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**COMMISSION STAFF WORKING DOCUMENT**

**Subsidiarity Grid**

*Accompanying the documents*

**Proposal for a Council Directive  
on Business in Europe: Framework for Income Taxation;**

**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;**

**and**

**Proposal for a Council Directive on Transfer Pricing**

{COM(2023) 528 final} - {SEC(2023) 308 final} - {SWD(2023) 302 final} -  
{SWD(2023) 303 final}

## Subsidiarity Grid

### 1. Can the Union act? What is the legal basis and competence of the Union's intended action?

#### 1.1 Which article(s) of the Treaty are used to support the legislative proposal or policy initiative?

Article 115 of the Treaty on the Functioning of the European Union (TFEU) constitutes the legal base for legislative initiatives in the field of taxation. Although no explicit reference to direct taxation is made, Article 115 refers to issuing directives for the approximation of national laws as those that directly affect the establishment or functioning of the internal market. It follows that, under Article 115 TFEU, directives are the appropriate legal instrument for the Union in this field. Based on Article 288 TFEU, directives shall be binding as to the result to be achieved upon Member States but leave the choice of form and methods to the national authorities.

Three proposals are meant to address the current challenges in the internal market related to corporate taxation: (i) a proposal for a Council Directive establishing a Head Office Tax (HOT) system for micro, small and medium-sized enterprises (SMEs); (ii) a proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT); and (iii) a proposal for a Council Directive on Transfer Pricing (Transfer Pricing Directive).

- (i) **The HOT system for SMEs** will provide tax simplification for SMEs with limited presence in other Member States;
- (ii) **BEFIT** will lay down a common set of rules for computing the tax base of groups of companies in the EU;
- (iii) **The Transfer Pricing Directive** will integrate key transfer pricing principles into EU law and put forward certain common approaches to Member States' practices in interpreting and applying the OECD Transfer Pricing Guidelines.

#### 1.2 Is the Union competence represented by this Treaty article exclusive, shared or supporting in nature?

In the case of direct taxation, as far as the proposals relate to the establishment or functioning of the internal market, the Union's competence is shared.

### 2. Subsidiarity Principle: Why should the EU act?

#### 2.1 Does the proposal fulfil the procedural requirements of Protocol No. 2<sup>1</sup>:

- Has there been a wide consultation before proposing the act?
- Is there a detailed statement with qualitative and, where possible, quantitative indicators allowing an appraisal of whether the action can best be achieved at Union level?

The proposals fulfil the procedural requirement of Protocol No. 2, as shown below.

In general, there has been an extensive consultation process while preparing the three proposals. The following steps have been pursued in order to determine their designs in the best way:

- Call for Evidence and the Public Consultation in which 123 contributions were received. Around half were submitted by business associations that represent general business interests, tax advisers, lawyers, or specific business sectors, such as insurance. Respondents also included citizens and both larger and smaller businesses, as well as academic and

<sup>1</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12016E/PRO/02&from=EN>

research institutions, non-governmental organisations, and trade unions. No input was received from national authorities.

- Targeted consultations were conducted with different key stakeholders, including businesses of different sizes operating in different sectors;
- SME stakeholders were consulted, and views were exchanged regarding the options envisaged specifically for SMEs operating cross-border during a meeting with the SME Envoy Network, an Expert group consulted regularly by DG GROW;
- Platform on Tax Good Governance were used for discussions in an expert group composed of Member States, business and the civil society;
- Receiving input from various other sources. Among others, the Commission has relied on publicly available information and OECD reports and on the expertise of its Joint Research Centre, which used the CORTAX model to study the possible impacts of the initiative.
- Using other networks, such as consultations with the OECD secretariat and input from academics specialized in the field of transfer pricing through a virtual panel discussion.

The necessity for EU action was supported by the majority of the stakeholders during the consultations.

For the HOT system for SMEs, the main message from stakeholders was to ensure that the measure provides for a simplification.

For BEFIT, insights received from stakeholders were considered which have led to the design of the measure that strikes a balance between the preferred objectives, e.g., simplifying tax rules for businesses and stimulating growth. The views on the actual design of the main features of a new system were more divided. The proposed design takes into account the options that were most favoured by stakeholders, for example with regard to the scope, the computation of the tax base, the introduction of cross-border loss relief, timing, administrative simplification, etc.

For the Transfer Pricing Directive, the respondents underlined that simplification should be envisaged. However, the respondents did not have a strong view on the usage of certain benchmarks to facilitate the risk assessment when applying transfer pricing rules. Regarding the inclusion of both the inbound and outbound transactions, a majority of almost two thirds of the respondents were in favour whereas one third were against such an approach.

Reference is made to the impact assessment reports which reflect in more detail the outcome of the various consultations and sources used in the preparation of the three proposals as well as the explanatory memoranda which support the proposals and in which the principle of subsidiarity has also been duly considered as explained in question 2.2 below.

**2.2 Does the explanatory memorandum (and any impact assessment) accompanying the Commission's proposal contain an adequate justification regarding the conformity with the principle of subsidiarity?**

The explanatory memorandum and the impact assessments contain adequate justification regarding the conformity of the proposals with the principle of subsidiarity.

All proposals comply with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union (TEU). They fall within the field of direct taxation and cover cases which primarily revolve around cross-border activity. It is thus the cross-border nature of the problems at stake that

calls for common initiatives across the internal market, and by reason of the scale or effects of the proposed action, the objective pursued can be better achieved at an EU level.

EU businesses increasingly operate across borders in the internal market, but the current tax framework in the EU consists of 27 different corporate tax systems. This multiplicity of rules results in fragmentation and presents a serious impediment to business activity in the internal market. Indeed, cross-border businesses face high tax compliance costs in the internal market, as they must comply with various legal frameworks. This is particularly the case for SMEs, for whom these costs are proportionately much higher. Moreover, the disparities between Member States create mismatches that can lead to double non-taxation and unintended tax benefits.

These problems are common to all Member States and cannot effectively be addressed by national actions. As they are the result of having different tax systems in the first place, national uncoordinated action would produce insufficient and uncoordinated effects. Similarly, while better cooperation may also be beneficial, this approach has mainly been bilateral and, therefore, limited in its effects, especially for groups that operate in more than two Member States.

In this context, only EU-wide initiatives can be effective. The complexity of current corporate taxation in the internal market and its consequences would be significantly reduced by introducing common initiatives specifically targeted at the different issues that businesses face. The variety of doing business in the internal market implies that three proposals are needed to address the current issues:

- (i) A simplification framework for SMEs would make it possible for certain SMEs to comply with the substantive tax rules of one Member State and interact with only that Member State. This would reduce a fundamental barrier to trade and cross-border expansion as tax compliance is a significant cost for smaller business. Similarly for SMEs, the simplification can only effectively work on the basis of mutual recognition between Member States of their national tax rules.
- (ii) A single EU-wide set of corporate tax rules primarily for large groups of companies would create clear added value if action were taken at EU level. Aggregation and allocation of the tax base would, for instance, be more objective and less costly than the current transfer pricing rules in determining the tax liabilities of groups of companies. However, Member States cannot effectively use such measures individually because the risk of double taxation and disputes would remain if the allocation method were not uniform for the whole group and the allocable tax base of the group were not computed in accordance with a single set of rules. Common substantive rules can also be governed by a simplified administrative framework, which would have definitive advantages for EU businesses and tax administrations. Instead of filing in each Member State, a one-stop-shop would allow groups of companies to comply with many administrative requirements by referring to one single entity.
- (iii) A common approach to transfer pricing which is built on internationally agreed principles. Transfer pricing rules are currently implemented nationally by the Member States and a coordinated approach would diminish the current fragmentation of the legal framework for transfer pricing and, thus, reduce complexity and compliance costs. For tax administrations, which currently assess the tax liabilities of the same cross-border businesses separately but each only with their own resources, it would be possible to collectively use those resources in a

more effective and targeted manner. In addition, cross-border issues may require agreement between different Member States and often result in lengthy disputes or procedures.

A legislative approach for all initiatives is therefore in accordance with the principle of subsidiarity, as set out in Article 5 TEU, considering that the objectives cannot be sufficiently achieved by the Member States, and a common approach for all Member States would have the highest chances of achieving the intended objectives.

**2.3 Based on the answers to the questions below, can the objectives of the proposed action be achieved sufficiently by the Member States acting alone (necessity for EU action)?**

The objectives of the three proposals cannot be sufficiently achieved by the Member States acting alone for the following reasons:

Since the identified problems in the area of corporate taxation are primarily of a cross-border nature, the individual uncoordinated action by the Member States, as it has taken place so far, would only add to the current fragmentation of the legal framework for corporate taxation, continue to constitute a barrier to trade and growth and fail to achieve the intended results. Therefore, the matter can only be effectively tackled by laying down legislation at the EU level. Adopting common approaches for all Member States is necessary and would be the most effective and efficient way to rectify the current distortions in the functioning of the internal market and in achieving the intended objectives.

These initiatives are therefore in line with the principle of subsidiarity, as laid down in Article 5(3) TEU, considering that their objectives cannot be sufficiently achieved by the Member States, and a common approach for all Member States would have the highest chances of achieving the intended objectives.

(a) Are there significant/appreciable transnational/cross-border aspects to the problems being tackled? Have these been quantified?

Today's business models increasingly involve economic groups that operate globally, including across more than one Member State within the EU. Consequently, groups have to comply with (up to) 27 different corporate tax systems in the EU. This creates a serious impediment to business activity in the internal market, as different country-specific rules imply high compliance costs for such businesses operating cross-border. The need to comply with various legal frameworks creates barriers. Such a large administrative burden and tax uncertainty discourage cross-border commercial activity. This is particularly the case for SMEs, for whom tax compliance costs are proportionately much higher and could impede them from crossing the border altogether. In addition, the complexity, which inherently exists in dealing with more than one tax administration, can give rise to lengthy and costly legal disputes and/or result in double/over-taxation. This is a situation which again discourages cross-border investment. This situation is exacerbated by the fact that Member States' practices of applying the internationally agreed transfer pricing standards tend to vary.

Regarding the quantification, reference is made to the impact assessments. Only certain points will be recalled here:

**On the compliance costs**

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 (tax compliance costs) has been carried out on behalf the European Commission (2022, see Impact Assessment). This study estimates the administrative burden of tax compliance for small and large businesses in Member States and the United Kingdom finds that *'differences in the broader public administration of the countries do have an impact on the burden of compliance'*. In general, 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 (tax compliance costs for all types of taxes). Furthermore, tax compliance costs have not declined over time. Total corporate tax compliance costs increased significantly (i.e., 114%) from 2014 to 2019. In addition, these compliance costs are regressive, which means that the relative burden of tax compliance is disproportionately higher for small businesses.

**On the mechanisms to prevent and resolve tax disputes**

The unpredictability and inconsistency of tax administration practices across 27 Member States as well as somewhat ineffective mechanisms for dispute prevention and resolution contribute to tax complexity. Data regarding the use of the procedure under the Arbitration Convention show for example that in 2021, there were some 3,200 ongoing MAPs to settle disputes on the questions of transfer pricing. On average, these procedures last around three years, and only half of them close with an agreement.<sup>2</sup> Today, disputes associated with transfer pricing tend to be extremely lengthy (they may extend for over a decade), time-consuming and costly. Costs include those for staff of legal departments in companies, but also costly external legal advice. In 2017, 2,400 firms informed that they had, on average, cost for outsourcing of compliance activities of more than EUR 4,000 per firm. For litigations in particular, the costs are a multiple of that amount. Moreover, costs of litigation also include the teams in national tax administrations administering these cases.

The three proposals would reduce such compliance costs, and significantly limit the room for mismatches and tax disputes and, as such, address the problems in a comprehensive and targeted manner.

(b) Would national action or the absence of the EU level action conflict with core objectives of the Treaty<sup>3</sup> or significantly damage the interests of other Member States?

National actions would not be sufficient to address the problems as their origin stems from individual uncoordinated initiatives by the Member States. The cross-border nature of the problems requires coordinated action from the EU as a whole. Removing the current barriers in the internal market caused by the existing 27 nationally designed corporate tax systems in the Member States would better guarantee the principles upon which the Union is built, such as the fundamental freedoms ensured by the Treaties.

(c) To what extent do Member States have the ability or possibility to enact appropriate measures?

Member States have the possibility to introduce measures in the area of corporate taxation through better tax treaties and closer cooperation between tax administrations. These actions are, however, insufficient to address the identified issues in the internal market. Such actions would only create more extensive fragmentation among national rules through bilateral agreements (treaties) and, thereby, further complexity which would feed into the core of the problem which the proposals seek

<sup>2</sup> OECD, Multiannual Agreement Procedure Statistics.

<sup>3</sup> [https://europa.eu/european-union/about-eu/eu-in-brief\\_en](https://europa.eu/european-union/about-eu/eu-in-brief_en)

to address. While double or over-taxation can indeed be prevented through bilateral tax treaties between Member States, such frameworks are only rectifying instances of occurred double/over taxation while the dispute resolution processes are lengthy and costly. The diversity of the national tax rules has led to tax complexity and barriers, and to the existence of loopholes that may open opportunities for tax planning or contribute to double/over taxation.

The outcome of individual actions by the Member States is another layer in the fragmented EU tax environment and does not address the reality of today's business environment where groups operate in the internal market in more than two Member States.

(d) How does the problem and its causes (e.g. negative externalities, spill-over effects) vary across the national, regional and local levels of the EU?

The identified problems seem to be mainly of a national nature. The current systems of corporate income taxation in the EU give rise to high complexity and an uneven playing field for businesses that operate in the internal market. Stakeholders in the consultations confirmed that this translates into businesses facing high compliance costs, barriers to cross-border operations, high risks of double or over-taxation leading to tax uncertainty and frequent, time-consuming legal disputes.

These tax barriers for businesses impede the proper functioning of the internal market and compromise the prospect for achieving its potential in terms of efficiency gains. As a result, the competitiveness of the internal market is undermined. The problems that the initiatives aim to address are complexity and an uneven playing field.

(e) Is the problem widespread across the EU or limited to a few Member States?

The aforementioned obstacles are widespread across the EU and common for taxpayers in all Member States. The coexistence and parallel application of 27 different corporate tax systems lie at the core of the problem as they hamper cross-border investment and business activities, while distorting competition and hindering EU competitiveness.

(f) Are Member States overstretched in achieving the objectives of the planned measure?

The three proposals only seek to introduce common rules and approaches where this is necessary to achieve the envisaged objectives. Member States will therefore have to implement the proposed measures by complementing their current tax rules, to be fully compliant with the standards set by these initiatives. In general, and as a result, Member States' systems would become more efficient, the allocation of tax base would become more predictable, the current tax disputes arising from transfer pricing application should be reduced, and tax administrations should have the possibility of dedicating more resources to better follow the taxpayers and also of re-allocating their resources to the other high-risk cases.

To the greatest extent possible, the initiatives build on existing rules and policies. For example, for the HOT system for SMEs, the simplification framework for SMEs is built on mutual recognition between Member States of their current tax systems rather than by introducing new common rules in this respect. For BEFIT, the mandatory scope is limited to the EU sub-set of the large groups which also fall within scope of the Pillar 2 Directive, unless a large group is headquartered outside the EU but has limited activity in the internal market (materiality threshold). Applying the rules in a uniform manner to these groups would ensure coherence with the Pillar 2 Directive and allow leveraging interactions and keeping the costs of implementation to a minimum. Processes can also be aligned,

for instance, they both rely on financial accounting statements as a starting point and companies must apply the EU-wide tax adjustments for both sets of rules.

These are proportionate steps forward to simplify tax rules, create a level playing field and enhance tax certainty in the EU, and thus render the impact of the tax administration manageable.

(g) How do the views/preferred courses of action of national, regional and local authorities differ across the EU?

There was no contribution or answer to the public consultation from national tax administrations in the EU. However, Member States were consulted at a technical level in Working Party IV. Out of all exchanges and input received from various stakeholders, it can be concluded that, while views differ on the specific design of the main features of the initiatives, there is a broad consensus on the problems arising from the differences between national tax systems and on the need for EU action to tackle the fragmented and inefficient situation.

**2.4 Based on the answer to the questions below, can the objectives of the proposed action be better achieved at Union level by reason of scale or effects of that action (EU added value)?**

The objectives of the proposals can be better achieved at Union level. It is the cross-border nature of the problems and the co-existence of 27 uncoordinated and different tax systems that require common rules across the internal market.

The added value of EU action is broadly confirmed in the public and targeted consultations where there was broad consensus that the existing problems constitute significant barriers and that common rules would be more efficient.

The HOT system for SMEs provides for a simplification which can only effectively work on the basis of mutual recognition between the Member State origin (head office) and the Member States of 'expansion'. It would consequently be possible for SMEs to interact with only one Member State.

Furthermore, under BEFIT, the introduction of common rules for the computation and allocation of the tax base will decrease the need for thorough assessments of intra-group transactions to ensure consistence with the arm's length principle and also provide cross-border loss relief. Such a common approach would be more objective and less costly than the current rules which are complex and cause many disputes. Member States cannot effectively use such approach individually, because the risk of double taxation and disputes would remain if the rules were not applicable to the whole EU group. Common rules can also be administered by a common framework, which would have definitive advantages for EU businesses and tax administrations. Instead of filing in each Member State, a one-stop-shop could allow groups of companies to comply with many requirements through one single entity. A common administrative framework would also allow EU businesses to obtain early certainty on certain items.

In general, for tax administrations, which currently assess the tax liabilities of the same cross-border businesses separately but each one only with their own resources, all proposals would make it possible to collectively use those resources in a more effective and targeted manner.

(a) Are there clear benefits from EU level action?

Action at EU level would bring significant and clear benefits to both the businesses and tax administrations. The key features of the three proposals have an inherent cross-border aspect and could only be addressed with an added value by a commonly agreed approach.



The introduction of the HOT system for SMEs that have taxable presence across the border will also significantly facilitate corporate decisions for business expansion, considering that SMEs tend to be short of resources in coping with a foreign tax system. Such simplification can only work on the basis of mutual recognition between the origin (head office) Member State and the Member States of 'expansion', and thus common rules will bring a definitive advantage.

Regarding BEFIT, common substantive corporate tax rules are also a prerequisite for administering a 'one-stop-shop' for groups of companies operating in the EU. Such solutions would both be expected to introduce the necessary unification across the EU and not only simplify the determination of the tax base for business, but at the same time, also successfully tackle the issue of mismatches between 27 different national systems.

As regards transfer pricing, common rules would provide a higher level of tax certainty for businesses operating across the internal market and bring down compliance costs thus making it more beneficial to invest in business operations in the Union.

In addition, for both BEFIT and the HOT system for SMEs, businesses active across the EU will have the opportunity to comply with their fiscal obligations by referring to only one system of corporate tax rules which will bring significant gains in terms of simplification. Common rules and approaches will be administered, to the extent possible, through a one-stop-shop, which will significantly reduce compliance costs for businesses. Dealing with the tax authorities of several Member States through a streamlined procedure will further minimise the number of disputes and ensure a consistent application of the rules.

(b) Are there economies of scale? Can the objectives be met more efficiently at EU level (larger benefits per unit cost)? Will the functioning of the internal market be improved?

The three proposals aim at simplifying tax rules for businesses, stimulating growth and investment and ensuring fair and sustainable tax revenues. By decreasing compliance costs and tax obstacles, the initiatives will in turn foster foreign and domestic investment as well as capital mobility in the EU, both for large groups and SMEs with cross-border presence or plans to expand abroad, as businesses operating in different Member States will be able fully maximize the freedom of establishment and the free movement of capital without being hindered by tax regulatory obstacles.

Considering the scale and effects of the envisaged initiatives, the objectives to attenuate the negative effects resulting from the current interaction of 27 disparate national tax systems and divergent transfer pricing practices and to create more favourable conditions for cross-border investment in the internal market are better achieved at Union level.

(c) What are the benefits in replacing different national policies and rules with a more homogenous policy approach?

The measures under the three proposals will facilitate cross-border investment by increasing tax certainty and reducing compliance costs and disputes both for taxpayers and tax administrations. They will allow the EU's economy to grow in a sustainable way and be more competitive vis-à-vis other big markets. An economically stronger Europe will better serve its citizens and help the EU to play a stronger role on the global stage.

Additionally, the initiatives will ensure more coordination among Member States' tax administrations, which will be given the adequate tools to address or to avoid the current

mismatches and obstacles arising from a fragmented tax environment. Therefore, these proposals aim to contribute to safeguarding the tax revenues of Member States, making tax systems more predictable and ensuring a level playing field.

(d) Do the benefits of EU-level action outweigh the loss of competence of the Member States and the local and regional authorities (beyond the costs and benefits of acting at national, regional and local levels)?

The benefit of EU action on these initiatives outweighs the loss of competence of the Member States. From the tax administrations' perspective, less resources would be required on average in the long term, to deal with the complex tax rules and procedures, lengthy disputes and litigation. This would allow Member States to free resources, to enhance cooperation between tax administrations as well as the national tax administration and taxpayers, and to re-allocate resources to high-risk cases. The main benefit for tax administrations is the availability of the appropriate information of the corporate tax payers and closer cooperation with tax administrations in other Member States. The common approach to transfer pricing is envisaged to entail benefits both for businesses and tax administrations. Thus, in the long term, there should be a need for less resources, on average, within the tax administrations to deal with the compliance of transfer pricing, lengthy disputes and litigation.

In relation to the macro-economic effects, rules provided by the three proposals should not significantly affect the tax revenues of the Member States.

(e) Will there be improved legal clarity for those having to implement the legislation?

With the three proposals, there will be improved legal clarity.

Under the HOT system, SMEs operating in (an)other Member State(s) through PE(s) would apply one single set of tax rules to compute their tax base across the EU.

The implementation of BEFIT would result in a framework of rules for computing a common tax base, which would be built on current accounting rules with limited adjustments and a simple allocation method for the groups' tax base.

In addition, the Transfer Pricing Directive would provide for more legal certainty as it would do away with national approaches which have shown to be highly subjective, and which often result in long and costly disputes regarding double taxation or double non-taxation and leave room for tax planning practices.

These key features of the proposals will result in lower administrative burden for taxpayers and tax administrations and hence time and costs savings for tax administrations and companies.

### 3. Proportionality: How the EU should act

**3.1 Does the explanatory memorandum (and any impact assessment) accompanying the Commission's proposal contain an adequate justification regarding the proportionality of the proposal and a statement allowing appraisal of the compliance of the proposal with the principle of proportionality?**

The three proposals do not go beyond the minimum necessary level of protection for the internal market and are therefore compliant with the principle of proportionality.

Under the HOT system, the single set of rules that a standalone SME would be subject to is the national framework of the Member State of its head office. The simplifications are built on a principle of mutual recognition rather than by introducing a new set of common rules. In addition, the system is optional for all eligible SMEs.

BEFIT does not prescribe full harmonisation of corporate tax systems but only sets out common rules to determine the taxable income of large groups of companies in the EU. The rules are targeted at businesses which are most likely to benefit from the rules while they are optional for others. The scope is, thus, limited to what is required to be able to attain the objectives of the initiative. Other aspects build on existing policies or remain fully in the competence of the Member States, such as tax rates and enforcement policies. For example, under BEFIT, the tax base will be primarily based on existing financial accounting rules which are already accepted under EU law, i.e., either the national generally accepted accounting principles (GAAP) of the Member States, or the International Financial Reporting Standards (IFRS). The proposal does not harmonise tax base rules generally, but only where this is necessary and allows for additional adjustments after the allocation of the BEFIT tax base, in consideration for national policy needs. The mandatory scope is limited to the EU subset of large groups that are also within scope of the Pillar 2 Directive, unless a large group is headquartered outside the EU but has limited activity in the internal market (materiality threshold). This targeted approach is taken in order to ensure consistency and coherence in the EU and because the common rules would benefit, in particular, these businesses. Large groups are thus most likely to have a strong cross-border presence and the new rules are aligned as closely possible with the Two-Pillar Approach.

For the Transfer Pricing Directive, a common standard for arm's length principle should result in a less fragmented application and interpretation of the arm's length principle across the Union which should reduce disputes, litigation and the overall compliance costs for businesses operating across the Union.

It is, however, envisaged that the three proposals would imply some initial adaptation and administrative costs. These costs are however outweighed by compliance cost savings as well as simplified administrative procedures and as a result, the improved allocation of resources by businesses and tax administrations.

As justified in the respective explanatory memorandum and impact assessment accompanying the initiatives, the proportionality principle is duly considered, and the initiatives do not go further than necessary in achieving the objectives.

**3.2 Based on the answers to the questions below and information available from any impact assessment, the explanatory memorandum or other sources, is the proposed action an appropriate way to achieve the intended objectives?**

The three proposals are appropriate to achieve the intended objectives as they do not go beyond what is needed:

- For the HOT system, the simplification rules for SMEs operating cross border only apply to specific limited situations of cross-border operations, i.e., standalone SMEs with limited cross-border activity and aim to encourage expansion.
- BEFIT lays down a framework for a more coordinated computation of the tax base. Yet, further adjustments for tax purposes are allowed at national level against each allocated part, to take into account national policy needs.

- The Transfer Pricing Directive ensures a common arm's length principle and a more harmonised approach towards transfer pricing.

(a) Is the initiative limited to those aspects that Member States cannot achieve satisfactorily on their own, and where the Union can do better?

The three proposals are limited only to businesses with cross-border activities.

The HOT system is addressed to SMEs with taxable presence in (an)other Member State(s) and provides for the possibility of using the rules of the jurisdiction of the Head Office in computing the tax base of the PEs.

BEFIT sets out common rules for computing the tax base of groups of companies in the EU, but Member States remain competent to make additional adjustments to the tax base beyond the common base, in consideration of their national policy needs.

In relation to the Transfer Pricing Directive, due to the inherent cross-border nature of transfer pricing and the current fragmented approaches to its application among the Member States, coordinated practices in transfer pricing can only be set at an EU level.

Investors wishing to invest cross-border will no longer be faced with the obstacles arising from double taxation, high compliance costs and disputes. These commonalities can only be set at an EU level.

(b) Is the form of Union action (choice of instrument) justified, as simple as possible, and coherent with the satisfactory achievement of, and ensuring compliance with the objectives pursued (e.g. choice between regulation, (framework) directive, recommendation, or alternative regulatory methods such as co-legislation, etc.)?

In order to reach common features and procedures within the EU, the choice of three proposals for directives is justified. Moreover, a proposal for a directive is the only permissible legal instrument under the legal basis.

Non-legally binding or bilateral actions, such as double tax conventions, were taken in the past but did not resolve the issues. In particular and for example, previous Commission Communication ([COM/05/702](#)) that presented a possible solution to the compliance costs and other company tax difficulties that Small and Medium Sized Enterprises (SMEs) face when doing business across borders. It provided for the general principles of a Home State Taxation system – to be implemented by bilateral conventions amongst Member State. It has however never been followed up by any Member States.

The network of bilateral conventions concluded by the Member States amongst each other and with third countries only deal with tax situation arising between two Member States situations, being thus inadequate for today's business environment where large groups operate worldwide and across several Member States and also have transactions with associated parties outside the EU.

In the past, the Commission dealt with transfer pricing issues through the work of the Joint Transfer Pricing Forum (JTPF), an expert group set up by the Commission in 2002 and whose work was to propose to the Commission pragmatic, non-legislative solutions to practical problems posed by transfer pricing practices in the EU. Its mandate expired in March 2019 and was not renewed. The

Reports produced by the JTPF were non-legally binding and thus did not achieve the wanted results in the Member States.

(c) Does the Union action leave as much scope for national decision as possible while achieving satisfactorily the objectives set? (e.g. is it possible to limit the European action to minimum standards or use a less stringent policy instrument or approach?)

The scope of the three proposals does not cover the tax rate. In addition, tax disputes and tax audits remain within the competence of the Member States. Each proposal leaves room for Member States to decide on aspects not covered. For example, in BEFIT, additional deductions after the allocation of the BEFIT tax base are left to Member States.

(d) Does the initiative create financial or administrative cost for the Union, national governments, regional or local authorities, economic operators or citizens? Are these costs commensurate with the objective to be achieved?

The initiatives will directly impact businesses with presence in other Member States and also national tax authorities. Citizens will indirectly benefit from the increase in GDP and tax revenues. Reference is made to the Impact Assessments accompanying the proposals. Only certain points are recalled here:

#### Impact on the business

Under the HOT system, all SMEs with permanent establishment(s) in (an)other Member State(s) will receive significant benefits, in terms of simplification of compliance as well as additional costs. Today, SMEs with taxable presence in other Member States bear costs for tax advisory services in respect of each jurisdiction in which they maintain a taxable presence, in order to comply to all their PEs in other Member States with the different national rules. With this initiative, SMEs will be able to apply the tax rules of the State of the Head Office to all PEs in other Member States which will reduce the overall administrative burden. In this way, more SMEs are expected to get incentivised to expand their activities across the border in the internal market.

For BEFIT, the parent company of a BEFIT group will be required to aggregate the tax base of all BEFIT group members, decrease the need for thorough assessments of intra-group transactions to ensure consistency with the arm's length principle, apply the baseline allocation method (to distribute the aggregated tax base among the group members), and finally to prepare the BEFIT Information Return and submit it to the Filing Authority. These companies will bear some initial adjustment costs for training the personnel to the new rules and acquiring customised IT software (necessary to adapt their Enterprise Resource Planning (ERP) system and to automatize the procedures). It is expected that these recurrent costs become "business as usual" quite shortly and indeed replace the current way of dealing with tax compliance.

The Transfer Pricing Directive should also bring some cost savings for MNEs thanks to the expected decrease in the number of litigation cases as a result of the legal certainty.

#### Impact on tax authorities

The HOT system for SMEs will bring more work for the tax authority of the Head Office, as it would have to perform some actions in relation to the tax liability at the Member State of the permanent establishment but given the small number of affected taxpayers, this is not expected to be significant.

For BEFIT, the burden (mainly on human resources) will depend on the number of BEFIT groups in scope and the role in the BEFIT Teams. However, apart from the initial cost for training, the additional human resources devoted to implementing BEFIT are expected to be limited, especially considering that BEFIT will replace national corporate income tax systems for the in-scope groups. In addition, tax authorities will enjoy a reduced burden linked to transfer pricing compliance.

(e) While respecting the Union law, have special circumstances applying in individual Member States been taken into account?

Yes. For example, some Member States have specific distribution-based tax systems (rather than the regular profit-based tax systems). BEFIT provides for customised rules to address the specific features of distribution-based systems where the taxation is triggered in the event of a dividend distribution. This will ensure the functioning of BEFIT in these Member States while allowing them to keep the general principles of their current systems. During the design of these rules in BEFIT, relevant Member States have been consulted.