**Head Office Taxation rules and simplification of compliance costs of SMEs**

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**Abstract:**

This study performs a legal assessment of the proposed Directive on Head Office Taxation, and puts forward alternatives to overcome the identified concerns. It is structured around the building blocks of the proposal: i) scope; ii) access to the regime; iii) substantive tax rules, and; iv) procedural tax rules. The study concludes with policy considerations on the proposed Directive's impact on the strengthening of the EU's internal market.

**Keywords:**

European Union; Direct Taxation; Head Office Tax System; Micro, Small and Medium Enterprises; Permanent Establishments.

**Contents**



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## 1. Introduction

### 1.1 Background

In 2001, and shortly after the adoption of the European Company Statute,[2] two scholars published a challenging proposal for a "home state taxation".[3] According to them, companies of a Member State "would adopt the domestic tax systems of that Member State and apply it to their activities in other participating Member State". Accordingly, "the tax base for all activities of a group of companies within the system would be that of a single tax system – the parent company's Home State".[4] The proposed Directive is not more than a smaller-scale implementation of such ideas.

It took more than twenty years for such ideas to be converted into a legislative draft. The origins of the current proposed Directive can be traced back to the 2021 Communication on Business Taxation for the 21st Century.[5] This document clearly noted that the "patchwork of national tax rules creates unnecessary compliance costs for businesses, which discourages cross-border investment in the Single-Market"[6]. Such patchwork also affects "SMEs, start-ups and other businesses looking to grow, expand and trade cross-border for which the costs are proportionately greater".[7] According to the Communication, whereas compliance costs for large companies were about 2% of their taxes, this percentage spiked to 30% in the case of SMEs.[8] However, the Communication did not propose any concrete action.

The 2022 State of the Union address[9] included, for the first time, a reference to an "SME relief package", which would "include a proposal for a single set of tax rules for doing business in Europe". Notwithstanding, no specific reference to a specific action was included.

The Head Office Tax system for micro, small and medium-sized enterprises[10] was finally released in September 2023 as part of the "SME relief package"[11] (which included several other non-tax measures addressing SMEs). On the same day, the Commission

[2] Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE), OJ L 294, 10.11.2001, p. 1–21 and Council Directive 2001/86/EC of 8 October 2001 supplementing the Statute for a European company with regard to the involvement of employees, OJ L 294, 10.11.2001, p. 22–32.

[3] S.O. Lodin & M. Gamie, Home State Taxation, IBFD, 2001.

[4] See S.O. Lodin & M. Gamie, Home State Taxation, supra n. 3, p. 21.

[5] European Commission, Communication from the Commission to the European Parliament and the Council on Business Taxation for the 21st Century, Brussels, 18.5.2021, COM(2021) 251 final.

[6] See Communication, supra n. 5, p. 5.

[7] See Communication, supra n. 5, p. 6.

[8] See footnote 21 of the Communication, supra n. 5.

[9] Ursula von der Leyen, 2022 State of the Union Address, 14.09.2022 available at: https://ec.europa.eu/commission/presscorner/detail/en/speech_22_5493.

[10] European Commission, Proposal for a Council Directive Establishing a Head Office Tax System for micro, small and medium sized enterprises and amending 2011/16/EU, COM(2023) 528 final, 12.9.2023.

[11] See European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions: SME relief Package, COM(2023) 535 final, 12.9.2023.

released BEFIT, an autonomous package including two proposals: i) the framework for Income Taxation (BEFIT),[12] and; ii) the transfer pricing directive.[13]

This study aims to provide an initial legal assessment of the Head Office Tax system, focusing on the simplification and decrease of compliance costs it represents for European businesses. It does not aim at being comprehensive and focuses on the most critical issues, putting forward alternatives that could be considered in future revisions of the proposed Directive. It also considers the impact that it would have on the design of corporate income tax systems within the European Union.

### 1.2 Aims and *modus operandi*

The proposed Directive aims at providing "tax certainty and easier tax compliance (…) for certain SME's that are at their incipient state of expansion",[14] at reducing compliance costs, at encouraging cross-border expansion and at ensuring a level playing field between MNEs and SMEs, as the latter bear a significantly higher percentage of compliance costs. It pursues such aims with measures at both the substantive and procedural levels.

At the substantive level, it proposed computation of the taxable base of all SME units (comprising the head office, hereinafter HO, and Permanent Establishments, hereinafter PEs) according to the rules of its Member State of residence (hereinafter, the head office Member State), regardless of where the units are located.

At the procedural level, it proposes condensing existing tax returns into a single tax return filing, next to the tax authorities of the SME Member State of residency (hereinafter, the filing authority). This authority will be responsible for assessing and collecting the tax. It would also be responsible for apportioning and remitting a part of the tax to each Member State where the SME has a PE (hereinafter, the host Member State).

According to the proposed timeline, the would be implemented until 31 December 2025, and would enter into force on 1 January 2026.

### 1.3 Sequence

This study focuses on a critical legal assessment of the proposed Directive and is structured around its main building blocks. It will cover the scope, the access to the regime, the substantive and the procedural tax rules. It concludes with a discussion of the wider policy impact of the proposed Directive.

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[12] European Commission, Proposal for a Council Directive on Business in Europe: Framework for Income Taxation, COM(2023) 532 final, 12.9.2023.
[13] European Commission, Proposal for a Council Directive on Transfer Pricing, COM(2023) 529 final, 12.9.2923.
[14] See "Legislative Financial Statement" included in page 24 et seq. of the document including the proposed Directive, see supra n. 10.

## 2. Entitlement (scope and eligibility)

### 2.1 Introduction

The rules on the entitlement to the proposed regime are scattered across several articles which distinguish between scope and eligibility requirements. This study addresses them in a consolidated and structured manner, considering the nature of each requirement. The next sections address: i) the traditional corporate tax directive requirements; ii) the size-related requirements; iii) the operational requirements, and; iv) the turnover-comparison requirements. This section ends with a reference to the exclusion of certain activities.

### 2.2 Traditional corporate requirements

The proposed Directive restricts entitlement to companies meeting the "traditional requirements" for entitlement under secondary domestic law in direct taxation, which *grosso modo* can be found already in the Parent-Subsidiary directive, [15] Interest and Royalty directive[16] and Merger directive, [17] *i.e.*: i) residency in the Union,[18] which needs to be kept in the same Member State for two years;[19] ii) adoption of one of the forms listed in the Annex,[20] and; iii) subjection to one of the taxes listed in the Annex.[21] The requirements are similar to those proposed under the BEFIT directive, which were already comprehensively assessed in another study co-authored by the author of this study.[22]

The first requirement is residency for tax purposes. It shall be ascertained taking into account both domestic and tax treaty rules. There is no indication why entitlement should not be available to companies that have recently been created or have recently transferred their residence and, in the absence of a sound policy reason, such limitation could be waived. The major difficulty in this field is created by applying the tie-break rule of treaties following the 2017 version of the OECD Model Tax Convention. Treaties following that model, instead of a single substantive criterion (place of effective management), adopt a two-tiered procedural approach, which does not allow an

[15] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast), OJ L 345, 29.12.2011, p. 8–16.

[16] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ L 157, 26.6.2003, p. 49–54.

[17] 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 (Codified version), OJ L 310, 25.11.2009, p. 34–46.

[18] See Art. 2(1)(b) of the proposed Directive and OECD Model Tax Convention on Income and on Capital, art. 4(3) (21 Nov. 2017), Treaties & Models IBFD.

[19] See Art. 4(1)(b) of the proposed Directive.

[20] See Art. 2(1)(a) of the proposed Directive.

[21] See Art. 2(1)(c) of the proposed Directive.

[22] See P. Pistone, J.F.P. Nogueira, I. Lazarov, A. Turina and S. Messina, Proposal for a Council Directive on BEFIT: an Initial Assessment, IBFD, 2023 available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4600456.

autonomous determination of the residency for tax treaty purposes of companies meeting the domestic residency criterion in more than one State.[23]

Companies must adopt one of the forms listed in the Annex. However, the Annex lists requirements beyond the mere corporate form, which must also be met. The proposal requires companies to be "established" under the law of a Member State: it is unclear what is concretely meant, but it appears to be referring to incorporation under the laws of a Member State.[24]

The proposed Directive requires that either the companies, or their members or shareholders are subject to a tax listed in the Annex.[25]

Finally, there is a proposal to confer the Commission with the power to adopt delegated acts to amend the list of corporate forms and of the taxes mentioned in the annexes.[26] The author notes, as further detailed in a previous co-authored study on BEFIT,[27] that such power may include "essential elements"[28] and, as a consequence, the power conferral may amount to an infringement of the essential elements doctrine, as defined by the Court.[29]

### 2.3 Size-related requirements

The new rules will only apply to micro, small and medium-sized companies as defined by the Directive on annual financial statements.[30] Accordingly, companies cannot exceed at least two of the following three criteria, on a yearly basis: i) total balance sheet of 20 million EUR; ii) net turnover of 40 Million EUR; iii) average number of employees of 250.[31]

It is unclear why the proposed rules include size-related requirements, as the underlying rationale of the intervention relates to the "patchwork of national tax rules", which affects companies of all sizes. The differential factual tax burden argued as a justification is caused by the ratio between compliance costs and due taxes (which is something co-natural to the dimension of such companies, and is not restricted to taxes, being also the case of any compliance costs) and not the rationale of the legislative

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[23] On the implication of the two-tiered mutual agreement procedure approach as recommended by Art. 4(3) of the 2017 version of the OECD Model Convention, supra n. 18, on corporate tax directive entitlement see J.F.P. Nogueira, Dual residency of companies and EU law: accessing directive benefits with the post-2017 OECD Model Tax Convention wording, forthcoming.

[24] Art. 2(1)(a) of the proposed Directive. One could question whether such requirement would not lead to an infringement of the ownership non-discrimination clause of pre-1958 or pre-accession tax treaties, according to Art. 351 of TFEU.

[25] Art. 2(1)(c) of the proposed Directive.

[26] According to Art. 2(2) and 16 of the proposed Directive.

[27] Supra n. 22.

[28] In the sense this expression is used in Art. 290(1) TFEU.

[29] Judgment of 26 July 2017, *République Tchèque / Commission* (C-696/15 P) ECLI:EU:C:2017:595, paras. 48 and 49.

[30] 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, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance, OJ L 182, 29.6.2013, p. 19–76.

[31] More precisely Art. 3(3) of Directive 2013/34/EU, see supra n. 30.

intervention, which relates to simplification measures alleviating the burden caused by the lack of harmonisation of corporate taxation within the EU. In any case, the supra-referred internal ratio[32] operates on a sliding scale,[33] which is also not congruent with the proposed size-related single threshold. Moreover, such scope may hamper the SMEs' growth as they may decide not to expand, taking into account the added compliance costs that such expansion entails. Finally, it may provide an incentive for precarious work disguised as service provision as a means of avoiding surpassing one of the thresholds: the maximum number of employees.

In the author's view, these rules should be extended to companies of any size insofar as they would not qualify for any EU tax computation regime (whose application is inconsistent with these rules).[34]

## 2.4 Operational requirements

The proposal is restricted to companies which: i) do not operate as part of a consolidated group;[35] ii) are not an associated undertaking;[36] iii) are not linked enterprise,[37] and; ii) operate solely via PEs.

The first requirement excludes members of a consolidated group, as required by the applicable international accounting standards.[38] However, in the author's view, there is no *prima facie* incompatibility between financial accounting rules on consolidation and these rules. The infra-referred underlying rationale applies also in the case of companies which are members of consolidated groups.

The second requirement excludes companies under a "significant influence" of another undertaking. There is a presumption of "significant influence" if another undertaking controls 20% or more of the shareholding or of the voting rights.[39] This appears to be lower than the threshold of "definite influence" set by *Baars*,[40] which is the criterion that the Court[41] relies upon to draw the limits between freedom of establishment[42] and free movement of capital and payments,[43] in third country cases. However, in this case, there is no risk that the Court extends the regime to third countries

[32] I.e. the ration between tax compliance costs and taxes due.
[33] Decreasing as the size of the company increases.
[34] Such as the proposed BEFIT, see supra n. 12.
[35] Art. 2(1)(f) of the proposed Directive.
[36] Art. 2(1)(f) first indent of the proposed Directive and Art. 2(13) of the annual financial statements Directive, supra n. 30.
[37] Art. 2(1)(f) second indent of the proposed Directive and Art. 3(3) of Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (Text with EEA relevance) (notified under document number C(2003) 1422), OJ L 124, 20.5.2003, p. 36–41.
[38] See, namely, Art. 4 and 5(b) of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.
[39] Supra n. 36.
[40] NL: ECJ, 13 Apr. 2000, Case C-251/98, C. Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem, Case Law IBFD, para. 26 et seq..
[41] See, namely PL: ECJ, 10 Apr. 2014, Case C-190/12, Emerging Markets Series of DFA Investment Trust Company v. Dyrektor Izby Skarbowej w Bydgoszczy, Case Law IBFD, para. 25 et seq.
[42] Art. 43 et seq. TFEU.
[43] Art. 63 et seq. TFEU.

since the proposed system only applies to the relations between head offices and their PEs, relation which requires exclusive control over those PEs, thus falling within the scope of *Baars*' "definite influence".

The third requirement excludes "linked enterprises", with the definition of such expression being remitted to a Recommendation,[44] which is a non-mandatory instrument of EU law.[45] This "hardification" of soft-law raises several autonomous questions that fall outside the scope of this study and will, therefore, not be addressed. Anyhow, such requirement excludes any company that has: i) the "majority of the shareholders' or member' voting rights in another enterprise";[46] ii) "the right to appoint or remove the majority of the members of the administrative, management or supervisory body of another enterprise"[47]; iii) "the right to exercise a dominant influence over another enterprise" through articles of association or a shareholders' agreement;[48] iv) the possibility of controlling, autonomously, a majority of shareholders' or member's voting rights in that enterprise, namely through a shareholder or member's agreement. A company will not be considered as a "linked enterprise" if the control is exercised through: i) public investment corporations, ii) venture capital companies; iii) "business angels";[49] iv) universities or non-profit research centres; v) institutional investors, including regional development funds; vi) autonomous local authorities insofar as their annual budget is less than EUR 10 million and fewer than 5000 inhabitants.[50]

The fourth requirement excludes companies that operate with other than PEs. Unlike prior requirements, there is no threshold or remission allowing us to understand whether it is still admissible for a company to hold (minority) corporate rights in other companies. Following the logic behind other requirements, wholly owned or controlled subsidiaries should be excluded. In contrast, mere passive investments, deprived of the capacity to control the company, would not be deprived of entitlement. As this is a standalone requirement, it must mean something other than the requirements mentioned in the previous paragraphs. However, the concrete delimitation is not yet clear.

This requirement may also exclude companies operating with certain PEs. In fact, if one also takes into account the definitions,[51] only "fixed place" PEs qualify.[52] This could be a drafting error since the provision aim appears to be a mere *renvoi* to tax treaty or domestic law in what concerns PE definition. Nevertheless, as it is currently worded, the proposed Directive excludes companies having dependent agent, service or other non-"fixed place" PEs. If that was not the aim, the PE definition of the proposed Directive should be amended.

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[44] Commission Recommendation concerning the definition of micro, small and medium-sized enterprises, see supra n. 37.
[45] According to art. 288 TFEU.
[46] Art. 3(3)(a) of the Recommendation, supra n. 37.
[47] Art. 3(3)(b) of the Recommendation, supra n. 37.
[48] Art. 3(3)(b) of the Recommendation, supra n. 37.
[49] Defined under Art- 3(2)(2)(a) as "individuals or groups of individuals with a regular venture capital investment activity who invest equity capital in unquoted businesses", insofar as "the total investment (…) in the same enterprise is less than EUR 1250000".
[50] All these requirements are listed under Art. 3(2), second indent, of the Recommendation, supra n. 37.
[51] Art. 3 of the proposed Directive.
[52] Art. 3(1) of the proposed Directive.

Many countries are currently extending their concepts of PE, including forms of digital presence PEs. If a third country with whom the residency Member State has no tax treaty suddenly adopts the concept of digital PEs, covering the SME because of its (limited) digital presence in the country: would this be enough to ensure disqualification from this regime? Following the current wording, it does. However, that could be a harsh consequence of the "legislative experimentalism" of a third country.

Overall, these requirements are undoubtedly complex. In the author's view, it makes sense to exclude companies included within the scope of an EU-tax computation regime insofar as the proposed rules would be inconsistent with such regime.[53] However, qualification for other-than-tax regimes should bear no consequences on the entitlement for HOT. Nothing in the proposed regime is incompatible or inconsistent with financial accounts consolidation or (more generally) with corporate grouping insofar as the proposal only affects (and not significantly) the computation of the taxable result of the PE of any individual company of such consolidated group. The proposed aims are not prevented if the company is associated, linked or if it also operates through subsidiaries. All such companies must equally face the "patchwork" of different national corporate income tax rules.

In addition, it is interesting to note that, according to the current wording, the second ("associated undertaking") and third requirement ("linked enterprise") only need to be met when the option is first exercised. If the head office fails to meet them later, it will no longer deprived of continuing to enjoy the regime or even renewing it.[54] Accordingly, and paradoxically, a company that has secured access to the regime may continue to benefit from it even if it becomes part of a consolidated group for financial accounting purposes, if it becomes an associated enterprise and/or it becomes a linked enterprise, as defined *infra*. Again, if this was not the intention, the proposal could be revised.

### 2.5 Turnover-comparison requirements

The proposal includes a turnover-comparison requirement to prevent, *inter alia*, jurisdiction shopping. Accordingly, the turnover of the qualifying company has to be equal to or more than half of the turnover of the PE, in the two preceding years.[55]

The provision does not specify how to compute such turnover and whether the rules regarding the attribution of profits to PEs play any role.[56] It also does not indicate whether one such computation should be made under the rules of the head office MS or of the host MS. On the one hand, for accessing the regime, it makes more sense to

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[53] And this is the case of BEFIT, supra n. 12.

[54] Art. 9(2) which refers to Art. 4, which includes Art. 4(1)(c) which refers to Art. 2(1)(d), the provision that requires companies to be an MNE but not the requirements laid down in Art. 2(1)(f) of the proposed Directive which refers to these three Directives.

[55] Art. 4(1)(a) of the proposed Directive.

[56] And whether the OECD authorised approach should be taken into account. See OECD (Centre for Tax Policy and Administration), Report on the Attribution of Profits to Permanent Establishments, 17 July 2008 and See OECD (Centre for Tax Policy and Administration), Report on the Attribution of Profits to Permanent Establishments, 22 July 2010.

compute turnover in accordance with the host MS rules. For the renewal of the regime,[57] PE profits are only computed according to the rules of the head office Member State, and it is more reasonable to follow such rules. However, it may make no sense to rely on different rules for the qualification and for the renewal. Therefore, any clarification of the provision would be welcomed.

### 2.6 Exclusion for certain activities

The proposal excludes PEs meeting the following conditions: i) derive income from shipping activities; ii) if such income is subject, at the level of the head office, to a tonnage tax regime.

Unlike all prior requirements, which operate in an all-or-nothing fashion, this provision only excludes part of the head office PEs, allowing for an SME to operate: i) partly following the proposed head office rules, and; ii) partly on the basis of existing tax treaties or domestic laws, for the non-qualifying PE's. This possibility reinforces the earlier criticism regarding the adequacy of excluding companies that operate simultaneously with PEs and subsidiaries. If a partial entitlement is possible in such cases, it would be even more logical in the latter scenarios.

### 2.7 Adjusting and circumventing the scope

It is too soon for companies to react to this proposal since there is no political agreement within the Council. When such a moment comes, companies can consider a wide number of alternatives, allowing them to secure access to HOT even when they, *prima facie*, do not meet all requirements (and *vice versa*).

First, they may decide to undergo a corporate reorganisation, ensuring that they fit within one of the Annex's forms. Second, they can move their (tax) residency to the Member State of election (either with the most favourable rules or the most "business friendly" one), up to two years before the proposal enters into force. Third, they can genuinely decrease the number of employees, by increasing the number of outsourced provided services and, thus, falling within the required employee threshold.

If a single individual is behind a corporate group,[58] such an individual may consider restructuring its shareholdings. If he decides to split otherwise related or linked companies into qualifying subsets (or in subsets that do and do not qualify), the individual may secure (partial) access to the new system.

Companies currently operating with PEs and subsidiaries may consider a merger by incorporation (benefiting from the neutrality regime ensured by the Merger Directive[59]) and to convert subsidiaries into PEs. Furthermore, they could consider the feasibility or adequacy of a reverse merger, allowing it to select and locate the head office

[57] Art. 2 refers to art. 4.
[58] Namely through an upper-level holding corporation that has regional or sectorial level companies that hold the lower-tiered subsidiaries and PEs.
[59] Merger Directive, supra n. 17.

company in the Member State whose tax rules would govern the overall computation of their taxable base.

Regarding the turnover-comparison requirements, and when relevant, nothing prevents companies from genuinely shifting functions, risks and assets within their units, adjusting the turnover of the head office and of each one of the PEs, and securing access to the regime.

### 3. Access to the regime

### 3.1 Introduction

Unlike BEFIT,[60] a company will only fall within the scope of this new regime insofar as it opts for it. The following sections will deal with the following issues: i) conditions to exercise the option; ii) tax consequences of such exercise, and; iii) disqualification for the renewal.

### 3.2 Exercise of the option

The option has to be exercised by the head office, next to its tax authority. The following conditions need to be met: i) identification of the head office and of the Member States where the head office has PEs;[61] iii) exercise at least three months ahead of the end of the tax year to which the rules would apply.[62]

The eligibility is assessed both by the head office and the host Member States. In what concerns the latter, its scrutiny is limited by the fact that: i) any challenge will not have suspensive effects on the applicability; ii) the final decision is always reserved to the HO tax authorities (which may decide to ignore the scrutiny of the host Member State).[63]

The proposed Directive does not clarify the consequences of a misreporting (namely, a wrong or incomplete identification of the Host Member States). It also does not clarify what happens if the filing tax authority does not reply to the exercise of the option. If one relies on sincere cooperation[64] and on national procedural autonomy, the consequences will be quite diverse, depending on the Member State in which the request is filed.

### 3.3 Consequences of the exercise of the option and (voluntary) termination

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[60] Supra n. 12.
[61] Art. 5(1) of the proposed Directive. According to the current wording, the head office has to identify the Member States where it has PE's but is not obliged to provide any information regarding the identification of such PE's.
[62] Art. 6(1) of the proposed Directive.
[63] Art. 6(2) and 3 of the proposed Directive.
[64] Art. 4(3) TEU.

If the option is successfully exercised, companies are bound to the new regime for a minimum of five years.[65] All newly incepted PEs will be mandatorily covered.[66] The regime ceases to apply, *ipso iure*, at the end of the period unless a request for renewal is submitted and accepted.[67]

Two circumstances may lead to an earlier termination: i) transfer of the tax residency of the head office; ii) during two consecutive tax years, the joint turnover of the PEs exceeds the triple of the turnover amount of the head office.[68] Both circumstances are, to some extent, within the control of the head office. Accordingly, the proposed Directive grants them the factual capacity to stop the application of the regime at any time, merely by triggering one of the conditions.

*A contrario*, and even if the head office fails to meet any of the other entitlement requirements during the five years, it will continue to qualify for HOT. This interpretation is reinforced by a reading of the renewal requirements (as referred to *infra*), which do not entirely match with the eligibility requirements. Therefore, and merely for the sake of illustration, a head office company deciding to create a subsidiary or a PE (within or outside the EU) after access to the regime would, despite falling outside of the scope,[69] remain entitled to the regime.

The disqualification due to a transfer of tax residency within the Union may not be compatible with the EU freedom of establishment.[70] It is true that in *Daily Mail*[71] and *Cartesio*,[72] the Court concluded "that companies are creatures of national law and exist only by virtue of the national legislation which determines its incorporation and functioning.".[73] Accordingly, a Member state could "make the company's right to retain its legal personality under the law of that Member State subject to restrictions on the transfer to a foreign country of the company's actual centre of administration".[74] However, the Court distinguished such cases from those in which a "company governed by the law of one Member State moves to another Member State with an attendant change as regards the national law applicable, since in the latter situation the company is converted into a form of company which is governed by the law of the Member State to which it has moved".[75] Any requirement of the Member State of incorporation hindering that move, namely if the "Member State of incorporation, by requiring the winding-up or liquidation of the company" prevents "that company from converting itself into a company governed by the law of the other Member State"[76] would amount to a restriction to the freedom of establishment.[77] Assuming that there are no (legal personality) issues

65 Art. 7(1) of the proposed Directive.
66 Art. 4(2) of the proposed Directive.
67 Art. 7(2) and 9 of the proposed Directive.
68 Art. 8(1) of the proposed Directive.
69 As defined by Art. 2 of the proposed Directive.
70 As protected under Art. 43 TFEU.
71 UK: ECJ, 27 Sept. 1988, Case 81/87, *The Queen v. H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc.*, Case Law IBFD.
72 HU: ECJ, 16 Dec. 2008, Case C-210/06, *Cartesio Oktató és Szolgáltató bt*, Case Law IBFD.
73 *Cartesio*, supra n. 72, para. 104.
74 *Cartesio*, supra n. 72, para. 107.
75 *Cartesio*, supra n. 72, para. 111.
76 *Cartesio*, supra n. 72, para. 112.
77 *Cartesio*, supra n. 72, para. 113.

concerning the transfer, the disqualification of the regime merely by the exercise of the freedom of establishment would amount to a blatant violation of the freedom of establishment,[78] which would only be admissible in case it pursued a valid justification on a proportioned manner, which does not appear to be the case.

### 3.4 Renewal

As mentioned, the renewal is explicitly conditioned to the eligibility requirements,[79] but not to (all of) the scope requirements.

One of the surviving scope conditions is the turnover-comparison rule, which excludes renewal if the joint PE turnover is equal to or higher than double of the head office turnover in two (consecutive or non-consecutive) tax years.[80] Other surviving conditions refer to the head office and exclude renewal: i) if such head office creates a subsidiary (within our outside of the Union); ii) if the head office fails to meet the conditions for being qualified as an SME for two consecutive tax years.[81]

In the absence of a cross-reference from the eligibility to the scope requirements,[82] and considering the explicit reference to only some of the scope requirements, one may conclude that head offices that met the scope requirements at the moment of the exercise of the option but no longer meet them in the day after the qualification, still qualify for the renewal. If that was not the intention, the wording of the Directive could be clarified, preventing Member States from interpreting (and implementing) the conditions for the renewal differently.[83]

Assuming that (most) scope requirements apply only to the entitlement and not to the renewal, one may wonder about the reasonableness of the proposal. Does it make sense to ask a company to be subject to a certain tax but solely when qualifying to the regime? Or to exclude companies with a PE outside of the Union for the eligibility but not for the renewal? In the author's opinion, all the requirements for eligibility should again be requested and scrutinised at the moment of the renewal.

## 4. Substantive tax rules

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[78] Accordingly, could also be scrutinized in case the infringement is introduced by means of secondary law. See DE: ECJ, 15 June 1994, Case C-137/92, *Commission v. BASF and others*, para. 48-50. The author has already previous referred to an identical situation in the framework of Pillar II, which was then solved with the removal of the issues he had identified. See J.F. Pinto Nogueira, GloBE and EU Law: Assessing the Compatibility of the OECD's Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, 12 World Tax J. 3 (2020), Journal Articles & Opinion Pieces IBFD, sec. 6.2.

[79] Art. 4 of the proposed Directive.

[80] Art. 10(a) of the proposed Directive. The previous considerations regarding the rules for the determination of the profit attributable to the PE's also apply at this stage.

[81] Art. 10(b) and(c) of the proposed Directive.

[82] As in the case of Art. 4(1)(c) which explicitly refers to Art. 2(1)(d) of the proposed Directive.

[83] Which has pervasive consequences since the host Member States will not be in a position of successfully objecting to the renewal.

## 4.1 Introduction

The proposed Directive allows for the computation of the taxable profit of both the company and its EU PEs under the rules of the Member State where the PE is located. This section deals with the computation of the taxable result, determination of the rate, cases of mismatches and interaction with tax treaties.

## 4.2 Computation of the profits of the permanent establishments

The Legislative Financial Statement clarifies that "the proposal builds on a mutual recognition framework, whereby the Member States of the expansion (where the permanent establishment is located) accept that the taxation rules of the Head Office State apply when computing the taxable results of the PE in their territories".[84] Accordingly, they will apply "rules that they are familiar with".[85]

Despite the absence of an autonomous provision regarding this substantive rule, when referring to the "consolidated" tax return, the proposed Directive states that "[t]he tax liability shall be computed by applying the national tax rate of the respective host Member State to the taxable result, as computed in accordance with the head office taxation rules".[86] This rule is confirmed in other provisions of the proposed Directive.[87]

The host Member State may reject such computation, revising the assessment "in connection with the attribution of profits to the permanent establishment in accordance with the provisions laid down in the applicable bilateral convention for the avoidance of double taxation between the host and head office Member States".[88]

The proposed directive distinguishes between: i) tax treaty attribution of profit rules, and; ii) domestic rules on the computation of the taxable results of the PEs. Host Member States may only react to the draft tax assessment but, following the wording of the proposal, the filing authority only has the obligation to "revise" the PE draft tax assessment in what concerns the treaty's attribution of profit rules.[89] Furthermore, even in such cases, "revising" does not mean that it has to follow the views of the host Member State. After "revising" and "communicating" the result of such revision to the host Member State, the filing authority may proceed with the assessment and "recompute the taxable result in accordance with the taxation rules of the head office Member State".[90] The host Member State has no mechanism to react to such assessment and is deprived of jurisdiction, in case the taxpayer wants to react before its Courts.[91] In any case, the

[84] Sec. 1.4.1 of the Legislative Financial Assessment, supra n. 14, p. 24.
[85] Sec 1.4.3 of the Legislative Financial Assessment, supra n. 14, p. 24.
[86] Art. 11(2)(b) second sentence.
[87] Art. 3(6) defining "taxable result of the permanent establishment" as the "taxable income or loss computed in accordance with the Head Office Taxation rules" and Art. 3(4) which defines "head office taxation rule" as "the taxation rules of the head office Member State which are used to compute the taxable result of the head office and its PEs. See Art. 1(3) a contrario.
[88] Art. 11(8) of the proposed Directive.
[89] Art. 11(8) first sentence of the proposed Directive.
[90] Art. 11(8) of the proposed Directive.
[91] Art. 11(8) of the proposed Directive, third sentence.

taxpayer is always able to claim treaty protection next to the courts of the head office State.[92]

### 4.3 Tax rate determination

The applicable tax rate is determined by the host Member State, which shall communicate it timely to the filing authority. This aims at preserving its tax sovereignty and at securing some level playing field between (competing) businesses located on its territory. Several issues may arise if countries do not adopt a single-rate system, particularly when the rate depends on the volume of profits. In the author's view, it is up to the host Member State to explain in a clear and straightforward manner to the head office Member State how such rules apply in more complex cases.

The Explanatory Memorandum[93] and the Preamble[94] refer to corporate tax. However, most of the provisions ignore such reference, which could lead to consider that the assessment of any tax or surcharge levied on the "taxable result" of the PE[95] could take place under HOT. The author raises attention to the provision on collection, which forces a systematic interpretation which restricts the scope to the "income tax liability" of the PE.[96] As a result, the head office Member State is not obliged to assess any other taxes levied on the "taxable income"[97] of the PE. In any case, and in the author's view, Art. 1 could be amended, restricting the scope to "corporate income taxation".

### 4.4 Linking rules and tax mismatches

Almost "hidden" within the tax filing provision is a (mind-bobbling) rule requiring Member States (head office and host) to "take appropriate measures to prevent possible mismatches" arising from the fact that: i) the host Member State has a rule allowing deduction of expenses insofar as they are either taxed at the employee level or subject to social security charges; ii) no such rule exists in the head office member State.

First, and taking into account the number of linking rules that may be adopted at the level of computation, one can wonder why only employee expenses were singled out.

Second, the wording appears to create an obligation ("shall") but does not identify the Member State which, in case of divergence or inaction, is responsible for preventing a mismatch. This may hamper a reaction by the Commission or the taxpayer.

Third, it is not clear which type of measure must be adopted. Since this mismatch is not created by a bilateral tax treaty, the mutual agreement procedure needs to be ruled

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92 See Art. 2(3) of the proposed Directive.
93 See p. 3, 4 and 5 of the Explanatory Memorandum included in the Proposal, supra n. 10.
94 See para. 1 and 18 of the Preamble of the Proposal, supra n. 10.
95 Art. 1, art. 3(4) of the Proposed Directive.
96 Art. 12(1) of the proposed Directive.
97 Art. 3(6) of the proposed Directive.

out.[98] The dispute settlement directive[99] is also ruled out since it is triggered when double taxation arises, and not to "prevent possible mismatches" before they happen.[100] All points towards action through domestic legislative measures.

Fourth, it is difficult for such "prevention" to work without harmonisation or coordination of the rules. One option is an agreement between Member States on a single deduction system, rolling it out unrestrictedly to subsidiaries and PEs. Another option is that Member States adopt linking rules by which deductibility of specific amounts becomes dependent on taxation (or subjection to social security charges) in the other Member States. In the latter scenario, this results in a new deviation in the head office Member State computation rules (and IT systems), bringing another layer of complexity to the system. Without preventing any other mismatches not currently covered by the wording of the Directive.

### 4.5 Interaction with tax treaties

The proposal states that the "Directive shall not affect (…) the applicability of bilateral conventions for the avoidance of double taxation".[101] This may be interpreted as meaning that bilateral tax treaties prevail over the proposed Directive system. In such case, the applicable treaty provisions, namely the rules on attribution of profits to PEs[102] and the PE non-discrimination clause,[103] could be claimed at any point to overrule this system in case of conflict.[104]

Maybe the interaction with those two provisions was not anticipated. However, the rules interact, and Art. 2(3) could impair the proposed simplification as the taxpayer would always be able to claim the PE non-discrimination clause which, according to its wording, would allow the taxpayer to request the head office the application of any most favourable tax provision which the host Member State applies to its subsidiaries. And the head office Member State would need to consider the treaties with all host Member States. Such a conclusion runs contrary to the aims of the proposed Directive.

Since the cited provision does not include any limitation, this also means that Member States remain free to renegotiate or to sign new treaties, including rules that would conflict with the proposed Directive, without breaching the principle of sincere cooperation and without any obligation of adjusting their domestic law (including tax treaties) to the *modus operandi* of the proposal.[105]

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[98] Namely under the provision equivalent to Art. 25 of the OECD Model Tax Convention, supra n. 18.

[99] Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, OJ L 265, 14.10.2017, p. 1–14.

[100] Art. 11(8) in fine of the proposed Directive.

[101] Art- 2(3) of the proposed Directive.

[102] Art. 7(2) of the OECD Model Tax Convention, supra n. 18.

[103] Art. 24(3) of the 2017 OECD Model Tax Convention, supra n. 18.

[104] This is particularly acute prior to the entry into force of the Transfer Pricing Directive, whose rules also apply to the attribution of profits to PEs. See European Commission, Proposal for a Council Directive on Transfer Pricing, COM(2023) 529 final, 12.9.2023.

[105] See art. 4(3) TEU and Art. 351 TFEU.

In the author's view, EU law primacy should be upheld, [106] with the proposed directive to specify (and incorporate in its text) any applicable tax treaty provision that it wants to keep. That would also ensure that the Court is given the capacity to interpret all such terms in the framework of preliminary rulings.[107]

## 5. Procedural aspects

### 5.1 Introduction

The proposed Directive innovates also (and mostly) on procedural matters. The following subsections focus on such rules.

### 5.2 Single-filing and assessment

HOT allows the head office SME to file a single return next to its residency tax authority (the filing authority), comprising all tax-relevant facts for the determination of the taxable income of the head office and all PEs.[108]

The proposed Directive also amends the mutual assistance directive,[109] introducing the changes that are needed for the proper functioning of the proposed Directive (namely, the automatic exchange of information between Member States).[110]

### 5.3. Assessment

Upon receipt of the return, the filing authority shall issue: i) a tax assessment for the head office, and; ii) draft tax assessments for each PE. The latter are shared with the host MSs, which can reject such assessments but, as observed *supra*, and according to the current wording of the proposed Directive, with strong limitations.

It is unclear whether the proposed Directive precludes self-assessment of the head office, namely within tax systems where such self-assessment is the rule. That would be an unwelcome change. The best would be allowing self-assessment by the head office regarding taxes at both head office and PE level, allowing the tax authority: i) of the head office to audit the full assessment; ii) of each PE, to audit the assessment of the PE (being provided with all information needed for such assessment). Such a system would better dovetail with current CIT systems without decreasing fiscal supervision levels.

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[106] Judgment of 5 February 1963, *Van Gend en Loos / Administratie der Belastingen* (26/62, ECR 1963 p. 1) ECLI:EU:C:1963:1, and DE: ECJ, 17 Dec. 1970, Case 11/70, Internationale Handelsgesellschaft mbH v. Einfuhr- und Vorratsstelle für Getreide und Futtermittel, Case Law IBFD.
[107] Art. 267 of the TFEU.
[108] Art. 11 of the proposed Directive.
[109] 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.
[110] Art. 11, 13 and 14 of the proposed Directive.

## 5.4. Collection

Collection of all tax due (by the head office and respective PEs) is entrusted to the filing authority, which shall transfer to each host MS the amount corresponding to the tax due by each of its PEs.[111] Further rules are to be determined by the Commission, using implementing acts through the committee procedure.[112]

The proposed Directive is silent on what concerns its interplay with the tax collection directive.[113] It is important to stress that the "income tax liabilities" of the PEs, for whose collection the head office Member State is responsible, can be collected through such a Directive.[114] In fact, and since the collection is entrusted to the filing authority, such authority may initiate assistance as "applicant authority",[115] even if it is not the end beneficiary of such amounts.

Nothing prevents the head office Member State from (systematically) requesting assistance from the host Member States (the "requested authority"), and nothing would prevent them from seeking collection out of the assets of the PE located in its territory. That would bring closer the interest in and effort on the collection but would, in practice, undermine the rationale behind the proposed Directive.

A careful revision of the tax collection directive rules is recommended to avoid cases in which the host Member State, as "requested authority", is not able to withhold or keep taxes that it collects and that are due in its territory as they refer to their PEs share of tax (which would be a sort of reward for its diligence in collection within its territory).

Finally, under the rules that must be defined under the committee procedure, it would be important to clarify how to split the tax revenue if the collected sum do not amount to the total tax due, and a pro-rata splitting is needed. A provision governing costs[116] would also be welcomed.

## 5.5. Audits, legal remedies, other proceedings and dispute resolution

The proposed Directive does not alter the current *status quo* in what concerns audits, legal remedies, other proceedings, and dispute resolution.[117] The only exception is the power granted to the host Member State to trigger a mandatory join audit under the Mutual Assistance Directive rules.[118]

The mandatory audit is, however, limited to three issues: i) the taxable result of the PE in accordance with the head office taxation rules; ii) the attribution of profits to

[111] Art. 12(1) and (2) of the proposed Directive.
[112] Art. 12 and 15 of the proposed Directive.
[113] Supra 127.
[114] Since Art. 2(1) of the tax collection directive, supra 127, covers "all tax and duties of any kind" not only "levied by" but also levied "on behalf of a Member State".
[115] Art. 10(1) and 3(a) of the Directive, supra 127.
[116] Similar to Art. 20 of the tax collection Directive, supra 127.
[117] Art. 13(1) of the proposed Directive.
[118] See Mutual Assistance Directive, supra n. 109, namely Art. 12a as introduced by the so-called "DAC 7", Council Directive (EU) 2021/514 of 22 March 2021 amending Directive 2011/16/EU on administrative cooperation in the field of taxation, ST/12908/2020/INIT, OJ L 104, 25.3.2021, p. 1–26.

the PE, and; iii) the applicable tax rate. The latter appears puzzling, since an audit is driven towards the "facts and circumstances" of the audited person(s), and may require an agreement between tax authorities.[119] The determination of the applicable tax rate is an inalienable right of the host Member State, and is not fact-dependent

One can understand the rationale of the provision, which is to allow the host MS the possibility of reacting against a possible mistake by the filing authority. However, the procedural mechanism to implement such a reaction cannot be a joint audit, which (being facts-and-circumstances driven) could never end up, without *excès ou détournement du pouvoir* (excess or misuse of the power of the Member States involved), with an amendment of the applicable tax rate.

### 5.6. Amendments to the DAC and timelines

As mentioned, the proposed Directive introduces amendments to the mutual assistance directive needed for allowing the functioning of the proposed rules, namely in what concerns automatic exchange of information for each of the building blocks of the proposed Directive, as addressed supra.

The timeline and deadlines may require some adjustments to ensure effectiveness and avoid excessive legal uncertainty on the taxpayer's side.

This is better illustrated with an example. Let us assume that: i) the tax year coincides with the civil year and that all the deadlines refer to consecutive days, without exclusion of any (bank) holidays; ii) the taxpayer informs the filing tax authority of its option by 30 September;[120] ii) the filing tax authority informs the taxpayer[121] and the host MS tax authorities[122] on 30 November; iii) the host MS tax authorities decide to challenge the decision by requesting a joint audit[123] for which no deadline appears to be set; let us assume that this was requested one month later, on 30 December; iv) the system would start to apply on 1 January since such challenge has no suspensive effects;[124] v) the filing authority accepts the audit by 1 March;[125] vi) let us assume that the audit was completed in six months,[126] and ends on 1 September; vii) the taxpayer is informed on the very next day. In this scenario, the taxpayer would only be informed of what substantive rules apply to determining its taxable base almost at the end of the respective taxable year. Moreover, as mentioned, nothing prevents a more extended timeline, leading to informing the taxpayer of the final decision regarding entitlement eventually after the end of the tax year to which the system would apply. In our view, such timelines defy the rule of law,

[119] Art. 12a(3) of the Mutual Assistance Directive, supra n. 109.
[120] Art. 6(1) of the proposed Directive.
[121] Art. 6(2) of the proposed Directive.
[122] Art. 6(3) first paragraph of the proposed Directive.
[123] Art. 6(3) third paragraph of the proposed Directive which refers to Art. 13. Art. 13 also allows a "unilateral audit" but that would not have any practical effect, since there is no mechanism (besides spontaneous exchange of information, which does not require a response by the other tax authority) to communicated the results of such audit.
[124] Art. 6(3) third paragraph of the proposed directive.
[125] Art. 12a(1) of the Mutual Assistance Directive, see supra n. 109.
[126] Art. 12a(2) of the Mutual Assistance Directive, see supra n. 109.

and may amount to an infringement of legality in its subdimensions of legal certainty and determinability.

## 6. Policy considerations

### 6.1 Introduction

The adoption of the proposed Directive will lead to fundamental changes in corporate income taxation within the Union, which are difficult to revert at a later stage. Accordingly, its adoption should be preceded by a thorough reflection on such changes. The following subsections address some of them.

### 6.2 Level-playing field

Territoriality remains a fundamental yardstick of EU CIT systems, leading to capital import neutrality of all establishments within a country (subsidiaries or PEs) which face the same tax burden, regardless of their origin. HOT will break such neutrality since comparable (neighbouring) businesses will face different tax burdens depending on whether they are domestic or foreign-owned (and, in the latter case, depending on the Member State where its owner is resident). In fact, and even if the rate is the same, the computation of the taxable profit of subsidiaries and PEs will differ, being possible to have 27 different ways of computing such profit within the entities resident or located within the same Member State.

Member States should carefully consider whether they find admissible to have side-to-side competing businesses bearing different effective tax rates. They must also consider how the respective electorate will assess their decision on allowing foreign business, established in its territory, to bear a (potentially) lower effective tax rate (and potentially inferior to the one which is currently being borne by domestic businesses).

### 6.3 Shattering the link between assessment/collection and budgetary needs

The proposed Directive introduces a fundamental transformation in tax systems' design. Tax systems are usually built around a dialectic relation between the taxpayer (the person evidencing an ability to pay and performing an act that was previously typified as the taxable event) and the active subject (a territorial public entity responsible for providing public and semi-public goods and services, distributing their cost among constituents according to their ability to pay, and levying, assessing, collecting and freely using the tax revenue collected).

The proposed Directive moves to a trilateral system where the traditional functions of the public entity are split between the head office Member State (which now becomes responsible for assessment and collection) and the host Member State (which, being the beneficiary of the tax, is prevented from collecting it). One State becomes dependent on the action of another in what concerns collection, without any guarantee that the collection "shall be treated as if it was" a collection of the head office Member State.[127]

From the current system where mutual assistance for collection is possible, we move to a system where mutual assistance is mandatory, with the State entitled to the revenues being prevented from collection (unless requested, in the framework of the Mutual Assistance Directive).

### 6.4 Erosion of tax sovereignty

Tax system design normally couples the taxable event with tax assessment and collection. This is more the case for active income, where assessment and audit may require a closer interaction not only with the taxpayer but also with the physical elements of its activity, and with third parties that play an active role or have knowledge about the taxable event.

The adoption of the proposed Directive erodes most of the host Member State's tax sovereignty in what concerns the activity of PEs in its territories. In fact, it is no longer in a position of autonomously: i) prevent them access to the regime, or; ii) determine the computation of the taxable result of an activity taking place in its territory and for which it remains entitled to the respective tax.

### 6.5 Interaction with other instruments of EU Secondary Law

Neither the proposed Directive nor its accompanying documents include a reference to the Global Minimum Tax Directive (hereinafter GMT Directive).[128] Such absence results from the fact that, as the proposed Directive is currently drafted, it shall never apply to groups falling within the scope of the Global Minimum Tax Directive.[129] In case of an extension of the entitlement, as proposed *supra*, such interplay needs to be considered.

Other secondary law on direct taxation includes several references to PEs, which must be revised to ensure that those instruments remain effective. That is undoubtedly the case of the Parent-Subsidiary[130] and of the Interest and Royalty[131] directives. Domestic law implementing such directives may also have to be revised.

[127] The cited expression comes from the tax collection directive – see Art. 13(1) of Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures, OJ L 84, 31.3.2010, p. 1–12.

[128] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, ST/8778/2022/INIT, OJ L 328, 22.12.2022, p. 1–58.

[129] Namely as the maximum revenue for qualifying for the proposed Directive (even including the combined revenue of the head office of the PE) is significantly lower than the minimum revenue threshold for the GMT Directive.

[130] Supra n. 15.

[131] Supra n. 16.

### 6.6 Interaction with EU primary law and the need for re-visiting the Court's case law on permanent establishments

One of the first rulings of the CJEU in direct taxation was *Avoir Fiscal*,[132] a case where the Court acknowledged the comparability of subsidiaries and PEs, requiring the host Member State to extend to PEs (part of the) tax benefits granted to subsidiaries. Shortly after, *Saint Gobain*[133] extended such obligation in what concerns tax treaty entitlement. Since then, the Court has been striking down several domestic tax features as restrictions on the freedom of establishment. The rationale of many such cases was to ensure that the host Member State, whose tax sovereignty covered not only subsidiaries but also PEs, had to treat them equally whenever they were in a comparable situation.

The proposed Directive departs from such rationale, since the only state responsible for the assessment (and, consequently, for designing the respective rules) is the head office Member State. This requires revisiting all Court's case law, namely to ascertain: i) whether existing case law is also applicable to the tax rules designed by the head office Member States; ii) whether the remaining legislative power on the host Member State (namely for setting the rates) still requires an equal treatment between subsidiaries and PEs, namely taking into account that it may still remain not in a position of ensuring equal treatment between both; iii) whether the proposed Directive rules amount to a blatant infringement of EU law. Although interesting, this exercise requires an autonomous and focused study.

## 7. Conclusions

The proposed Directive introduces a novel system for the determination of the taxable base of SMEs operating in other Member States solely through PEs within the EU, under which the taxable result of all the SMEs (comprising the head office and all PEs) would be computed according to the rules of the head office Member State. The latter would also be responsible for the assessment and collection of the tax due, and for transferring to the host Member State the share of tax corresponding to the taxable revenue of its PEs. The system represents a significant simplification of SMEs' substantive and procedural tax obligations, leading to a major decrease in their compliance costs. It is a notable step towards strengthening the EU internal market.

Several design options appear to prevent the proposal from fully implementing its underlying rationale. This study not only identified such provisions but also proposed suitable alternatives.

Once a political agreement is reached, businesses should carefully assess the impact of this proposal. First, in what concerns entitlement to the regime, which could be secured through simple changes such as: i) changing the corporate form; ii) converting subsidiaries into PEs through (tax neutral) mergers by incorporation; iii) alienating non-EU subsidiaries or PEs; iv) altering functions, assets and risks within the corporate

[132] FR: ECJ, 28 Jan. 1986, Case 270/83, *European Commission v. French Republic*, Case Law IBFD.
[133] DE: ECJ, 21 Sept. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*, Case Law IBFD.

structure to ensure that head office has an adequate level of turnover. The location of the head office becomes crucial, not only in what concerns the rules applicable to the computation of the taxable result but also in what concerns the (more or less) business-friendly approach of tax authorities of such State, as they will be the one-stop shop contact points for all issues regarding corporate income taxation. Once such a Member State is determined, timely planning may allow an SME to (genuinely) change its residency, namely through conversions of PEs into subsidiaries (and vice-versa) and reverse mergers. Residency of the head office needs to be defined at least two years in advance, to secure application as of the year the new system enters into force.

The author trusts that this study will allow European institutions to improve some features of this proposed Directive, ensuring that the final result leads to a better achievement of its underlying policy goals and, as a consequence, to a more robust strengthening of the EU internal market which is particularly important since it allows releasing to the real economy significative sums which are currently being sunken in tax compliance.