

Tax Simplification 101: HOT is Moving Forward

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On 12 September 2023, the European Commission launched three proposals for Council Directives – the [Business in Europe: Framework for Income Taxation \(BEFIT\) Directive](#), the [Head Office Tax \(HOT\) Directive](#) and a [Transfer Pricing \(TP\) Directive](#). All three proposals are meant to simplify tax rules and provide certainty to EU businesses (the scope of the present note covers solely the HOT Directive). At their outset:

- BEFIT targets mostly large corporate groups which already have extensive cross-border activity;
- HOT focuses on small and medium-sized enterprises (SMEs) at the initial stage of their cross-border activity in the European Union; and
- the TP Directive establishes a common definition of the arm's length principle (among other things).

HOT (as well as BEFIT) is rooted in the [Communication on Business Taxation for the 21st Century](#), as published in May 2021, and is expected to complement the array of the Commission's initiatives for simplification in corporate taxation.

Understanding HOT

The aim of HOT is to provide for an optional, simplified approach of subjecting stand-alone SMEs operating cross-border in the European Union through permanent establishments (PEs) to taxation rules exclusively in the head office (HO) Member State in respect of such PEs.

The initiative is limited to the taxation rules for the computation of the taxable result of PEs and does not interfere with the social security rules applied in the Member State of the PE, nor does it affect existing bilateral conventions on the avoidance of double taxation. For the purposes of applying the rules, a PE encompasses a fixed place of business situated in another Member State as defined under the relevant bilateral convention on the avoidance of double taxation or (in the absence thereof) under national law.

Standalone SMEs (as defined by [Accounting Directive \(2013/34\)](#)) that operate exclusively through PEs in one or more Member States may opt into the rules. The proposal provides for the creation of a one-stop shop, which practically entails that the HOs will interact only with one tax administration – that of the HO (i.e. the filing authority) for the purposes of opting into the rules, filing obligations and actually paying taxes. The filing authority will then, as a first step, collect the tax corresponding to the tax liability of each PE and subsequently, as a second step, apply the tax rate of the PE's Member State. This tax administration will then transfer the resulting tax revenues to each Member State in which the SME maintains a PE.

Milestones achieved

HOT falls under the consultation procedure, which requires that the Council consider the opinion of the European Parliament and that of the European Economic and Social Committee (EESC). Both institutions have delivered their opinions, which in general greenlight HOT but propose amendments/clarifications.

At the same time, national parliaments have been very vocal in expressing their views regarding HOT rules. Examples of such reactions include those of:

- Sweden, which submitted a reasoned opinion asserting that HOT does not comply with the principle of subsidiarity; and
- [Finland](#), which, although generally supporting HOT, has expressed serious doubts on the transfer of taxing powers, which should presumably remain at the national level. The government pointed out that the HOT Proposal specifically entails significant harmonization regarding corporate taxation and might create uncertainties regarding the corporate income tax revenue that Finland could generate.

The EESC opinion

The [EESC suggested](#) – among other things – that the Commission work closely with Member States after the adoption of HOT to raise awareness on the availability of the rules and that relevant parties offer methodological support on how to prepare the “HOT tax return”. The EESC also observed that the interaction of HOT’s optional nature with BEFIT’s scope will create different legal frameworks across the European Union for companies in potentially comparable situations. It therefore encouraged the Commission to monitor the evolution of the HOT rules, since the coexistence of different legal frameworks applicable to comparable players might generate fragmentation and discrepancies, possibly harming the consolidation of the internal market.

The European Parliament opinion

In its [opinion \(adopted](#) on 10 April 2024), the European Parliament opened a window for a substantially modified version of the proposal. The list below summarizes the observations and suggestions made by the European Parliament but does not enter into in-depth technical discussions. The European Parliament:

- emphasized that SMEs – due to their limited resources – face significant compliance costs linked to taxation, which in turn hamper their development and discourage them from investing in more than one Member State;
- recognized that there are more than 24 million SMEs in the EU, which represent two thirds of private sector jobs and are the backbone of the Union economy. By protecting SMEs, the EU will promote job creation, enhance growth, encourage fair and transparent competition, support competitiveness and attract investment;
- proposed extending the scope of the rules to include companies which operate cross- border exclusively by way of PEs or a maximum of two subsidiaries;
- reassured that the principles governing the attribution of income to a PE or subsidiary, set out in the applicable bilateral convention for the avoidance of double taxation between the Member State of the PE or subsidiary and the Member State of the HO, would also continue to apply and that relying on the HOT rules remains optional;
- reaffirmed that the one-stop shop should provide all the features of simplification (with optimism stemming from how the tool applied for VAT purposes) so as not to become another obstacle for businesses that wish to invest abroad and by establishing a cooperation obligation for the Member States’ tax authorities. This, practically, would translate into a scenario whereby if the Member State of the HO conducts an audit on its own initiative, it should invite the host Member State to jointly carry out such audit;
- proposed to make HOT known to eligible companies by launching a Union-wide information campaign; and
- suggested accelerating the timeline of the proposal by having Member States adopt it before 31 December 2024 so that the rules apply from 1 January 2025.

What's next?

The adoption of HOT requires unanimity in the Council of the European Union. Practically, HOT, along with BEFIT and the TP Directive, are presented as one initiative on the Commission's website, even though they have different timelines and an even more different anticipated impact. For completeness, the TP Directive appears also to be moving along (with the European Parliament's opinion adopted on 10 April 2024), while BEFIT seems to be facing a bit of "turbulence".

With regard to the information campaign, the Commission is already taking steps in this direction by organizing two [webinars](#) on the matter (on 17 April and on 19 June 2024). If adopted in its current version (without taking into account the Parliament's suggestion to accelerate the process by 1 year), HOT should be transposed into domestic laws by 31 December 2025 and apply as from 1 January 2026.

IBFD references

- For an overview of legislative initiatives at the EU level on direct tax matters from the moment they are planned by the European Commission until their adoption by the Council of the European Union, see the [EU Direct Tax Law Initiatives Tax Dossier](#).
- J.F. Pinto Nogueira, [Head Office Taxation Rules and Simplification of Compliance Costs of SMEs](#), 31 Intl. Transfer Pricing J. 1 (2024), Journal Articles & Opinion Pieces IBFD.
- J.J.A.M. Korving, "[BEFIT and HOT: FASTER and SAFE! EU Law or Slogan for Slimming Pills?](#)", 63 Eur. Taxn. 12 (2023), Journal Articles & Opinion Pieces IBFD.
- O. Popa, [An Overview of the HOT Proposal](#), 63 Eur. Taxn. 11 (2023), Journal Articles & Opinion Pieces IBFD.
- EU tax law developments are reported in the daily IBFD [Tax News Service](#).