who can benefit. This ensures effectiveness for those SMEs within scope. It follows from the analysis in Chapter 6 that the impact would be positive.

#### *Option 2*

As above, applying the HOT rules to both standalone SMEs with PEs and SME groups with subsidiaries in other Member States would broadly address the objectives for SMEs. A larger number of SMEs that may be planning to expand across the border or that already have activity abroad would be eligible to opt in. This option may therefore potentially reduce compliance costs for a higher number of opting-in SMEs. The broader scope of this option could therefore translate into an effective means of achieving the objective of reducing compliance costs in total.

**Table 4: Effectiveness to achieve the objectives of the initiative**

*Source: TAXUD*

Criteria	Baseline	Option 1	Option 2
Reducing tax compliance costs for SMEs	0	++	+++
Encouraging cross-border expansion of SMEs	0	++	++
Ensuring a level playing field for the participation of SMEs in the internal market	0	++	++
<b>OVERALL SCORE</b>	0	++	+++

### 7.1.2 Efficiency

In addition to effectiveness, the policy options are also assessed on their efficiency, i.e., for achieving the benefits in a cost-efficient manner.

#### *Option 1*

The first policy option appears efficient in achieving the objectives of the initiative. From the perspective of **SMEs**, option 1 focuses on a key aspect for cross-border expansion: PEs can allow SMEs to start operating across borders without already setting up a subsidiary i.e., a legal form under the company laws of the other Member State. Indeed, the latter would come with additional initial costs, as it also engages non-tax administrative and legal compliance. Starting off with only a PE may therefore be especially useful for SMEs with limited resources and that previously may have held back from expanding abroad. This would be made simpler under option 1 while costs are also kept lower, as many Member States for instance already require taxpayers to include information on PEs on their corporate income tax returns, as explained above. Also including subsidiaries in other Member States, would involve more changes.

As explained in section 6.2.3, **tax administrations** would benefit from dealing with all operations of businesses with PEs through one administration, as there are risks of irregularities and fraud associated with companies that have PEs in multiple countries. In addition, with a view to implementing a new system, the legal complexity burden is lower and the sample of eligible SMEs is smaller. Similarly as for SMEs, the HOT tax return would involve less administrative changes for PEs compared to option 2.

For these reasons, this option has clear advantages in proportion to the costs of implementing a new system.

#### *Option 2*

The second option, on the other hand, appears less efficient when comparing costs and benefits. As said, for **SMEs**, the HOT tax return may require more changes than under option 1. Furthermore, evidence from Orbis data suggests that many subsidiaries are located across borders from their headquarters, which is much less the case for PEs. It follows that the scope of the second option would include many SME groups that are already operating across borders. The potential extra benefits for encouraging SMEs to expand abroad and start developing their operations across borders could therefore be less outspoken.

Although those benefits could nonetheless be larger in total for option 2, as more SMEs would be eligible, the HOT rules may not be the most efficient way to reduce compliance costs for businesses that already operate cross-borders with subsidiaries (see below, the Commission is also proposing an initiative specifically to simplify the tax base for groups of companies). The main advantage of the HOT rules is that SMEs can continue to apply the national tax rules with which they are already familiar for a time. This may be less relevant for cross-border SMEs and for SMEs that decide to cross borders by directly setting up a company under the company laws of the other Member State.

Potential benefits should also be weighed against the higher complexity for **tax administrations** to implement the second option, not just because they would, in turn, indeed be dealing with a larger sample of eligible SMEs but also different types of SMEs, since subsidiaries have a legal form that

is different from PEs. Both the initial cost of implementation of the system and the recurring cost for exchanging, coordinating, and interacting between Member State tax administrations could be higher.

As such, while the second policy option involves more eligible SMEs within its scope and therefore has a higher potential to reduce total compliance costs in the EU overall, the first option would provide a more targeted solution. Under this option, the benefits would be similar but focusing on the most relevant parts, and at lower costs. Hence, when comparing the benefits with the costs, the first option seems the most cost-efficient.

**Table 5: Efficiency**

Source: TAXUD

Criteria	Baseline	Option 1	Option 2
Costs and benefits for SMEs	0	+++	++
Costs and benefits for tax administrations	0	+++	++
<b>OVERALL SCORE</b>	<b>0</b>	<b>+++</b>	<b>++</b>

### 7.1.3 Proportionality of the intervention

#### *Option 1*

The first option does not require significant changes to tax regulatory systems in any Member State and can strongly support the use of PEs as a first step into expanding the company’s activity across the border. In view of the legal differences and implications between operating abroad through a (separate) subsidiary company, or an (ancillary) permanent establishment, this first option has higher chances to be deemed proportionate with the tax sovereignty of Member States. The first option should therefore also be more politically acceptable.

In addition, the HOT rules can encourage firms to go abroad and ‘test the ground’ in other Member States without having to incur in additional significant costs associated with having to know different tax rules and complying with those. It is more limited and targeted in scope, which avoids potential risks, related for instance to the cost of implementation or the effect of many SMEs opting in for different purposes. This option is therefore closer to what is strictly necessary to attain the objectives of the initiative.

#### *Option 2*

The extension of the HOT rules to also include subsidiaries, which are separate domestic taxpayers of the other Member State, would more strongly relate to the tax sovereignty of the Member States. Member State would have to accept that the tax rules of the Member State of the headquarter apply to its own companies, when those companies are subsidiaries of SMEs. This option could therefore be interpreted as an extraterritorial application of national tax rules to foreign companies that may interfere with domestic tax policies. The readiness to endorse this policy option is therefore expected to be significantly lower.

**Table 6: Proportionality**

Source: TAXUD

Criteria	Baseline	Option 1	Option 2
Tax sovereignty of Member States	0	+++	+
Cost of implementation	0	++	+
OVERALL SCORE	0	++	+

#### 7.1.4 Coherence with other EU policies

##### *SME Relief Package*

The need to simplify rules and reduce compliance costs for all businesses operating in the EU is a priority across EU policies. To achieve this, it is important that policies are tailored to the specific needs of companies and designed in the most effective manner for each business. Notably, this tax initiative complements the “SME Relief Package”, which aims to make it easier for SMEs to do business in the internal market by simplifying rules and reducing compliance costs. The HOT rules are designed for SMEs specifically and both policy options are in line with this goal.

##### *Direct business taxation*

This should be coherent with other EU policies to simplify tax rules and reduce tax compliance costs. In the area of direct taxation, existing EU policies such as the Parent-Subsidiary Directive, the Interest & Royalty Directive, the Merger Directive<sup>41</sup>, the ATAD, and the Pillar 2 Directive, mostly concern cross-border groups of companies. As mentioned above, the Commission also envisages a ‘BEFIT’ initiative specifically for the tax base of groups of companies in order to simplify tax rules and reduce compliance costs. Feedback on this has been sought from stakeholders,<sup>42</sup> and it has been included in the Commission Work Programme 2023.<sup>43</sup> Moreover, groups of companies would also be provided more predictability and simplification for their intra-group transactions in the EU by a common EU approach to transfer pricing.

Relevant to the HOT rules, SMEs which have subsidiaries also constitute groups of companies. As envisaged, these SMEs would be able to opt into the BEFIT rules. In this light, the present initiative considers two options. The first excludes SMEs with subsidiaries from its scope, while the second also includes these SME groups. It would thus seem that, under the second option, these SME groups would also be covered by other initiatives. This may create inconsistencies and result in complexity. From a coherence point of view, it is therefore preferable to take one approach to SMEs with subsidiaries, i.e., groups of companies. Taken together, these different initiatives would then form a coherent approach to simplifying tax rules and reducing compliance costs for both smaller and larger businesses operating across the internal market.

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<sup>41</sup> Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States.

<sup>42</sup> [Business in Europe: Framework for Income Taxation \(BEFIT\) \(europa.eu\)](https://business.europa.eu/framework-for-income-taxation-befit).

<sup>43</sup> [https://commission.europa.eu/strategy-documents/commission-work-programme/commission-work-programme-2023\\_en](https://commission.europa.eu/strategy-documents/commission-work-programme/commission-work-programme-2023_en). This proposal is also relevant from an own resource perspective, as set out in the 2021 Communication on the next generation of own resources for the EU Budget, see COM(2021) 566 final.

## *Indirect business taxation*

The initiative is also coherent with other EU tax policies in the area of taxation. Reducing compliance costs for businesses is a common objective with the above-discussed ViDA proposal, which also aims to improve reporting requirements and minimise the need to register in multiple Member States. The proposal also reduces the multiplicity of the existing national frameworks and increases legal certainty by harmonising administrative requirements.

Most notably, the proposed Union One Stop-Shop is also an optional simplification measure that businesses can use to declare and pay their taxes (in this case, VAT) without having to register in each Member State where they are active. Similarly, the HOT rules will allow cross-border businesses to only interact with one tax administration for the purpose of their corporate tax returns. Also more generally, the approach taken in the field of direct taxation follows this logic, as a BEFIT framework would also allow to centralise filing requirements for groups of companies.

Regardless of the policy option chosen, EU policy is therefore consistent in trying to provide all cross-border businesses with simplification and a one-stop-shop to the extent possible. Both policy options appear coherent with EU tax policy generally, while the first option does not have an overlap with other potential initiatives in the area of corporate taxation.

**Table 7: Coherence**

*Source: TAXUD*

<b>Criteria</b>	<b>Baseline</b>	<b>Option 1</b>	<b>Option 2</b>
SME Relief Package	0	+++	+++
EU policies on direct business taxation	0	+++	+
EU policies on indirect business taxation	0	+++	+++
<b>OVERALL SCORE</b>	<b>0</b>	<b>+++</b>	<b>++</b>

## **8. PREFERRED OPTION**

*Option 1 (optional for standalone SMEs, operating only with PEs in other Member States)* is the preferred option based on the assessment above. Option 1 strikes a balance between effectively and efficiently supporting SMEs that are most likely to be affected by the current fragmentation in the internal market, and ensures greater coherence with the treatment of groups of companies and proportionality with implementation costs and national tax sovereignty. The approach does not go beyond what is strictly necessary and does not pre-empt upon a possible future proposal for groups of companies.

### **8.1. REFIT (simplification and improved efficiency)**

All SMEs which have cross-border activities via a PE and which envisage to grow and expand across the border through PEs will be able to opt in to use the HOT rules and in doing so, benefit from tax simplification by continuing to apply the tax rules that they are familiar with to calculate the taxable result of their PE(s) in other Member States.

This simplification will reduce tax compliance costs (e.g., administrative, legal and time costs), because standalone SMEs with PEs will no longer be required to prepare and compute their taxable results according to different sets of national tax rules but, rather, be able to file a single tax return and pay all their taxes with the same tax administration (one-stop-shop). It also entails, for example, no additional learning costs to familiarise with unknown corporate tax rules, as the SME will already be applying the tax rules of its Member State of the head office. Finally, by allowing this system to be optional, SMEs will be given the opportunity to reach a business decision that suits best, namely after assessing the compliance costs and administrative complexity that can arise from dealing with distinct tax rules.

## **8.2. Application of the ‘one in, one out’ approach**

The ‘one-in, one-out’ approach consists of offsetting any new burden for citizens and businesses resulting from the Commission’s proposals by removing an equivalent existing burden in the same policy area. As noted above, the preferred option has the potential to significantly reduce the cost to comply with tax rules for companies with a taxable presence in other Member States. Estimated savings could range from EUR 1.3 billion per year to EUR 3.4 billion per year, according to different scenarios. While it is difficult to identify the precise nature of such costs savings, one can assume that the great majority are related to administrative activities and reporting obligations linked to national tax rules, rather than adjustment costs. On the other hand, the additional costs for SMEs that will decide to opt-in for the HOT tax return and the additional costs for tax authorities could be estimated on the range of half a billion euro (high-end estimation): EUR 332 million to EUR 428 million one-off costs and recurrent costs on the range of EUR 60 million to EUR 78 million per year.

## **9. HOW WILL ACTUAL IMPACTS BE MONITORED AND EVALUATED?**

Monitoring and evaluation are key constituents of this initiative, regardless of the policy options to be finally selected. The introduction of the new rules requires tax administrations to introduce a new system, which will be voluntary for SMEs and can cover different realities. The actual impacts of the initiative and reactions from stakeholders will therefore be closely monitored and evaluated on the basis of the data and other information. This will allow the Commission to determine if the Directive must be reviewed in order to better achieve the intended objectives.

### **9.1. Monitoring**

The European Commission will periodically monitor the implementation of the legal proposal and its application in close cooperation with the Member States. Monitoring in a continuous and systematic way will allow the Commission to identify whether the policy proposal is being applied as expected and to address implementation problems in a timely manner. Collection of factual data on the suggested monitoring indicators will also provide the basis for the future evaluation of the simplification for SMEs.

In terms of objectives to be monitored, as described in Chapter 4, the general objectives of the proposal are to ensure the good functioning of the internal market and have the effect of stimulating growth and investment. The specific objectives that have to be materialised to set the path for achieving this are to: (i) reduce tax compliance costs for SMEs, (ii) encourage cross-border

expansion of SMEs, and (iii) ensure a level playing field for the participation of SMEs in the internal market.

Below, indicators are suggested to measure the success of the initiative, in light of these objectives. The measurement tools in Table 4 are targeted to specific objectives, which are more suited for concrete monitoring.

- A decrease in **tax compliance costs for SMEs, relative to their turnover**, which could indicate that the initiative has reduced these costs;
- An increase in **the number of SMEs that expanded cross-border by setting up permanent establishments**, which could indicate that the initiative has supported SMEs in their cross-border expansion and participation in the internal market;
- An increase in **the number of SMEs having applied the simplification and moving from having only permanent establishments to setting up subsidiaries**, which could indicate that they have grown significantly and are ready to structure their business in a more stable manner across borders, and therefore that the initiative has furthered cross-border expansion and thereby effectively enhanced the good functioning of the internal market and stimulated growth and investment.
- A positive **evolution of the turnover of SMEs that are in scope**, which could indicate that the initiative has increased the participation of these SMEs in the internal market and therefore effectively enhanced the good functioning of the internal market and stimulated growth and investment;
- A positive **evolution of private investment and, in turn, EU GDP**, which could indicate that the initiative has not only supported in-scope SMEs as such, but that this has also been beneficial for the EU in general, by enhancing the good functioning of the internal market and stimulating growth and investment.

*Table 4: Objectives, Monitoring Indicators and Measurement Tools*

Specific Objectives	Indicators	Measurement Tools
Reduce tax compliance costs for SMEs	<ul style="list-style-type: none"> <li>• Compliance costs for SMEs, relative to their turnover and to comparable SMEs that do not apply the proposed simplification</li> </ul>	<ul style="list-style-type: none"> <li>• Survey on tax-related issues for SMEs, carried out by DG TAXUD, possibly with external assistance, in cooperation with Member State tax authorities</li> </ul>
Encourage cross-border expansion of SMEs	<ul style="list-style-type: none"> <li>• Number of SMEs that opted in</li> <li>• Number of SMEs that expanded cross-border by setting up a PE</li> <li>• Number of SMEs leaving the scope by setting up a subsidiary</li> <li>• Feedback from stakeholders on the practical use and effects of the HOT rules</li> </ul>	<ul style="list-style-type: none"> <li>• Using an updated version of the Study on SMEs Performance conducted for the European Commission to include questions that deliver</li> </ul>

<p>Ensure a level playing field for the participation of SMEs in the internal market</p>	<ul style="list-style-type: none"> <li>• Number of SMEs that expanded cross-border by setting up a PE</li> <li>• Turnover of SMEs that are in scope, relative to comparable SMEs that do not apply the proposed simplification</li> <li>• Feedback from stakeholders on the practical use and effects of the HOT rules</li> </ul>	<p>data on these indicators</p> <ul style="list-style-type: none"> <li>• Survey on aggregated data circulated by DG TAXUD to Member State tax authorities, which would have this information available</li> <li>• Data received by DG TAXUD from Member State tax authorities</li> <li>• Using various EU fora to obtain feedback from national authorities and SMEs representatives</li> </ul>
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As for the sources of information that will be used, the official Balance-of-Payment statistics take stock of the Foreign Direct Investment (FDI) flows and income streams thereof. From the macro-economic perspective, this will also be a crucial publicly available indicator. Regarding other administrative information, considering that the Commission is not a tax authority, it does not possess primary sources of information. The main sources that TAXUD could make use of, to derive useful and comprehensive information will be the tax administrations themselves and the SMEs in scope of the rules. It will be important that Member States provide useful numerical data, including data that they will have collected from the SMEs, to allow TAXUD to come to conclusions on the above topics. For this purpose, the proposal will lay down an obligation for Member States to report to the Commission all requisite aggregated information for a comprehensive assessment.

The monitoring framework will be subject to further adjustments in accordance with the final legal and implementation requirements and timeline.

## 9.2. Evaluation

The Commission would have **an evaluation after five years of application of the new rules**. After establishing a first picture at that point in time, the evaluation of the initiative should assess the extent to which the outlined objectives have been met. 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 clarify which data and other information will be needed from the tax administrations and stakeholders in order to carry out the evaluation.

The Commission will communicate the evaluation results in the form of a report, and the proposal will include **a review clause allowing the Commission to amend the Directive** according to the results of the evaluation. When the evaluation report will be adopted, the Commission will indeed have closely monitored the above indicators, including feedback and reactions from stakeholders. This information will allow the Commission to usefully revise and further tailor the HOT rules, if necessary.



## ANNEX 1: PROCEDURAL INFORMATION

### 1. LEAD DG, DECIDE PLANNING/CWP REFERENCES

The lead Directorate General is the Directorate General for Taxation and the Customs Union (DG TAXUD).

### 2. ORGANISATION AND TIMING

An interservice steering group was set up to steer and provide input to the impact assessment report that included this initiative and was assessed by the Regulatory Scrutiny Board. The steering group, led by the Secretariat-General, met on: 2 September 2022, 18 November 2022, 6 March 2023 and 11 April 2023. The following Directorates General were invited to the Inter-Service Steering Group (ISSG): AGRI, BUDG, CNECT, COMM, COMP, ECFIN, EEAS, EMPL, ESTAT, FISMA, GROW, INPTA, JRC, JUST, REGIO, SJ, OLAF, TRADE. In addition to the meetings of the Inter-Service Steering Group, DG TAXUD met in bilateral meetings with representatives of the following Directorates General to discuss the analysis in the impact assessment, the design of options, and other policy issues: COMP, FISMA, GROW, JRC. The report was submitted to the Regulatory Scrutiny Report on 26 April 2023.

### 3. CONSULTATION OF THE RSB

This impact assessment report was scrutinised by the Regulatory Scrutiny Board and discussed in the relevant meeting on 24 May 2022. In the opinion dated 26 May 2023, the Regulatory Scrutiny Board outlined recommendations which were integrated in the impact assessment.

It was found necessary that the initiatives assessed in the report that received the positive opinion with reservation from the Regulatory Scrutiny Board will be presented as separate proposals. For this reason, this impact assessment report only assesses the impact of the proposal for a Council Directive establishing a Head Office Tax system for small and medium-sized enterprises. This represents faithfully the analysis on SMEs contained in the scrutinised impact assessment and integrates the recommendations of the Regulatory Scrutiny Board in that regard. The main changes to the document are summarised in Table A1.

**Table A1: TAXUD revisions following the RSB positive opinion with reservations**

<i>Comments of the RSB</i>	<i>How and where comments have been addressed</i>
<b>(C) What to improve</b>	
(1) The report should elaborate on the lessons learned from the previous corporate tax initiatives. It should better explain how the initiative fits with the OECD Pillar I and Pillar II work. It should also summarise the main features of the national tax frameworks.	This comment mainly relates to the proposal on large corporates, now included in a separate impact assessment report. For the present report, <b>section 2.2</b> ‘What are the problem drivers’ now summarises main features of the national tax frameworks. In particular, it explains that all systems have a common aim and include rules on income, deductible expenses, adjustments, the

	<p>allocation of income of cross-border businesses, and common features to deal with mismatches and interactions between systems (treaties, exchange of information, anti-abuse rules, disputes). This section has also been extended with elements from the Commission’s most recent Annual Report on Taxation (ART) of 2023, which includes a comprehensive overview of the different features of the tax systems of the Member States.</p>
<p>(2) The report should better discuss the robustness of the Corporate Income Tax-related compliance cost estimates under the baseline. It should also better substantiate, with further evidence, the description of the consequences. It should clarify the causal link between the design of a particular tax system and business decisions and discuss the available evidence on the magnitude of double taxation and/or over-taxation. It should explain how the problem will evolve without EU intervention, with a consideration of relevant ongoing and existing legislation (including international policies).</p>	<p><b>The robustness of the Corporate Income Tax-related compliance cost estimates under the baseline</b> are set out in greater detail in <b>section 6.2.1</b> and <b>Annex 4</b>. The report acknowledges limitations of the available data in this regard. It also clarifies that the assumptions are illustrative scenarios to be able to estimate the effects, in absence of reliable information about cross-border investment behaviour following a reform of this nature. Annex 4 also provides more explanation for the assumptions for the survey-based projection of compliance cost reduction and for the regression results.</p> <p>The elements of the <b>description of the consequences</b> which should improve partly related to the part on BEFIT and transfer pricing in the initial draft impact assessment (distortion of business decisions, double and/or over-taxation). A separated description of the consequences has been included in <b>Chapter 2</b> of this impact assessment. In addition, the part on subsidiarity in <b>Chapter 3</b> has been reviewed to clarify that better cooperation between tax administrations cannot solve the problems through bilateral agreements. More generally, the document has been verified for consistency.</p>
<p>(3) The report should better explain the analysis of benefits. It should clarify the validity of the cost saving estimates. It should better explain the ‘simplified tax regime’ variable used in the regression analysis and clarify whether this is a reasonable representation of the options proposed in this initiative. The report should better discuss the likely uptake (and</p>	<p><b>Chapter 6</b>, as well as <b>Annex 4</b>, have been updated to better explain the analysis of the benefits. The assumptions and method behind the broader macro-economic estimates are further explained in Annex 4. The annex provides additional explanation of the long-term simulations, in particular <i>Cortax</i>. This includes the assumptions made, which is also why it is complemented by a series of sensitivity analyses:</p>

<p>hence aggregate cost saving potential) of the option packages with voluntary elements. When presenting the macroeconomic benefits, the report should explain the assumptions and method behind the estimates. It should strengthen, with further evidence, the claim that international companies are more productive than their non-multinational counterparts.</p>	<p>the long-term effects on GDP and tax revenues are set out for different hypotheses. It also discusses the country-by-country reporting data that is used for the analysis. Annex 4 also clarifies the validity of the cost saving estimates and includes a more detailed explanation of the ‘simplified tax regime’ variable in Box 1 and why the HOT rules can be considered a simplified tax regime for the simulations. It provides literature/studies as evidence on the point that cross-border businesses would be more productive than businesses which do not expand across borders. In addition, a section on additional impacts has been added for fundamental rights and competition.</p>
<p>(4) The report should quantify the costs introduced by this initiative. The analysis should build on relevant examples as well as stakeholder views. In line with this, the report should strengthen the presentation of the one in, one out approach and revise the presentation of costs and benefits in Annex 3.</p>	<p><b>Chapter 6</b> has been elaborated to include a dedicated sub-section on estimating transition costs. This part explains why it is difficult to quantify the costs and it considers the ViDA proposal and SAF-T as examples for comparison. The same chapter provides a more detailed explanation of the costs of tax administrations. We have also revised <b>Annex 3</b> to include benefit and costs estimates and to address comments as best as possible. However, the report also affirms that it is difficult to estimate as BEFIT has no precedent.</p>
<p>(5) The report should better present and discuss the distributional impacts of the initiative. It should provide the estimates of the GDP and tax revenue % increases in absolute (EUR) terms.</p>	<p>This comment relates to the proposal on large corporates. This is difficult to estimate in the current circumstances with the available CbCR data and while the implementation of Pillars 1 and 2 is pending. The BEFIT proposal therefore only includes a transition allocation rule which refers to the average of the tax results of the previous three fiscal years, with the purpose of ensuring that the impacts of the BEFIT framework can be assessed more accurately once the effects of implementing Pillars 1 and 2 materialise.</p>
<p>(6) The report should present a consistent description of the monitoring arrangements with indicators that more clearly outline what success would look like for this initiative.</p>	<p><b>Chapter 9</b> has been revisited to provide a consistent description and factor in more targeted monitoring for the initiative. It now includes more indicators and the description of the tools that will be used for measurement are more detailed. We also clarified where the information</p>

could be gathered, and that evaluation would require cooperation from the Member States. This has also been added in the proposal.

## **ANNEX 2: FEEDBACK TO THE CALL FOR EVIDENCE, PUBLIC CONSULTATION ON BUSINESS TAXATION AND TARGETED CONSULTATION ON SIMPLIFICATION FOR SMES**

### **Feedback to the Call for Evidence published on the Commission website on 13 October 2022**

The consultation period through this feedback mechanism took place between 13 October 2022 and 26 January 2023 via the Commission website. 46 contributions were submitted during this consultation period from companies, NGOs, citizens, researchers, trade unions, business associations. Overall, respondents confirmed existing challenges for the internal market. It was recognised that businesses face complexity and high costs in order to comply with the rules of 27 different national corporate tax systems. Most respondents preferred that the rules to be optional for SMEs and supported a ‘one-stop-shop’ mechanism. In general, business associations welcomed an initiative that could reduce administrative burden and compliance costs and, additionally, strengthen competitiveness within the EU.

### **Public consultation and position papers**

A public consultation on a framework for business taxation was launched on 13 October 2022. It remained open until 26 January 2023 for a total of 12 weeks. The consultation questionnaire was first published in English. Two weeks later it was published in the other 22 official EU languages. There were 77 respondents again from companies, NGOs, citizens, researchers, trade unions, business associations and public authorities.

Several respondents highlighted the high tax compliance costs due to complexity and several, notably researchers, pointed to the problem that businesses pursuing cross-border activities can face inconsistencies compared to the consistency of tax regimes for those in purely domestic situations. 50 respondents (65%) agreed, or partly agreed, that the current situation with 27 different national corporate tax systems in the Member States gives rise to problems in the internal market.

All respondents did, in general, acknowledge the idea of introducing a proposal that would remove obstacles related to corporate income taxation and distortions in the internal market. To reduce the administrative burden, most respondents strongly supported filing simplifications, e.g., through a “One-Stop-Shop”.

There were 30 position papers submitted in complement to the public consultation. 6 position papers came from respondents in the area of tax consultancy. From this category, most of the respondents argued that they are in favour of addressing the issues related to the existence of 27 different corporate tax systems in the internal market. 13 position papers were received from respondents qualified as business associations. Respondents of this category argued that the current EU tax framework is inadequate for taxpayers. In addition, most of the respondents underlined that the removal of (corporate) income tax obstacles in the internal market would be essential to enhance growth and competitiveness in the EU. Removing such obstacles could also foster innovation and support the creation of jobs. All of them saw the harmonisation and streamlining of tax rules as a way forward to facilitate cross-border trade and activities. Respondents also stressed the need for a reduction of compliance costs for businesses operating in the internal market. Several respondents favoured the proposed “One-Stop-Shop” solution, which would allow groups in scope to settle all filing issues with only one tax authority. In their view, this would effectively reduce the administrative burden and limit tax disputes.

**Commission/ DG GROW Expert group - [SME Envoy Network](#) – Sherpa meeting**  
**29.03.2023: Physical meeting**  
**Participants: Various stakeholders**

In the framework of the regular meetings that DG GROW organises with one of its Expert groups – the SME Envoy Network - TAXUD presented and exchanged views on the solutions envisaged for SMEs in the upcoming SME simplification proposal. This was not a tax-oriented event, but more DG GROW – SME exchange of views on internal market barriers, reporting obligations etc.

There were a handful of questions on technical details, mainly from 3 participants, and these were very general. Importantly, there was a large support for some main aspects:

- the optionality nature for SME - Opt-in for standalone SME with a PE in another Member State; they would not welcome anything mandatory;
- and if possible to follow a one-stop-shop principle as much as possible, to reduce the reporting obligations and administrative burden for SME.

Finally, one idea put forward regarding the optionality and its implementation – find a way to ensure clear access to information for the SME taxpayers that may wish to use the options in SME simplification proposal, to provide a sort of Guidance and/or explanatory steps how that would work.

## ANNEX 3: WHO IS AFFECTED AND HOW?

### 1. SUMMARY OF COSTS AND BENEFITS

As explained in section 6.2.3 and 6.2.4, it has not been possible to estimate costs and benefits with any precision because the proposal does not have a precedent and there is no dedicated data that one can reliably use to produce very concrete estimates. Below, an attempt is made to describe some of the possible benefits and costs, under different assumptions.

Quantification of benefits and costs is then presented as range from high-end and low-end depending (1) on the potential of reducing current CIT-related compliance costs for cross-border operating firms (32% or 16%); (2) on the potential SMEs' productivity growth (15% or 4%) and (3) on the number of purely domestic firms that will expand their operation cross-border, incentivised by the HOT rules (from 12.5% to 1.25%). In order to make the costs and benefits comparable, the table below shows the high/low ends under the assumption that 10% and 5% of SMEs will decide to expand abroad, respectively.

It is important to underline that the available data does not allow to calculate with precision how much benefits and costs would be generated in the case of option 1 (voluntary simplification only for SMEs with PEs) or in the case of option 2 (voluntary simplification for SMEs with PEs and subsidiaries).

<b>– I. Overview of Benefits</b>		
<i>Description</i>	<i>Amount</i>	<i>Comments</i>
<b><i>Direct benefits</i></b>		
Reductions of CIT-related compliance costs for cross-border operating SMEs	1. High-end estimate: EUR 3.4 billion per year 2. Low-end estimate: EUR 1.3 billion per year	1. Under the assumption of 32% reduction of CIT compliance costs and 10% of additional domestic SME going abroad. 2. Under the assumption of 16% reduction of CIT compliance costs and 5% of additional domestic SME going abroad. Alternative scenarios are possible under different assumptions.
EU GDP and tax revenue increase driven by companies' higher productivity.	1. High-end estimate: EUR 61 billion per year (EU GDP could be higher by +0.7%, tax revenue by +1%, relative to the status quo) 2. Low-end estimate: EUR 19 billion per year (EU GDP could be higher by +0.08%, tax revenue by +0.12%, relative to the status quo).	1. Under the assumption of 15% productivity boost and 10% of additional domestic SME going abroad. 2. Under the assumption of 4% productivity boost and 5% of additional domestic SME going abroad. Alternative scenarios are possible under different assumptions.
<b><i>Indirect benefits</i></b>		
Reduction of the CIT tax gap and freed-up resources thanks to a reduced overall number of tax return filings across the EU.	The HOT system should facilitate anti-fraud policies and should contribute to the tax administrations' efforts to reduce the tax gap for corporate income taxation. The initiative is expected to reduce the amount of tax return filings across the EU on average.	

Improved efficiency for tax administrations	Resources for tax administrations are expected to be put to more efficient use due to the overall reduced number of tax returns EU-wide.	
<b>Administrative cost savings related to the 'one in, one out' approach</b>		
Recurrent (direct/indirect)	From EUR 1.3 billion per year to EUR 3.4 billion per year (*)	According to the different scenarios
One-off		

(\*) While it is difficult to identify the precise nature of the costs savings, one can assume that the great majority are related to administrative activities/reporting obligation, rather than adjustment costs.

<b>• II. Overview of costs (total for both options, except for costs for administrations)</b>							
		Citizens/Consumers		Businesses		Administrations (preferred option)	
		One-off	Recurrent	One-off	Recurrent	One-off	Recurrent
Simplification for SMEs with taxable presence in (an)other Member State(s)	Direct adjustment costs	N/A	N/A	High-end estimate: EUR 428 million Low-end estimate: EUR 332 million		EUR 20 million	
	Direct administrative costs	N/A	N/A	N/A	High-end: EUR 78 million per year Low-end: EUR 60 million per year	N/A	EUR 4 million per year
	Direct enforcement costs	N/A	N/A	N/A	N/A	N/A	N/A
<b>Costs related to the 'one in, one out' approach</b>							
<b>Total</b>	Direct and indirect adjustment costs			High-end estimate: EUR 428 million 2. Low-end estimate: EUR 332 million		EUR 20 million	
	Administrati				High-end:		

	ve costs (for offsetting)				EUR 78 million per year Low-end: EUR 60 million per year		EUR 4 million per year
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The table below provides an overview of the Sustainable Development Goals (SDGs) that can be related to this initiative.

<i>Overview of relevant Sustainable Development Goals – Preferred Option</i>		
<i>Relevant SDG</i>	<i>Expected progress towards the Goal</i>	<i>Comments</i>
SDG no. 8 – Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.	The initiative will reduce tax compliance costs, have a positive effect on cross-border investment and tackle distortions in the market, thereby stimulates economic growth and investment in the EU.	See above for the impact on GDP
SDG–no. 9 – Build resilient infrastructure, promote inclusive and Sustainable industrialization and foster innovation.	Although not possible to quantify, the overall reduction in compliance costs may indirectly contribute if the freed resources are used by businesses to invest in innovation.	

## ANNEX 4: ANALYTICAL METHODS

### 1. Assumptions for the survey-based projection of compliance cost reduction

A company survey for the European Commission on tax compliance costs, conducted by VVA/KPMG and published in January 2022, is the major source of analysis in the impact assessment report.<sup>44</sup> It looks at firms' tax compliance costs caused by specific types of taxes. Apart from Corporate Income Tax (CIT), the survey also covers administrative burdens caused by Value Added Tax, wage-related taxes, property and real estate tax and local taxes. The sample covers around 2.400 firms, and the dataset also provides weights for each firm, needed to project the total firm population represented by the sample. Survey questions refer to the situation of the respective firm in the year 2019.

The compliance cost projections in Chapter 6 take into account both outsourced and internalised compliance activities. If internalised, the survey asks for frequency of data collection as well as the hours spent on data collection, preparation, review, submission and other related activities. It is thus possible to calculate total hours internally spent within the firm on the different CIT-related compliance activities. These hours were then multiplied by average hourly labour costs for administrative and support activities.<sup>45</sup> Total CIT compliance costs are then the sum of outsourced and internalised compliance costs.

The survey information also includes relevant firm characteristics:

- the size of the firm (turnover, number of employees);
- whether not the firm operates cross-border<sup>46</sup>;
- whether or not the firm is subject to 'regular' CIT or to some kind of 'simplified tax regime'.

A simplified tax regime could be a lump-sum tax for SMEs, the filing of simplified tax return requirements, simplified accounting rules, balance sheet or income statement requirements, or other simplified documentation rules. Stakeholders interviewed for the study tend to have a positive view on simplified tax systems, considering them as a solution for reducing administrative burdens for SMEs. This is a relevant variable to estimate the impact of the SME simplification of this initiative, because while SMEs would remain subject to the regular national corporate tax rules of a Member States, they would no longer be subject to multiple national sets of CIT rules. This substantially reduces the amount of tax rules that SMEs need to know and comply with. In fact, where other simplified tax regimes bring simplification by moving from a more complex set of rules to a simple set of rules for taxation, the HOT rules will thus eliminate the need to consider one or more sets of rules altogether, and henceforth only comply with one set of rules, which the SME is already

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<sup>44</sup> VVA/KMPG for the European Commission (2022). See <https://op.europa.eu/en/publication-detail/-/publication/70a486a9-b61d-11ec-b6f4-01aa75ed71a1/language-en>

<sup>45</sup> Source: Eurostat, series Labour cost levels by NACE Rev. 2 activity [LC\_LCI\_LEV\_\_custom\_5553786].

<sup>46</sup> In the study, cross-border activities are defined as "all activities which involve the selling of goods, services or intangibles to a country other than the enterprise's home country" (European Commission, 2022, p. 11). In other words the definition is quite broad and not necessarily just about what we consider foreign direct investment.

applying. For the purpose of this analysis, the HOT rules are therefore considered a simplified tax regime.

### What is the current level of CIT-related compliance costs, and to what extent are SMEs concerned?

The corresponding dataset from the VVA/KPMG survey represents a firm population of some 16.4 million in the EU-27. The amount of CIT-related compliance costs these firms paid in 2019 is an estimated EUR 54 billion, representing a significant 0.4% share of the EU's GDP. The vast majority of these firms (14.6 million firms) do not (yet) engage in cross-border activities. These have combined compliance costs of EUR 48 billion (89%).

For the analysis, a new binary variable is constructed which indicates whether a certain firm falls in the category 'Micro, Small and Medium-Sized Enterprises' (SME). Following a Commission Recommendation, those are defined as 'enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million'<sup>47</sup>. All other firms are treated as 'Larger Enterprises'. Table A3.1 informs that **98% of all CIT-related compliance costs are borne by SMEs** (around EUR 6 billion per year). Using this information, we can compute CIT compliance costs per company size, distinguishing between those with a cross-border activity (i.e., sales, PEs, subsidiaries abroad) and those without.

*Table A4.1 (replicated Table 2 of Chapter 6): Number of firms, absolute and average CIT compliance costs (CC), cross-tabulated by firm size and cross-border activity, 2019*

		Operating cross-country?		
		no	yes	Total
SME	CIT CC (bn EUR)	46.9	5.9	52.8
	.. per enterprise	3,223	3,308	3,232
	Number of enterprises	14,566,027	1,784,673	16,350,700
Larger Enterpr.	CIT CC (bn EUR)	0.8	0.3	1.0
	CIT CC per enterprise	9,929	8,266	9,436
	Number of enterprises	77,939	32,824	110,763
Total	CIT compl. Costs (bn EUR)	47.7	6.2	53.9
	.. per enterprise	3,259	3,398	3,274
	Number of enterprises	14,643,966	1,817,497	16,461,463

Source: Commission services, based on data from VVA/KMPG (2022).

### What is the potential of reducing CIT related compliance costs through simplifying corporate taxation?

To approximate the potential decline of CIT-related compliance costs through reduced complexity of a tax system, a linear regression analysis was performed. The model explains total (logarithm of) CIT-related compliance costs, calculated as explained above, on a set of explanatory variables that include:

- the (log) number of employed workers (in quintiles),
- the (log) turnover (in quintiles),

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<sup>47</sup> C (2003) 1422. Information about the balance sheet total is not given in the survey.

- a binary dummy CROSS, informing whether the firm operates cross-border,
- a binary dummy SIMPL informing whether the firm is subject to a ‘simplified tax regime’ or CIT,
- an interaction term CROSS x SIMPL informing whether the impact of operating cross-border is moderated by the availability of a simplified tax regime,
- fixed effects controlling for the sector and the jurisdiction in which the firm operates.

The table below shows to what extent the CIT-related compliance costs would decline, relative to the respective reference category. For Model 2, which contains the interaction term, the reference category are purely *domestic* firms *not* subject to simplified tax rules. All coefficients are highly statistically significant ( $p < .001$ ).

*Table A4.2: Explaining CIT related CC, regression analysis, selected coefficients*

Variable	% change relative to reference	
	Model 1	Model 2
CROSS	+2%	+10%
SIMPL	+30%	+35%
CROSS x SIMPL		-25%

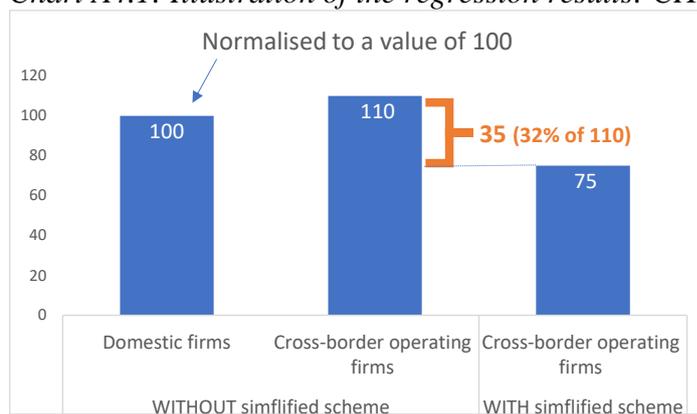
Source: Commission services, based on data from VVA/KMPG (2022).

Both models are controlled for firm size, the number of employees, the firm’s turnover as well as country and sector specificities. The simple model without interaction term (Model 1) reveals that operating cross-border increases CIT-related compliance costs overall. However, if the interaction term is included in the model, it becomes clear that **the availability of simpler tax rules matters a lot for the level of compliance costs**. If a simplified tax regime is *not* available, cross-border operating firms have, on average, 10% *higher* CIT compliance costs than domestic firms not subject to a simplified tax regime (the reference group). By contrast, if there are simplified tax rules, cross-border operating firms have 25% *lower* compliance costs than the reference group. Therefore, the regression analysis suggests that the simplification of tax rules has a very positive effect on **cross-border operating firms** in the sense that they **are able to reduce compliance costs very substantially: by 32%, relative to cross-border operating firms with no access to simplified rules**.<sup>48</sup>

The below chart illustrates these regression results, normalising the CIT compliance costs of domestic firms without simplified tax regime to a value of 100. This is the reference situation. The CC for cross-border operating firms *without* simplified regime would be 110 (+10% higher than in the reference situation), while *with* simplified regime they would amount to 75 (25% lower than in the reference). For cross-border operating firms, simplified schemes would then make a difference of 35, corresponding to 32% of 110.

<sup>48</sup> That is:  $(100\% - 25\%) / (100\% + 10\%) = (100\% - 32\%)$ .

Chart A4.1: Illustration of the regression results: CIT compliance costs by firm type



The findings strongly support the introduction of new, simpler rules for corporate tax systems in the EU.

**What is the potential reduction of CIT-related compliance costs in the short term, per cross-border operating firm?**

Applying a reduction of 32% on current CIT compliance costs of cross-border operating firms (EUR 6.2 billion as shown in Table A4.1 which replicates Table 2 of Chapter 6) would reduce these costs by EUR 2 billion. Existing simplified tax regimes tend to reduce complexity of tax rules significantly, so that in terms of simplicity, ‘simplified tax regimes’ as defined in the underlying study, could indeed be equivalent to SME simplification **high-end estimates** for cost saving due to simplification.

Moreover, there are further savings that should be taken into account for a high-end estimate. SME simplification rules will also incentivise so-far purely domestically working firms to extend their business, crossing EU borders, thereby reaping the benefits of the internal market. However, in the absence of a precedent for SME simplification it is impossible to calculate an exact elasticity informing about how much additional investment will be triggered. **It is therefore assumed that 10% of today’s 14.64 million domestic firms (see Table A4.1) will expand and start to operate in another Member State.** It implies that those firms have seen complicated national tax rules as an obstacle to extending their business beyond Member State borders. In economic terms, as CIT-related compliance get reduced, this would lower the threshold of extending business to other countries. This is because a 32% CIT-related compliance cost reduction is very significant. For many firms, the expected profits from going international would now exceed costs, inducing firms to start operating cross-border.

This would affect another 1.5 million firms, i.e., 10% of the 14.6 million so-far domestic firms not operating cross-border (see Table A3.1) which would save an amount of EUR 1.5 billion as they also benefit from the 32% decline in CIT-related compliance cost (i.e., 32% of 10% of EUR 47.7 billion). Total savings would then amount to EUR 3.5 billion per year.

In the case of **low-end estimates**, savings per firm could amount to only half of 32%, i.e., 16%, relative to cross-border operating firms without access to simplified systems. For those, they could then amount to EUR 1 billion (half the high estimate). Moreover, if only 5% (instead of 10%) of

so-far domestic firms felt incentivised to extend business cross-border, their savings amounted to EUR 0.4 billion (i.e., 16% of 5% of EUR 47.7 billion). Total savings were then EUR 1.4 billion p.a.

These short-term estimates have to be interpreted with due care. It obviously depends on an array of assumptions, each of them having a decisive impact on the outcome. This affects, first and foremost, the assumption that 10% of so-far domestic firms take up cross-border business, incentivised by simplifications that come with this proposal. Empirical evidence, however, is lacking. It would also not be accurate to draw on (1) investment-tax elasticities or (2) investment-compliance cost elasticities from literature. In the first case, the level of taxes in a country says little about foregone investment due to complex tax rules. In the second case, direct expenses linked to activities for tax compliance are only a very small proportion of compliance costs, given that the latter includes future profits foregone as SMEs may refrain from crossing of borders due to uncertainties and thresholds. Indeed, with a view on the driving factors, what counts more than the short-term savings on compliance expenses is the long-term economic prospect of better legal clarity and better transparency of the tax system. Concretely, if SMEs can continue to apply the same tax rules when they first expand across borders, the thresholds are lowered and the new markets will appear much more accessible. This is why we extend the analysis by model-based long-term simulations.

### **What effect can we expect in the medium to long term? A simulation with *Cortax***

*Cortax* is a multi-country general equilibrium model run by the European Commission's Joint Research Centre, covering households, firms and governments. It includes all Member States, plus the United Kingdom, Japan, the United States and low-tax jurisdictions. *Cortax* models the tax base explicitly, taking account of tax depreciation, (non) deductibility of interest, and allowance for corporate equity. It also embeds the feature of loss carry-forward and distinguishes between domestic and multinational firms. For the latter, it allows for cross-border aggregation. *Cortax* explicitly takes account of compliance costs, i.e., workers in firms absorbed by compliance activities.

One important point to understand is that, in the short-term, the effects outlined in the previous sections only cover the reduction of (immediate) expenses that firms may have due to compliance to CIT rules. They do not include second-round macro-economic effects of more CIT transparency and better legal certainty. Those are a high multiple, relative to its short-term impact, and especially relative to the transitory investment that becomes necessary with the introduction of the HOT rules.

There are several ways of demonstrating the long-term benefits. One is to look at resources freed-up as firms save on compliance costs. For example, due to the savings on compliance costs outlined in the previous sections, firms would have more resources available for investment in firm-sponsored training (see next section's simulation with the *Labour Market Model*). Another, different source of higher labour productivity is that SMEs in particular can better capitalise on the internal market. This is because the simplification introduced by the proposal, enables firms to extend their businesses to countries from which they have abstained so far. In that context, it was shown with *Cortax*, that the productivity shift resulting from better tax transparency would have a decisively positive impact on economic activity.

The productivity shift would come from so-far domestic firms extending their businesses into other Member States as tax-related obstacles are reduced for SMEs. There is plenty of evidence that firms exposed to international competition are more productive than purely domestic firms. Most

relevant in the context of SME simplification, Mikić et al. (2016)<sup>49</sup> find that internationalisation has a positive impact on business performance of SMEs. Bellak (2004)<sup>50</sup> finds that performance gaps arise in such fields as productivity, technology, profitability, wages, skills and growth and that the multinational aspect of the company, more than the nationality of the firm, seems to explain these gaps. Helpman et al. (2001)<sup>51</sup> see productivity differentials between international and domestic firms as a result of choice: low-productivity firms may not even try to engage on foreign markets at all, while the most productive firms engage not only by exporting but also through Foreign Direct Investment. Markusen and Trofimenko (2009)<sup>52</sup> see that FDI, through foreign experts working in a country, are a channel of knowledge transfer and push productivity. Indeed, the positive impact of internationalisation on a firm's performance seems to increase with the extent of a firm's FDI activity (Lu and Beamish, 2001)<sup>53</sup>. We used the 2020 [CompNet Firm Productivity Report](#)<sup>54</sup> which reckons that exporters' labour productivity premium over non-exporters could amount to 15%.

Re-iterating the assumption that 10% of so-far domestic firms would expand their business cross-border (previous section), the shock introduced into the *Cortax* model is thus **a 15% productivity shift, applied to 10% of domestic firms** in the EU. Technically, in model terms, the exogenous productivity shift thus implies that firms will be able to produce more with a given factor (labour and capital) input.

Apart from the pure model technique, what happens in reality is that firms can better foresee what the crossing of borders means for them: in what countries (and to what extent) are they present for the purpose of taxation; what effort would they have to make in order to comply with EU-wide tax rules; and ultimately: what effective tax rate would they have to factor in for future investment. They will thus expand their business to other Member States. As they get exposed to international competition, they become more efficient in production, so that total factor productivity increases.

The long-term effect on **GDP (+0.7% in the long run)** and on **tax revenue (+1%)** indicate that the macro-economic impact is very significant for the entire economy. The results stem from the illustrative assumption that 10% of so-far domestic firms will become active across borders as administrative burden reduces and transparency and legal clarity about international CIT improves. As this is a rather optimistic scenario, it is complemented by a series of sensitivity analyses.

Keeping the high-end **estimate of 15% productivity gains** for international firms found by CompNet(2020), the link between the share of firms going international, on the one hand, and the

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<sup>49</sup> Mikić, M. & Primorac, D. & Kozina, G. (2016). *Determining the link between internationalization and business performance of SMEs*. Tehnicki vjesnik - Technical Gazette. 23. 1201-1206. 10.17559/TV-20150701204258.

<sup>50</sup> Bellak, C. (2004). *How Domestic and Foreign Firms Differ and Why Does It Matter?*. Journal of Economic Surveys. 18. 483-514. 10.1111/j.0950-0804.2004.00228.x.

<sup>51</sup> Helpman, E., Melitz, M. J., Yeaple, S. R. (2004). *Export Versus FDI with Heterogeneous Firms*. American Economic Review, 94 (1): 300-316. DOI: 10.1257/000282804322970814

<sup>52</sup> Markusen, James & Trofimenko, Natalia. (2007). *Teaching Locals New Tricks: Foreign Experts as a Channel of Knowledge Transfers*. Journal of Development Economics. 88. 120-131. 10.1016/j.jdeveco.2008.02.002.

<sup>53</sup> Lu, J. & Beamish, P. (2001). *The Internationalization and Performance of SMEs*. Strategic Management Journal. 22. 565 - 586. 10.1002/smj.184.

<sup>54</sup> CompNet, The Competitive Research Network, Firm Productivity Report, May 2020.

impact on GDP and tax revenue, on the other hand, is a bit stronger than linear.<sup>55</sup> The following relation holds:

- 2.5% of so-far domestic firms go international: EU GDP increases by +0.16% , EU tax revenues increase by +0.24%.
- 5% of so-far domestic firms go international: EU GDP increases by +0.32% , EU tax revenues increase by +0.48%.
- 7.5% of so-far domestic firms go international: EU GDP increases by +0.50% , EU tax revenues increase by +0.75%.
- 10% of so-far domestic firms go international: EU GDP increases by +0.70% , EU tax revenues increase by +1.03%.
- 12.5% of so-far domestic firms go international: EU GDP increases by +0.90% , EU tax revenues increase by +1.32%.

For the **low-end estimate** of a productivity premium for going international of only **4%** (de Loecker, 2013), the following holds:

- 2.5% of so-far domestic firms go international: EU GDP increases by +0.04% , EU tax revenues increase by +0.06%.
- 5% of so-far domestic firms go international: EU GDP increases by +0.08% , EU tax revenues increase by +0.12%.
- 7.5% of so-far domestic firms go international: EU GDP increases by +0.12% , EU tax revenues increase by +0.19%.
- 10% of so-far domestic firms go international: EU GDP increases by +0.17% , EU tax revenues increase by +0.25%.
- 12.5% of so-far domestic firms go international: EU GDP increases by +0.21% , EU tax revenues increase by +0.32%.

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<sup>55</sup> For example, 12.5% is 5 times 2.5%. But the GDP-increase +0.9% for 12.5% of domestic firms going international is 5.8 times the +0.16% increase for 2.5% going international.

## ANNEX 5: COMPETITIVENESS AND SME CHECK

### 1. OVERVIEW OF IMPACTS ON COMPETITIVENESS

Dimensions of Competitiveness	Impact of the initiative (++ / + / 0 / - / -- / n.a.)	References to sub-sections of the main report or annexes
Cost and price competitiveness	++	Chapters 3, 4, 6, 7
International competitiveness	+	Chapters 3, 4, 6, 7
Capacity to innovate	+	Chapters 3, 4, 6, 7
SME competitiveness	++	Chapters 3, 4, 6, 7

#### *Synthetic assessment*

By introducing a simplification framework for SMEs operating cross-border, the proposal is expected to have a positive impact on cost and price competitiveness. The main purpose is simplification regarding application of the current corporate tax rules which will reduce compliance costs for SMEs operating in all sectors in the internal market. The possibility of developing activity across the border through one or more permanent establishment while continuing to calculate the taxable result in line with the corporate tax rules of the Member State of origin is expected to reduce SMEs' international expansion costs.

SME simplification is also expected to establish a level playing field, break down barriers to cross-border expansion and trade and, as such, improve the international competitiveness within the SMEs businesses. Helping SMEs to first grow in the internal market would subsequently allow them to expand even outside the EU.

SME simplification does not directly touch upon SMEs capacity to innovate as such. Though, the overall reduction in compliance costs may, indirectly, have an impact as it will release an amount that can be used on a number of activities, including investing in innovation.

### 2. THE SME TEST

*Step 1/4 Identification of SMEs:* The present initiative is considered **highly relevant** for SMEs insofar all SMEs with a head office in the EU are the (only) direct beneficiary. The SME simplification framework offers to eligible SMEs - standalone entities, i.e., one single legal person without subsidiaries optional rules that will enable them to choose the simplest and most cost-efficient option based on their individual needs.

*Step 2/4 Consultation of SME stakeholders:* See Annex 2.

*Step 3/4 Impacts:* As explained above and in Chapter 6, eligible SMEs will highly benefit from the tax compliance cost reduction when going abroad that, in turn, will improve the level playing field. Considering that the system is optional for SMEs, we do not estimate adverse effects. In addition,

the fact that the simplification is not available to SME groups but only to standalone entities, should not bring forth negative impacts.

*Consultation of alternative options:* It was considered to entitle not only standalone entities, but also SME groups up to a certain ceiling of revenues. This option is assessed in the main report, and it is explained why it was not retained.

*Step 4/4. Minimising negative impact on SMEs.* Policy options in this proposal have been designed with SMEs in mind. Additional adjustment and compliance costs have been kept to the minimum and the net benefits for the SME are very important.

## **ANNEX 6: TERRITORIAL IMPACT ASSESSMENT – NECESSITY CHECK**

The problem and its consequences that this initiative aims to address (complexity and high compliance costs) are spread across the Union evenly, indeed they are a product of the existing of many systems. The initiative itself will not impact regions differently.