



**European Commission's proposal for a Council Directive on establishing a Head Office Tax system for micro, small and medium sized enterprises**

**Position Paper**

**21 December 2023**

## About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 6,000 is part of the international CTA network which has more than 32,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, the Taxation Institute of Hong Kong and the South African Institute of Taxation. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members, and our role in serving the best interests of Ireland's taxpayers in a new international world order.

**Irish Tax Institute - Leading through tax education**

## Introduction

The Irish Tax Institute welcomes the opportunity to contribute to the European Commission's public consultation on the proposal for a Council Directive on establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU (known as the HOT Directive).

The HOT Directive is intended to simplify tax compliance for SMEs operating cross-border in the EU by providing them with the option to interact with only one tax administration, instead of having to comply with the tax systems in multiple Member States. The Explanatory Memorandum notes that the objective of the proposal is to reduce compliance costs for SMEs, encourage cross-border expansion and ensure a level playing field for the participation of SMEs in the Internal Market.

The Institute welcomes the proposal to simplify the taxation of SMEs. In principle, a one-stop shop for SMEs operating cross-border within the EU could encourage expansion by such companies. Providing SMEs with the option to centralise all filings and disputes through the tax administration of the head office would ease the compliance burden for SMEs.

However, the narrow scope of the proposal means that the potential benefits offered by the HOT regime will be limited to companies in the very initial phases of expansion within the EU. In addition, we believe that clarity is needed regarding the tax rules that would apply where a company transitions in and out of the HOT regime.

## Scope of the Directive

The scope of the HOT rules is restricted to certain EU-based standalone SME entities that operate exclusively through a PE in one or more Member State(s). SMEs with one or more subsidiaries in another EU Member State are not in scope of the HOT regime.

The HOT rules are intended to combat the cost and compliance barriers that can often prevent SMEs from expanding from one market in the EU to another. While in-scope SMEs which opt to apply the HOT regime would benefit from the simplification on offer, the narrow scope of the HOT Directive, in particular the requirement that the entity operates exclusively through a PE in the EU, means that the proposal would be of benefit to a very small number of SMEs.

For Member States, such as Ireland, with a small open economy, indigenous businesses are more likely to expand into other markets in the initial phases of their economic activity. Such businesses may operate in another Member State through a subsidiary rather than a PE for a variety of commercial reasons. However, the narrow scope of the HOT rules means that such businesses would not be entitled to avail of the proposed simplification framework.

In our view, broadening the scope of the simplification framework to include SMEs that choose to expand their operations by establishing a subsidiary in another Member State, would encourage more early-stage businesses to expand cross-border in the EU.

## **Transitioning in and out of the HOT regime**

As outlined above, under Article 7 of the HOT Directive, a company may apply the HOT rules for a period of five years. Under Article 8, the option to apply the HOT rules can be terminated before the end of the five-year period in certain circumstances, such as where the turnover of the PE exceeds three times the turnover of the head office.

The rules which apply when a company transitions in or out of the HOT regime are unclear. For example, an Irish company with a German PE may elect under the HOT regime to apply the Irish tax rules for five years in accordance with the HOT Directive. At the end of the five-year period, if the company does not opt to renew the application of the HOT rules, or the option to apply the HOT rules is terminated before the end of the five-year period, it is unclear how the tax attributes of the PE would be calculated on transitioning out of the HOT regime. For instance, would there be a balancing event in Ireland in respect of assets used in the PE and how would the equivalent German tax rules be applied to such assets?

In our view, clarity is needed in the Directive regarding the tax rules which would apply where a company transitions in and out of the HOT regime.

## **Conclusion**

In summary, the Institute considers in principle, a one stop shop for SMEs operating across border in the EU as a welcome initiative, given the potential to streamline compliance and avoid potential disputes for such companies. However, the narrow scope of the HOT regime, in its current form, means that the potential benefits offered by the Directive will be extremely limited and consequently, only relevant to a few businesses.