



Questions and Answers on establishing a Head Office Tax System for SMEs (HOT)

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What are some of the problems SMEs face in the Single Market?

If micro, small and medium enterprises (SMEs) wish to operate cross-border, they become taxable in more than one Member State as soon as their activity abroad creates a permanent establishment. The current systems of business taxation in the EU can be complex, which means that cross-border businesses can face high tax compliance costs, as well as risks of double or over-taxation and time-consuming legal disputes. This can prevent SMEs from developing their business in more than one Member State, particularly for new enterprises.

How much are SMEs spending in compliance costs associated with corporate income tax?

Corporate income tax-related compliance costs in the European Union could amount to as much as €54 billion a year. Moreover, 90% of this amount is incurred by very small enterprises, with fewer than 10 employees. SMEs spend approximately 2.5% of their turnover on compliance with their tax obligations, while large enterprises spend 0.7%. This is because it is proportionally more difficult for SMEs to deal with the different set of tax rules of EU Member States.

What is the Commission proposing?

The Commission's proposal would give SMEs operating cross-border through permanent establishments the option to interact with only one tax administration – that of the Head Office – instead of having to comply with multiple tax systems.

SMEs would therefore calculate their taxes based only on the tax rules of the Member State of their Head Office. SMEs would file one single tax return with the tax administration of their Head Office, which would then share this return with the other Member States where the SME is operating. The Member State of the Head Office would also subsequently transfer any resulting tax revenues to the countries where the permanent establishments are located.

The scope of these rules would be limited to standalone SME entities with permanent establishments and would not be extended to SME groups with subsidiaries. Therefore, if an SME reaches a degree of expansion that allows it to grow into a group, it will no longer be entitled to the simplification framework. It would have the possibility to continue to apply the simplification rules, but only up to the end of the five-year period of the option.

How will this help SMEs?

The Commission's proposal will increase tax certainty and fairness, reduce compliance costs and distortions in the market that influence business decisions, while minimising the risk of double and over taxation and tax disputes.

The expected decrease in compliance costs should, in particular, foster investment and cross-border expansion in the EU. SMEs operating in different Member States will be able to fully maximise the freedom of establishment and the free movement of capital without being hindered by unnecessary tax related obstacles.

How long can SMEs apply these rules?

Once an SME chooses to apply the new rules, it will have to remain under this system for five fiscal years, unless the Head Office changes residence in the meantime, or their foreign business activity grows exponentially in comparison to the business activity in the Member State of origin. In that case, the rules cease to apply. SMEs will be able to renew their choice every five years without limit as long as they continue to meet the eligibility requirements. The eligibility and termination provisions are designed to discourage potential tax planning practices, notably the deliberate transfer of the Head Office to a low-tax country.

How does the HOT proposal relate to Business in Europe: Framework on Income Taxation

(BEFIT)?

The BEFIT proposal is primarily aimed at large groups operating across the EU. The HOT proposal simplifies rules for SMEs during their early stages of expansion. If SMEs successfully expand and grow, they may outgrow the scope of the HOT rules, but then they will be able to opt into BEFIT. In this way, the two proposals are complementary. Smaller businesses will be able to choose the best option for their own needs throughout their lifecycle.

For more information

[Press release on SME relief package](#)

[Legal documents on the Head Office Tax System for SMEs](#)

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