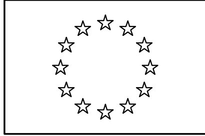

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 23.12.2005
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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE EUROPEAN PARLIAMENT AND THE ECONOMIC AND SOCIAL COMMITTEE

Tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market – outline of a possible Home State Taxation pilot scheme […]

{SEC(2005)1785}

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1. INTRODUCTION

1.1. Purpose of the Communication

Achieving the Lisbon objectives requires action in the tax area.

The Commission Communication to the Spring European Council COM(2005)24 and in particular its companion document SEC(2005)192, the Lisbon Action Plan have given a new impetus for achieving the Lisbon objective, including in the tax field. In this context the conclusions of the Presidency of the European Council of 23 March 2005 repeatedly highlight the important role of small and medium-sized enterprises (SMEs) and call for broad policy actions in favour of SMEs[1]

This is true in particular for small and medium-sized enterprises.

The underlying problem is that while SMEs play a pre-eminent role in the economic development of the European Union, the participation of SMEs in the Internal Market is considerably lower than that of larger companies, not least for fiscal reasons. This results in economic inefficiencies and consequently lost potential for economic growth and job creation which compromises the achievement of the renewed Lisbon objective. Accordingly, appropriate action for fostering the cross-border expansion of SMEs is called for in the multiannual programme for enterprise and entrepreneurship, and in particular SMEs (2001-2005)[2] and in the Commission Action Plan: The European Agenda for Entrepreneurship[3]. Moreover, the recent Commission Communication on the contribution of taxation and customs policies to the Lisbon strategy and Communication on modern SME policy for growth and employment[4] refer to the need for an appropriate tax framework for SME and mention the Home State Taxation initiative.

"Home State Taxation" is a possibility worth exploring.

The purpose of this Communication is first to set out the particular problems which SMEs active in more than one Member State face in the company tax area and to examine how these undermine the functioning of the Internal Market and, secondly, based on the work of recent years and the Commission's current company tax strategy, to present a possible, practically viable solution based on the "Home State Taxation" approach. In the Commission's view, this concept could be usefully tested by interested Member States and companies in an experimental pilot scheme. As demonstrated in the attached Impact Assessment the potential overall economic benefit for the Internal Market is considerable.

1.2. Previous Commission action for improving the fiscal situation of SMEs

Previous Commission

So far, Commission actions for improving the fiscal situation of SMEs have focused on cross-border problems relating to taxes other than corporation tax. In particular the transfer of SMEs, which are frequently

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[1] Presidency Conclusions of the Brussels European Council of 22 and 23 March 2005, e.g. in para. 25

[2] Council Decision 2000/819/EC of 20 December 2000

[3] COM(2004)70 dated 11/02/2004

[4] COM(2005)532 dated 25/10/2005 and COM(2005)551 dated 10/11/2005

action focused on the transfer of businesses ...

family businesses, entails a number of tax issues that are often more difficult and onerous than for large, publicly quoted companies. Cash-effective gift and inheritance taxes are an important example in this respect. The Commission has repeatedly referred to these issues and presented recommendations on tax problems concerning the transfer of small and medium-sized enterprises[5] and a Communication on the general improvement of the tax environment of small and medium-sized enterprises[6]. Most of the recommendations concern tax problems relating to the legal status of sole proprietorships and partnerships, in particular the succession of SMEs.

... and current efforts so far concentrate on value added tax.

Moreover, a variety of measures are currently being put in place to address the particular problems of SMEs in the area of value-added tax. In particular, the Commission initiative on the 'one-stop-shop' concept will make it much easier for SMEs to expand in the Internal Market, as they will be able to deal with their VAT obligations at one single point of registration only. Therefore, from an SME perspective, company taxation remains one of the biggest Internal Market tax problems, which so far is not being properly addressed at EU level. Moreover, progress in this field and tax measures favourable to SMEs in other areas would be mutually reinforcing.

2. THE NEED TO IMPROVE THE FISCAL POSITION OF SMALL AND MEDIUM-SIZED ENTERPRISES IN THE INTERNAL MARKET

2.1. Company tax obstacles in the Internal Market and their relevance for SMEs

Companies face numerous and varied tax obstacles in the Internal Market ...

Recent analysis and research by the Commission services[7] subsequently confirmed by independent research institutes[8], reveals that the cross-border economic activities of businesses in the EU are seriously hampered by many different company tax obstacles. In a nutshell, these concern deficiencies in existing EU tax legislation and its implementation in some Member States, the general lack of cross-border loss-offset for subsidiaries, tax problems with cross-border restructuring operations, the application of double taxation treaties and transfer pricing issues. The resulting higher or additional tax burden, (economic) double taxation and high compliance costs act as a disincentive to cross-border economic activity within the Internal

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5 Commission Recommendation of 25 May 1994 concerning the taxation of small and medium-sized enterprises, OJ L 177, pp.1-19; Commission Recommendation of 7 December 1994 on the transfer of small and medium-sized enterprises, OJ L 385, p.14-17.; Communication on the Commission recommendation of 7 December 1994 on the transfer of small and medium-sized enterprises, OJ C 400, pp.1-9.

6 Commission Communication to the Council and to Parliament on the improvement of the tax environment of small and medium-sized enterprises, COM(94)206, OJ C187, p.5-10.

7 Commission staff working paper "Company Taxation in the Internal Market"[SEC(2001)1681]

8 see for instance: Centre for European Policy Studies, "EU Corporate Tax Reform", Report November 2001 and "An EU Company without an EU Tax? A Corporate Tax Action Plan for Advancing the Lisbon Process", Report April 2002, both with further references.

Market.

Given the progress in many other policy fields where measures of harmonisation or mutual recognition have been taken, the relative importance of these tax obstacles has increased in recent years and is now one of the biggest problems in the completion of the Internal Market and the fulfilment of its economic potential. The Commission is therefore currently working on the implementation of a "two-track strategy" which contains both short-term measures that are targeted at resolving specific obstacles to cross-border economic activities in the Internal Market and longer-term comprehensive solutions.[9] In many areas this strategy has already resulted in tangible progress. Good progress is also being made with the technical work on a Common Consolidated Corporate Tax Base which will hopefully provide a systematic 'solution', in the medium term, to the Internal Market corporate tax problems of (mostly) the larger companies.[10] However, so far no systematic remedy for the specific company tax problems of SMEs active in more than one Member State has been put forward.

... the relative importance of which is continuously increasing.

Such a remedy is needed, however. In the above-mentioned analysis by Commission services, particular attention was also paid to the specific situation of SMEs.[11] It was found that, generally, the tax obstacles to cross-border economic activity are identical for SMEs and larger companies. However, the impact of many obstacles on SMEs is greater as they have, simply because of their smaller size, fewer economic and human resources and less tax expertise available. The limited size of the business thus inherently limits the possibilities of avoiding certain tax obstacles. The adverse effect of tax obstacles on SME participation in the Internal Market is also confirmed by a number of surveys. For instance, the replies by interested stakeholders to a "Questionnaire on corporate tax as a barrier to EU expansion of small and medium-sized enterprises" published by the Commission services in July 2004 revealed among other things that around one third of SMEs in the EU consider corporate taxation to be an important obstacle to cross-border expansion.[12]

Small and medium-sized enterprises are hit particularly hard by these obstacles ...

... in particular as regards compliance

Moreover, it was clearly established that there are also two additional areas which are of particular importance for SMEs.[13] First, SMEs have particular difficulties in meeting the compliance costs resulting from the

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9 For details see the Commission Communications “Towards an Internal Market without tax obstacles. A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities” [COM(2001)582] and "An Internal Market without company tax obstacles – achievements, ongoing initiatives and remaining challenges" [COM(2003)726]

10 Detailed information on this work is available at the following website: http://europa.eu.int/comm/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm

11 Part III, ch. 8 and part IV, B, ch. 11 of the study [SEC(2001)1682]

12 For more information on the questionnaire and the replies see at http://europa.eu.int/comm/taxation_customs/taxation/company_tax/home_state_taxation/index_en.htm

13 This conclusion by the Commission is also supported by the literature, see for instance: Chittenden F., Michaelas N. & Poutziouris P. (2000) ‘Small Business Taxation: An Agenda for Growth’, Executive Development Centre, Manchester Business School and NatWest Bank PLC, p.2 .

costs ...

need to deal with up to 25 different taxation systems. This finding is strongly supported by tax practitioners and business federations which represent SME interests[14]. According to UEAPME, the European Association of Craft, Small and Medium-sized Enterprises, "tax-related compliance costs for small businesses are up to 100 times higher than for large companies"[15]. There is also relevant scientific and quantitative evidence of this phenomenon. In addition to the available general studies suggesting that compliance costs decrease with company size and put a disproportionately higher[16] or even prohibitively high burden on SMEs compared to bigger companies,[17] the European Tax Survey[18] which was obtained from the Commission's European Business Test Panel has confirmed the importance of tax-induced compliance costs for SMEs. Compliance costs in the field of company taxation related to sales were estimated to be five times higher for small businesses as compared with large businesses. Thus, because of the smaller business size, high compliance costs are particularly relevant for SMEs and clearly deter many such firms from cross-border expansion.

... and problems of cross-border loss-offset.

Second, among the other more specific tax obstacles to cross-border economic activity in the Internal Market, the cross-border offsetting of losses has been identified as the most important obstacle from the perspective of small and medium-sized businesses. Losses often occur at the beginning of an activity in a foreign country, i.e. precisely when these activities are typically still being run in a smaller enterprise. Bigger companies are usually in a better position to avail themselves of tax planning strategies and hence to obtain effective relief for cross-border losses. SMEs usually do not have such optimisation opportunities. Moreover, given their usually limited capital base, it is particularly important for small businesses to be able to carry over losses.

For SMEs the effect of the cross-border

In the domestic context most Member States apply special tax arrangements (fiscal incentives or tax breaks) for the self-employed and SMEs.[19] These arrangements, which are usually not geared to cross-

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14 See for instance the replies given to the Commission consultation in 2003 and a questionnaire launched in 2004 (ch.7), both available at the following website http://europa.eu.int/comm/taxation_customs/taxation/company_tax/home_state_taxation/index_en.htm

15 Press release dated 11 June 2004.

16 See, for instance: Cressy, R. (2000) 'Tax, Assistance, Compliance & the Performance of the Smaller Business', A Research Report to the Federation of Small Businesses; and: Chittenden F., Michaelas N. & Poutziouris P. (2000) 'Small Business Taxation: An Agenda for Growth', Executive Development Centre, Manchester Business School and NatWest Bank PLC

17 See Annex 2 of the Commission services study [SEC(2001)1681] with further references.

18 Commission Staff Working Paper SEC(2004)1128. In particular, it revealed that compliance costs relative to sales are larger for SMEs than for large companies. Moreover, it was established that cross-border activity leads to higher compliance costs for companies. Based on the econometric analysis carried out it was demonstrated that compliance costs are higher for companies with at least one subsidiary in another EU Member State compared with companies without subsidiaries in another Member State and that they increase with the number of subsidiaries abroad.

19 For a broad overview and an assessment see, for instance OECD, Directorate for Science, Technology and Industry, STI Working Paper 2002/9 "Taxation, SMEs and Entrepreneurship" by Duanjie Chen; Frank C. Lee and Jack Mintz.

tax obstacles are often exacerbated by favourable rules at the domestic level.

border economic activities and the related tax issues, essentially concern the determination of the tax base, flat-rate arrangements and other simplified methods of profit determination. Some Member States also grant specific lower rates. The combination of these two effects - the particular importance of cross-border obstacles for SMEs and relief for domestic tax problems - may even raise the bar in terms of starting cross-border business for SMEs.

2.2. Conclusion and need for EU action

Company tax obstacles are one of the reasons for the under-participation of SMEs in the Internal Market.

Statistics show that the effects of the company tax obstacles and their interplay with other tax and non-tax factors, among other reasons, lead to [20] relatively low participation of SMEs in the Internal Market. In other words, SMEs often refrain from cross-border trade and investments because they are inhibited by the tax problems or prefer purely domestic transactions, even when these are less lucrative in strictly economic terms. When they do develop activities in other Member States, SMEs are systematically subject to higher compliance and finance costs than larger companies and therefore run a higher risk of business failure (altogether and/or of the newly created foreign establishment).

The obstacles have negative implications going beyond the pure tax problem.

In addition to the barrier to participation in the Internal Market, the SME tax obstacles also have other negative side-effects. For instance, as a result of the problems of offsetting losses in start-up companies in other Member States, not only is the creation of an establishment abroad discouraged, but these problems also limit the business' access to finance at an essential stage in a company's development life-cycle, which is frequently subject to supply-side constraints imposed by risk-averse financial provision from banks and other financial institutions (in particular in the case of technology-driven start-up companies). This has a negative effect on the broader conditions for the survival and development or cross-border expansion of SMEs.

This compromises the Lisbon goal in various ways.

Given the overall importance of SMEs as a key driver of economic growth, their reluctance to participate in the Internal Market and their poor survival rate is not only very costly to the individual businesses; it also adversely affects the overall economy in terms of productivity and the job creation that is necessary in order to achieve and maintain low unemployment levels, or tax revenue creation to support public services Both of these factors are essential to achieving the final goal of social cohesion stated in the Lisbon Council conclusions.

Addressing the SME company tax obstacles is therefore a

In order to exploit the full economic potential of the Internal Market and contribute to higher growth and employment rates it will therefore be necessary to encourage and increase SME investment and expansion in other Member States by removing or at least mitigating the relevant company tax obstacles. This is the fundamental policy objective of the

[20] For more details see the attached impact assessment.

necessity.

pilot scheme concept elaborated below. The operational goal is to remove SME tax anomalies that are specific to cross-border economic activity so that such activity can be undertaken in the Internal Market in the same way, or at least in a broadly comparable way to national markets.

Counter-productive side-effects should be avoided.

The achievement of this objective is subject to several constraints. Any measure taken in order to achieve this objective should not at the same time lead to significant revenue shortfalls for Member States, open new major tax fraud or avoidance possibilities and/or compromise the ability of tax administrations to oversee SMEs. All these effects would adversely affect the achievement of the overall economic benefit, which was the original purpose of the measure. The design of a possible pilot scheme must take this into account.

3. HOME STATE TAXATION AS A PROMISING APPROACH FOR TACKLING THE COMPANY TAX OBSTACLES OF SMES

3.1. Basic approach and suitability for SMEs

'Home State Taxation' applies the mutual recognition approach of the Internal Market to company taxation.

The concept of 'Home State Taxation' is based on the idea of voluntary mutual recognition of tax rules. According to this concept the profits of a group of companies active in more than one Member State are computed according to the rules of one company tax system only, i.e. the system of the Home State of the parent company or head office of the group (the "lead company"). An SME wishing to establish a subsidiary or permanent establishment in another Member State would therefore be able to use *only* the tax rules with which it is already familiar. Each participating Member State would continue to tax its share of the profits of the group member's business activities in that State at the corporate tax rate which it has itself defined. This share is determined using an apportionment formula. No steps are taken to harmonise rules. The Home State Taxation approach therefore preserves each Member State's ability to raise revenue through corporate taxation.

This would tackle the main tax problems of SMEs …

In the Commission's opinion, the concept of Home State Taxation appears to be a very promising way of tackling the above-mentioned tax problems that hamper SMEs most when they are expanding across borders, in particular by reducing compliance costs and inherently solving the problem of cross-border loss-offset. At the same time, however, given some of its possible implications if applied to all EU companies, there is some doubt whether Home State Taxation may be considered the most suitable tax approach for the Internal Market. The concept could therefore be usefully tested in a pilot scheme only for interested SMEs and Member States with a similar tax base. The attached annex describes in some detail how this could technically be done, but obviously the details of a possible pilot scheme must be determined by interested Member States in the light of the national framework conditions. The Commission is, however, prepared to lend technical support to this work, which could also be channelled through

the FISCALIS programme[21].

... and is therefore worth testing in an experimental pilot scheme.

The basic idea of the pilot scheme is to test the practical merits of the Home State Taxation concept for SMEs and its broader economic benefits for the EU while limiting the administrative costs and potential revenue risks for Member States. The pilot scheme could thus be introduced by Member States via appropriate tailor-made arrangements with other Member States. Depending on the actual situation on the ground, there are various possibilities such as via a bilateral or, preferably, multilateral agreement, by temporarily supplementing existing double-taxation treaties or multilateral conventions, or by concluding a new multilateral convention for this purpose. Appropriate suggestions are also presented in the outline of a possible pilot scheme in annex.

3.2. Development of the idea so far

'Home State Taxation' is a fully developed concept that has been refined over the years.

This idea of the pilot scheme project has gradually taken shape over the last four years, starting with the publications on Home State Taxation by its authors Malcolm Gammie and Sven-Olof Lodin[22], and continuing with the Commission work on a new company taxation strategy, and the reactions to these initiatives. On this basis, the Commission presented specific ideas for taking the pilot scheme further and proposed a number of practical key points on how such a pilot scheme could be usefully designed[23]. In 2003 the Commission services carried out a public consultation on this idea, and subsequent discussions (both formal and informal) with experts from the business community and the academic world led to further refinement of the project. Detailed working papers, summaries, official documents and reports on all of these preparatory works are available (for instance on the Commission web-site[24]). This Communication completes this long-standing technical and political preparatory work.

Testing with SMEs is

The European Parliament supported the idea of Home State Taxation and invited the Commission to take this concept forward[25]; the

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[21] Decision No 2235/2002/EC of the European Parliament and of the Council of 3 December 2002 adopting a Community programme to improve the operation of taxation systems in the internal market (Fiscalis programme 2003-2007); OJ L 341, 17/12/2002 p. 1-5

[22] see in particular Gammie, M. and Lodin, S.-O., "*Home State Taxation*"; IBFD Publications 2001

[23] E.g. in the above-mentioned Communications [COM(2001)582] and [COM(2003)726]. It is noteworthy that, in its 1994 Communication to the Council and the Parliament on the improvement of the tax environment of small and medium-sized enterprises [COM(94)206 dated 25/05/1994, OJ C 187 dated 09/07/1994] the Commission had already issued an orientation stating that "the foreign activities of small and medium-sized enterprises could, under certain conditions, be taxed only in the Member state of residence of the enterprise. This would imply a major administrative simplification.". However, in its current form Home State Taxation does not go so far. It does not involve taxation in only the Home State, rather the calculation of the base in accordance with only the Home State rules.

[24] http://europa.eu.int/comm/taxation_customs/taxation/consultations/home_state_sme.htm

[25] Report on the Commission communication to the Council, the European Parliament and the Economic and Social Committee on tax policy in the European Union – Priorities for the years ahead (COM(2001)260 – C5-0597/2001 – 2001/2248(COS))

supported by the EP, ECOSOC ...

European Economic and Social Committee advocates a pilot project on "Home State Taxation" as a solution for cross-border activities of SMEs which could be tested on a bilateral basis before being eventually widened to the whole of the EU following a positive evaluation[26].

... and the SME Community.

The public consultation on the idea of a Home State Taxation pilot for small and medium-sized enterprises held by the Commission services in 2003 and a questionnaire distributed in 2004 showed support among EU small and medium-sized enterprises for the Home State Taxation approach and high interest for taking part in a possible pilot scheme. However, due to the low response rate to the questionnaire, the results cannot be considered as being statistically significant.

Member States are sceptical.

Obviously, the Commission has also consulted Member States on the prospect of such a pilot scheme, among other things in 2004 in a working group meeting and at the Informal ECOFIN Council. It has to be admitted that these consultations revealed considerable and widespread scepticism. The essential arguments presented to the Commission in this context were, first, that claims about specific cross-border tax obstacles for SMEs were misleading and, second, that any such pilot scheme would give rise to serious administrative and legal problems, including discrimination[27]. The Commission considers, however, that there is clear evidence of the need to improve the fiscal position of SMEs in the Internal Market and that the potential administrative and legal problems can be addressed and should not be exaggerated. Moreover, as the scheme would be entirely voluntary, it is difficult to see any rational justification for preventing those Member States that wish to do so from entering in a bilateral or multilateral agreement to conduct a pragmatic trial of an innovative tax scheme for SMEs.

Nevertheless, there is an actual precedent…

Moreover, notwithstanding their reservations towards Home State Taxation, two Member States recently agreed a protocol to their double-taxation treaty under which an exception is made, in certain border regions, to the rules on permanent establishments. In the regions concerned, establishments of companies from the other Member State are not treated for tax purposes as "permanent establishments" even though the normally applicable criteria are met. Consequently no taxation on the territory of the country where the establishment is located is triggered – in contrast to normal rules. The main differences between this approach and Home State Taxation are that it is limited to

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[26] Opinion ECO/127

[27] While an independent "Study on analysis of potential competition and discrimination issues relating to a pilot project for an EU tax consolidation scheme for the European Company statute (Societas Europaea)" also ascertains the existence of such problems there are various, legal and practical, counter-arguments against the supposed discrimination claims. Most importantly the scheme does not systematically reduce the tax burden of the participating companies; the benefit is reduced compliance costs. Moreover, there are broadly comparable initiatives based on the country of origin principle and mutual recognition both in the tax arena and in other public law areas where the argument is apparently not being made.

a narrowly defined border area and the two Member States have agreed that no further allocation of the tax base between the two countries is needed.. However, the inherent logic of the approach - mutual recognition - is identical to that of the pilot scheme, and its practical implementation via the double-taxation treaty mechanism confirms that such arrangements are perfectly feasible and can be introduced in a relatively short period of time.

… and real life simulations have also confirmed its practical feasibility.

Finally, the Home State Taxation approach has also been simulated with actual data from a relatively large Swedish group of companies, in a project led by the Stockholm School of Economics. No technical difficulties were encountered and only a few adjustments to the companies' accounts were required. There was a reduction in tax payable, but this was explained by the better loss-offset possibilities (a desired result) which means that negative revenue will automatically be clawed back. That is to say, group relief under domestic Swedish law would become available to companies participating in the HST scheme. However, any deductions in respect of subsidiaries in another Member State would be reversed in subsequent profit years. There would thus be no reduction in tax in the longer term.

4. CONCLUSION AND OUTLOOK

In the light of the renewed Lisbon agenda, and bearing in mind the economic importance of EU company tax reform for the improvement of the EU Internal Market as a whole and for promoting economic growth and employment creation, specific action in favour of SME participation in the Internal Market is more necessary than ever before. The field of corporate taxation deserves particularly close attention in this respect.

The economic reasons for testing a new concept for taxing SMEs in the Internal Market are compelling.

In this regard, the Commission considers that the Home State Taxation concept provides a realistic and effective means to address the specific tax problems of SMEs in the Internal Market, in particular the problems of high compliance costs. It may be considered that Home State Taxation does not provide a systematic long-term "tax solution" for the Internal Market (in the way that the Common Consolidated Corporate Tax Base -CCCTB - does), but its potential benefits for SMEs and consequently for the broader EU economy should not be left unexploited, particularly as it will no doubt be some years before the CCCTB is implemented. Furthermore, in case the common consolidated tax base would only be optional, it will be more attractive for bigger companies than SMEs. The approach could thus be usefully explored relatively quickly and in a straightforward manner by interested Member States and businesses in an experimental pilot scheme. The attached outline of such a possible pilot scheme presents the relevant technical and legal issues in some detail.

It is hoped that Member States

Interested Member States are invited to involve the Commission

will examine the possibility and the technicalities of a pilot scheme constructively.

Services at an early stage when preparing a pilot project along the lines set out in this Communication and to inform them of any legislative or regulatory initiatives, not least in order to ensure compatibility with Community law, notably in the field of competition rules.

The Commission is aware of the fact that a large majority of Member States currently view this idea with degree of scepticism. In the Commission's view the concerns underlying this critical stance can, however, be dealt with effectively. Moreover, in all likelihood only Member States with a broadly similar tax base would enter into such an agreement. The suggested approach ultimately constitutes no more than a pragmatic and modest initiative aimed at the mobilisation of the growth potential of SMEs - it should not be hampered by purely administrative considerations.

It is hoped that Member States will examine the possibility of a Home State Taxation pilot scheme for SMEs and the detailed arrangement set out in annex in a constructive and open spirit. The Commission is prepared to provide support and advice to any interested Member States on specific projects.

ANNEX

OUTLINE OF A POSSIBLE HOME STATE TAXATION PILOT SCHEME FOR SMALL AND MEDIUM-SIZED ENTERPRISES

Introduction

1. The basic concept and the fundamental objective of the Home State Taxation pilot scheme are very simple: to tackle the tax obstacles encountered by small and medium-sized enterprises (SMEs) when they operate in other EU Member States in addition to their own, by giving them the possibility to apply, in certain respects, the corporate tax rules of their home state, with which they are familiar. Thus, a SME would be allowed to calculate the taxable profits for the parent company together with all its qualifying subsidiaries and permanent establishments in other participating Member States according to the tax base rules of its home state. The tax base thus established would then be allocated to the Member States concerned in accordance with their respective share in the total payroll and/or turnover. Each Member State would subsequently apply its national tax rate.

2. This document explains the technical features of this concept in the form of an experimental pilot scheme for interested SMEs. The purpose is to provide interested Member States with as detailed a basis as possible for working out the practicalities and the legal content of a concrete bilateral or multilateral pilot scheme and to demonstrate practical solutions to problems that might occur. The following explanation does not seek to cover every possible situation and potentially complex issue in relation to the pilot scheme. However, the application of the scheme should in practice be easy and straightforward for the vast majority of participating SMEs.

3. Obviously, this 'template' cannot replace an actual tailor-made agreement that takes into account the precise features of the tax laws and other relevant framework conditions in participating Member States. The Commission services are, however, prepared to provide additional support and advice in practical preparations if the relevant Member States so wish. Such support could, for instance, also take the form of common FISCALIS seminars and project groups.

4. It goes without saying that insofar as a possible pilot scheme refers to existing national tax laws and practices this does not involve any assessment of whether individual rules are compatible with the EU Treaty. The application of such rules in the context of the pilot scheme would in no case and by no means prejudge any position or decision to be taken by the Commission or any other institution in this respect.

Basic approach and procedures

Definitions

5. The fundamental approach of "Home State Taxation" is based on the idea of voluntary mutual recognition of tax rules. The taxable income of the 'Home State group' is computed according to the rules of one company tax system only, that of the Home State of the lead company. Each participating Member State continues to

tax at its own corporate tax rate its share of the profits of the group member's business activities in that State. This share is determined by applying a formulary apportionment mechanism. For the purpose of a pilot scheme the relevant new concepts and terms, i.e. those which do not follow standard practice in international taxation, must all be carefully defined. The following definitions are useful in this regard:

– "Home State" means the country of tax residence of the direct or indirect parent company, or of the company to which the permanent establishment belongs (head office), as appropriate.

– "Host state" means the country of tax residence of the subsidiary or the country in which the permanent establishment is situated, as appropriate.

– "Home State Group" means the group of companies, or the company with permanent establishments, participating in the pilot scheme, as appropriate.

– "Lead company" means the company at the head of the Home State Group (parent company or head office), which is resident in the Home State, and which is ultimately accountable for the operation of the pilot scheme.

6. There is no need for a separate definition of SMEs – on the contrary, it seems advisable to use the general EU definition of SMEs as laid down in Commission recommendation 2003/361/EC[28], since this definition is common and familiar in all Member States. This definition distinguishes between:

– medium-sized enterprises [headcount < 250 and turnover ≤ € 50 million and / or balance sheet total ≤ € 43 million]

– small enterprises [headcount < 50 and turnover ≤ € 10 million and / or balance sheet total ≤ € 10 million]

– micro enterprises [headcount < 10 and turnover ≤ € 2 million and / or balance sheet total ≤ € 2 million]

In order to avoid any ambiguity, this definition should be binding for the purpose of the pilot scheme. This also concerns in particular the definition of terms used for the SME definition and the types of enterprises taken into consideration in calculating staff numbers and financial amounts.

7. The following diagram illustrates the basic functioning of the scheme under consideration and the definition of the related technical terms as used in the remainder of this document.

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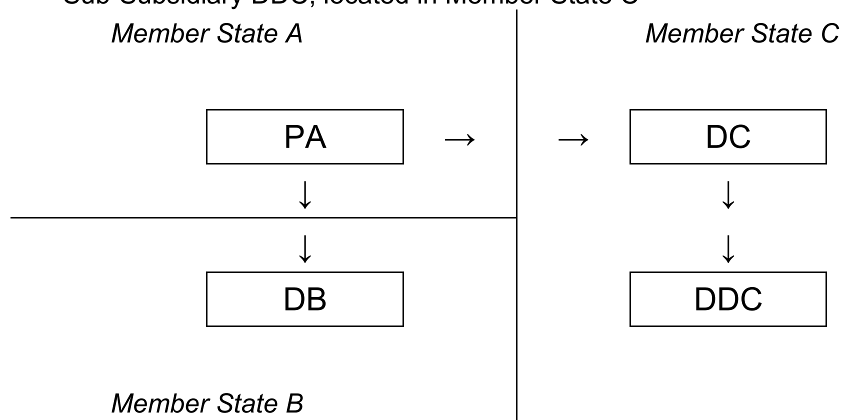
[28] Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises (2003/361/EC); OJ L 124 of 20.5.2003, p.36-41.

Description of facts

A group of companies has the following structure:

- Parent company PA, located in Member State A
- Subsidiary DB, located in Member State B
- Subsidiary DC, located in Member State C
- Sub-Subsidiary DDC, located in Member State C



Definition of terms:

- Company PA is the lead company
- Companies PA, DB, DC and DDC can form a "Home State Group"
- Member State A is the "Home State"
- Member State B is "Host State" for DB
- Member State C is "Host State" for DC and DDC
- Member States A, B and C will formalise their cooperation in the pilot scheme by appropriate legal instruments, e.g. via a multilateral "Home State Convention" or "Home State agreement"

Functioning of the scheme:

- PA establishes the taxable income of PA, DB, DC and DDC according to the tax legislation of Member State A
- The tax base so established is apportioned among Member States A, B and C following for instance the proportions of payroll and turnover in each jurisdiction
- PA files a group/comprehensive tax return in Member State A and pays tax (on its share)
- DB self-assesses and pays their individual tax liability in Member State B
- DC and DDC self-assess and pay their individual tax liability in Member State C

Qualifying enterprises

8. It seems strongly advisable to apply the pilot scheme only to small and medium-sized enterprises which are subject to corporate income tax. Moreover, it should in principle be open to *all* such small and medium-sized enterprises. However, ,in order, on the one hand, to target the pilot scheme more effectively at the first expansion cross-border of enterprises which have not yet reached a size which would allow them to support the additional costs caused by the application of the unfamiliar tax laws of another Member State and, on the other hand, to put a strict limit on the potential costs and risk for tax administrations, Member States could, if they so wished, include only small companies as defined in Commission recommendation 2003/361/EC in the pilot scheme. Further restricting the pilot scheme to micro

enterprises only would call the economic objectives of the pilot scheme into question and is therefore not a viable option.

9. The definition laid down in Commission recommendation 2003/361/EC also contains rules for the categorisation of 'autonomous enterprises', 'partner enterprises' and 'linked enterprises' and explains how these are taken into consideration for determining the data used for the required staff headcount and the financial amounts. It seems sensible for these rules to be applied in order to determine whether a company fulfils the criteria of a small and medium-sized enterprise and thus qualifies, in this respect, for participation in the pilot scheme. At the same time, these rules should be used for defining the Home State group.[29]

10. Given the narrow scope of the pilot scheme it is unlikely that SMEs with head offices in third countries would want to take part in the scheme in respect of their EU-wide activities in an EU group, as this would involve attributing the parent/head office function to one subsidiary for the sub-subsidiaries. Equally it appears to be improbable that SMEs with indirect ownership via third countries, i.e. a parent company in a Member State with a subsidiary in third country which holds a (sub-) subsidiary in another Member State, could qualify for the pilot scheme. While there is no need to systematically exclude the first type of companies from access to the pilot scheme if they fulfil the basic requirements set out in the relevant agreement, and in particular comply with the definition of a small and medium-sized enterprise, there are good reasons to believe that the second situation would be too complicated to handle for the purposes of a pilot scheme. In the opinion of the Commission’s services' opinion, indirect ownership via third countries or non-participating Member States should therefore disqualify a group of companies from participation taking part in the pilot scheme.

11. Member States may opt to exclude internationally active partnerships, single entrepreneurs and sole proprietorships or other tax-transparent or hybrid entities from the pilot scheme, even though they are partly covered by the definition of small and medium-sized enterprises. Their inclusion would drastically complicate the pilot scheme and offer no prospect of major economic benefits. For this purpose the assessment e.g. of the 'hybrid' character of an entity (i.e. one which is considered to be tax-transparent by one State and opaque by another) can of course only be made from the perspective of those Member States taking part in the pilot scheme and not by a Member State which is <u>not</u> that of any of the entities in the 'Home State Group'.

12. The potential complications and additional technical problems can be illustrated as follows. Unlike the example of incorporated companies, the inclusion of internationally active partnerships and other tax-transparent or hybrid entities within the scope of the scheme could, for instance, lead to diverging opinions on the correct application of existing double-taxation treaties, especially when the partners are residents of other Member States other than that in which the partnership is located. An example of this type of problem is the situation where one Member State considers the interest on a loan by the partner to the partnership as normal interest and another regards it as a form of hidden profit distribution. The scheme would thus

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[29] see "The new SME definition - user's guide and model declaration", available under: http://europa.eu.int/comm/enterprise/enterprise_policy/sme_definition/sme_user_guide.pdf

in some respects effectively extend into personal income taxation. It is therefore conceivable that, if Member States wish to include partnerships, these would only be accepted into the scheme in exceptional cases, which have to be analysed by the tax administrations of the Member States involved on an individual basis. In any event, only commercially active partnerships with business income should be allowed to apply to take part in the scheme.

Determination of the Home State and the Home State Group

13. The "Home State" of a participating SME-group is defined as the country of tax residence of the lead company. Following the generally accepted tie-breaker rule this is, in case of doubt or of double-residence, the country in which the place of effective management (or central management and control) of the lead company is located and where this company is subject to corporation tax before entering the pilot scheme. If there are problems with the application of this rule for the purpose of the pilot scheme, the tax administrations of the Member States in which the group is active have to reach a common agreement on the Home State; otherwise the company cannot take part in the pilot scheme.

14. The corporate tax base rules of the Home State will therefore apply to the participating lead company and its subsidiaries and/or permanent establishments in the participating Member States. Whether or not these activities of the participating company are included in the 'Home State group' for the purpose of the pilot scheme depends on the domestic group taxation rules of the Home State and the conditions defined therein. It seems that world-wide consolidation schemes are extremely difficult, or evenimpossible, to apply in the context of the pilot scheme

15. Under no circumstances should a company (parent or subsidiary) be allowed to be part of two different "Home State groups". Therefore, Member States should set a generally applicable majority ownership requirement in the relevant bilateral or multilateral agreement. This additional threshold would, for the purpose of the pilot scheme, supplement and replace existing national thresholds if these are lower

Coverage of taxes

16. It seems sensible that the scheme should apply to corporation taxes only. Taxes other than corporation taxes should not be included in the scope of the scheme. This concerns in particular value added tax, excise duties; wealth tax, inheritance tax, land tax and land transfer tax. If they so wish, Member States could nevertheless continue to apply national or local profit-related surcharges on the corporate tax as established under the conditions of the pilot scheme (i.e. on that Member State’s share of the overall tax base). Non-profit related local or regional taxes could also continue to be levied under the rules of each of the Member States involved.

17. The pilot scheme should not indirectly influence the levying of taxes other than corporation tax. Insofar as the determination of the taxable income for corporation tax interacts with or impacts on the assessment of other taxes or social security contributions, and insofar as this link cannot be technically established on the basis of the Home State tax base rules, specific accounts should be kept on the basis of the Host State rules. An example of this would be the treatment of fringe benefits in many Member States' income or wage tax laws. Applying different tax rules for the

calculation and treatment of benefits in kind under corporation tax law at company level and under personal income tax law at staff level may result in an undesirable mismatch and thus lead to over- or under-taxation. The only way to address this mismatch is to re-calculate the benefit, either in the Home State for the income of the Home State group or in the Host State for the personal income tax treatment of the recipient. Given the variety of rules on fringe benefits and comparable issues in Member States, no general solution can be suggested; appropriate arrangements would need to be worked out in the specific situation in the light of the laws of the Member States concerned.

Coverage of sectors

18. Several sectors of the economy are usually subject to specific corporate tax rules. For the purpose of an SME pilot scheme this might lead to additional complications that are hard to justify, either because very few, if any, SMEs are active in these sectors or because the sectors in question are often still national. Therefore, Member States might give some thought to the idea of stipulating that, for instance, 'Home State groups' with more than 10% of their turnover in the sectors of shipping, financial services, banking and insurance, oil and gas trade and exploitation, and agricultural activities (including forestry and fishery) shall not be allowed to participate in the pilot scheme.

19. The definition of the sector should be based on the domestic taxation rules applied in the 'home state' concerned, but the tax administrations of the Member States concerned must in any event approve the sector allocation on a case-by-case basis. Alternatively, common EU definitions should be employed or, if need be, developed for the purpose of the scheme. The Commission services would be prepared to assist interested Member States with this task, where necessary.

Provisions for specific cases and anti-avoidance rules

20. It goes almost without saying that the pilot scheme has to include rules for dealing with exceptional cases and anti-avoidance provisions. The following possible arrangements seem to make sense from the Commission’s point of view and should be considered as possibilities by interested Member States. These rules also should provide certainty for participating companies.

(a) A lead company which takes part in the pilot scheme cannot choose which qualifying subsidiaries or permanent establishments in participating Member States will form part of the Home State Group ("all in/all out" approach).

(b) Only existing enterprises which have been tax resident in the 'Home State' for at least two years should be allowed to participate in the scheme.

(c) A business which, while participating in the pilot project, by performing its normal commercial activities grows organically beyond the limits set out in the SME definition should not for this reason be excluded from the project.

(d) A change of ownership does not automatically lead to an exclusion of the participating company, unless it breaches the definition of small and medium-sized enterprise.

(e) One-off transactions and 'abnormal' business fluctuations in turnover should not automatically lead to exclusion of the participating company (or the disposal of a large capital asset should be excluded from the turnover requirements).

(f) Mergers and acquisitions which do not affect the constituent elements of the pilot scheme (SME definition; determination of Home State, etc.) should not automatically lead to the exclusion of the participating company. The responsible tax administrations will, however, have to re-assess whether the prerequisites for participating in the scheme are still met under the new group structure.

(g) The change of the Home State of a participating company during the pilot scheme could be deemed impossible. The transfer of the lead company's tax residence to another Member State should then lead to the termination of the pilot scheme. The same holds for a merger leading to a change of tax residence of the lead company. Alternatively, in the case of change of residence to another Member State, the group could, in principle, continue to benefit from Home State taxation, albeit under the rules of a new Home State. The transition from one Home State regime to another should then be seamless; although this appears to be technically complicated, it is not impossible.

(h) Where the tax years of the lead company and the Home State group member do not coincide, it falls to the lead company to keep corresponding accounts which allow the tax administrations concerned to assess the application.

(i) The transfer of assets between the lead company (parent company or head office) and the subsidiary and/or permanent establishment in another Member State under the pilot scheme is possible in keeping with the domestic taxation rules of the Home State. However, the participating lead company is required to establish, in collaboration with the responsible tax authorities, the book value and the market value of the transferred asset so that the transfer can be taxed according to the current 'normal' rules if the pilot scheme is not prolonged or if the asset is sold (i.e. "freezing" of the position and tax deferral). Insofar as the transaction is covered by the fiscal Merger Directive[30], the rules of the Directive apply.

(j) Unless otherwise stipulated, all transactions within the Home State group between lead company and subsidiaries or permanent establishments or between group members should be dealt with according to the domestic tax rules of the Home State.

(k) The general anti-abuse rules of the State of residence apply for every group unit in relation to non-participating Member States and third countries, in order to forestall "rule shopping".

Application of existing double-taxation treaties

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30 Council Directive 2005/19/EC of 17 February 2005 amending Directive 90/434/EEC 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States; OJ L 58/19; 04/03/2005

21. It follows from the very concept of Home State Taxation that the relations between 'Home State group' members under the pilot scheme during the application of the scheme fall outside the scope of the relevant double-taxation treaties. The bilateral double-taxation treaty between two participating Member States should not be applicable for transactions between members of the Home State group. The treaty should, however, continue to be applied to those aspects of the tax treatment which are not affected by the pilot scheme.

22. The pilot scheme does not involve any change in the remit of the tax treaties. The various group members should remain subject to the same tax treaty as before joining the pilot scheme. In other words, the tax treaty of the 'Host' or residence State should apply to a member of a piloting Home State Group, but to the taxable income as established under Home State rules. Accordingly, the pilot scheme does not require changes to Member States' double taxation treaties with third countries. As each member of the 'Home State Group' remains a taxpayer in its country of residence, the respective treaties should continue to apply.

23. As regards foreign source income of the group members (dividends, interests, royalties, income from immovable property etc.) from third countries or non-participating Member States, it seems sensible that this should generally fall outside the scope of the pilot scheme and be accounted for under the normal rules. Foreign source income should thus be added to the income of the group member after apportionment. This procedure avoids problems that might otherwise arise if the Home State and the Host State had agreed on different arrangements in their respective treaties with a third state, e.g. on the use of the credit method and the exemption method for certain income items. Where the participating enterprise has such income, it will therefore be required to file two tax returns, one in the Home State and one in the Host State for specific income items.

24. In specific circumstances, double taxation treaty non-discrimination issues could occur, both within the EU in relation to non-participating Member States and vis-à-vis third countries, as enterprises in the same State are treated differently under the pilot scheme. While the available research[31] suggests that the comparison between enterprises participating in the pilot scheme and those outside the pilot scheme may no longer be the relevant reference point, these issues would ideally require a formal common understanding with the respective Treaty partners on the interpretation of this clause under the conditions of the pilot scheme.

Transfer pricing issues

25. It follows from the very concept of Home State Taxation that national transfer pricing rules should cease to be applied within the Home State Group under the pilot scheme. In the framework of the 'Home State Group' the rules of the Home State should be equally applied in the other Member States concerned.

26. As regards transfer pricing adjustments, e.g. concerning affiliated companies, related parties or sub-subsidiaries in non-participating Member States or third countries, the

[31] International Bureau of Fiscal Documentation (IBFD); The compatibility of the Home State Taxation system with double taxation agreements based on the OECD Model: a study", reproduced in Lodin/Gammie, op.cit, p. 77-104, p.99.

competent authority should be the Home State tax authorities (unless the adjustment arises from a transaction between a third country and a member of the Home State group resident outside the Home State). This seems to be the only practically feasible way of proceeding. Moreover, the available research[32] suggests that a careful distinction should be made between primary and secondary corresponding adjustments. In particular, it seems advisable to make corresponding adjustments after the tax base allocation is carried out and not before. This is because only the (foreign-sourced) income of that affiliate and only the Member State responsible for the negotiation should be affected.

27. Consultation between the administrations of the Home State and the Host State would in any event seem prudent. Such consultations are probably imperative in relations between the Host State and a third country not having a double-taxation treaty with the Home State.

Other technical issues

28. As regards withholding taxes, dividend payments and the related procedures concerning transactions between members of the Home State Group, the domestic rules of the Home State should apply to all members of the 'Home State Group'. Again, this way of proceeding follows logically from the very concept of Home State Taxation.

29. As regards payments between two enterprises established in the same Member State but subject to the tax rules of different Home States, following the suggestion of the authors of Home State Taxation[33], this transaction could usefully be considered a domestic transaction rather than a cross-border payment, and consequently the domestic rules of the residence (Host) State should be applied. This would avoid any complications of introducing new rules for what is a straight forward domestic transaction within one State.

30. As far as dividend payments to possible minority shareholders are concerned, although this might to some extent require additional book-keeping, these payments should be dealt with by applying the domestic rules of the residence (Host) State, as this approach appears to be the only practically feasible way of proceeding.

Procedural and administrative aspects of the pilot scheme

Practical implementation of the pilot scheme

31. In addition to the tax treatment of SMEs under the possible pilot scheme, a method of for access to the scheme and its procedural operation need to be laid down. It is suggested to use the mechanism of double-taxation treaties for implementing the pilot scheme. Interested Member States should thus enter into appropriate negotiations, prepare and conclude a bilateral or, preferably, multilateral agreement allowing interested companies to participate in the Home State Taxation pilot scheme. If they so wish, support and assistance for these efforts would be available from the Commission services, possibly via the FISCALIS programme (seminars

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32 Lodin/Gammie, op.cit., p.57; IBFD, op.cit, p. 95f.

33 see Lodin/Gammie, op.cit, p. 37

and/or project groups). The Member States concerned should then implement the agreement domestically, in accordance with their national laws and practices. The bilateral agreement could usefully take the form of a protocol supplementing the relevant double-taxation treaty, and multilateral agreements should be concluded in an intergovernmental convention. This way of proceeding would make sure that the pilot scheme could be introduced and relatively quickly and in a flexible manner, while fully respecting the principle of legality of taxation.

32. On the basis of their agreement with other Member States, the tax administrations of participating Member States should, for instance via appropriate internal procedures (e.g. circular letters or publication of a call for 'expression of interest'), establish the possibility for companies to volunteer to participate in the 'pilot scheme'. Interested companies (both the lead company and subsidiaries) would have to notify their interest in taking part in the pilot scheme to their usual counterparts in the tax administrations of their respective residence States and these would be obliged to inform and consult without delay the tax administrations of the other Member States concerned. A decision on the application should be given by the two or more administrations concerned within a reasonable period of time, e.g. two to three months after the notification of interest by the company. As with other administrative decisions a possible refusal should be accompanied by reasons and can only be justified if the applying company does not meet the requirements set out in the relevant agreement (no discretion for the authorities).

Filing and payment requirements

33. As far as the filing and payment requirements are concerned, it is suggested that in principle the lead company should be obliged to file a tax return for the Home State group only in the Home State. The responsible tax administrations of the other states concerned should receive copies of this tax return and the relevant annexes (e.g. balance sheets, profit/loss account etc. – as required under local Home State laws and practices). The information provided must be sufficient to allow additional profit-related taxes or surcharges or other inter-related features of personal income tax to be assessed. In the view of the Commission's services, in order to limit the cost there should not be any systematic requirement for translation; however, tax administrations could ask for key documents to be provided in the national language or another appropriate language at the expense of the taxpayer.

34. The very concept of the pilot scheme makes it inevitable that most of the actual administrative burden falls on the lead company. The lead company should thus compute the combined profits of the group according to the rules of its residence 'Home State' and allocate those profits among the group members according to the pre-established formula (see below). The figures of the various allocation criteria should be reported to the tax authorities of all Member States involved. The payment of the tax will, however, be made by the respective group member in its residence (Host) State.

Control and supervision issues

35. As regards the supervision of the pilot scheme, the general rules for mutual assistance and administrative co-operation in the EU apply and should be used. Moreover, the tax authorities of the interested Member States should, if this is

considered necessary, form joint audit teams for auditing the lead company and group members. The audits should be allowed to be carried out by the joint team in all premises covered by the Home State group, but be strictly limited to those aspects governed by the pilot scheme. In the event of litigation it would be logical, in the Commission services' view, to apply, in principle, the rules of the residence state of a "Home State group" member company, e.g. the host state for a subsidiary and the home state for a lead company. It seems difficult to envisage another solution which does not infringe the Member States' respective national laws.

36. In the bilateral or multilateral agreement it will be necessary for Member States to agree on appropriate arrangements for the termination of the pilot scheme(s). These 'exit provisions' must determine the valuation of assets and liabilities as well as the treatment of expenditure after the end of the pilot scheme, assuming the latter is not prolonged, without imposing on participating enterprises the systematic need to keep two sets of accounts under the rules of the Home State and the Host State throughout the pilot scheme test phase.

Time frame

37. By definition, the pilot scheme should de designed as an experimental trial and therefore be limited in time. For both the participating Member States (tax administrations) and the participating companies it will be important that the trial period is long enough so as to allow it to be analysed thoroughly and to justify the changeover cost. Based on the feedback received, it is suggested to run the pilot scheme for a period of five years after which a final evaluation should take place. The time frame of five years is to be understood to mean that a start date for the scheme is fixed and that the scheme automatically expires five years after that date (e.g. 1 January 2007 – 31 December 2011). Qualifying enterprises could, however, join the scheme at any time during the period and thus also participate for shorter periods (e.g. 1 January 2009 – 31 December 2011)

38. The decision by a company to take part in the pilot scheme should be binding for the entire five-year period or for a shorter period until the pre-determined end of the pilot scheme. If a company insists on ending the application of the scheme before the expiry of the five-year period, this shall be possible, but may be subject to a re-assessment of the tax years under the pilot scheme and retroactive application of the "traditional" rules.

Apportionment formula

39. For the purpose of this narrow pilot scheme it should be sufficient to use a simple but economically robust formula for apportioning the tax base between the participating Member States. This is because the tax revenue 'at stake' is limited by various factors: the restriction to small or small and medium-sized companies; the limited number of small and medium-sized companies with establishments in other Member States; the optional character; strict monitoring; the generally low tax liabilities of SMEs etc. Moreover, a simple formula is easy to administer and operate

40. The following economic factors may be used for devising the allocation formula: payroll; number of employees; sales (turnover); assets. Combining these factors will increase the economic representativeness but render the application of the formula

more complex. Depending on the formula chosen by Member States it will be necessary for them to agree on commonly accepted and practically operational definitions of the factors used.

41. It is recommended to use the respective share in the total payroll (50%) and overall turnover (50%) of the participating business in each Member State concerned as apportionment formula. These figures are easy to identify in the company's accounting and tax declarations. Moreover, the combination of an input-related factor (payroll) with an output-related factor (sales) also reduces the possible arbitrariness

42. Following the inherent logic of the Home State Taxation concept and the pilot scheme, both profits and losses should be subject to the formulary apportionment. Any losses allocated to the group units will be subject to the carry-forward and carry-back rules of the State of residence of the unit, i.e. the home state for the lead company (parent company or head office) and the host state for subsidiaries and permanent establishments

43. Under the Home State Taxation system the lead company uses the tax return forms of the Home State for combining and reporting its taxable activities in all Member States concerned (see above). These do not necessarily include the required information on the apportionment factors. An appropriate, simple form for declaring these in an annex to the tax return should therefore be devised.

Evaluation

44. It seems advisable that the Commission and participating Member States should create a monitoring group to supervise the pilot scheme; the members of this group would consul one another, consider possible practical problems and assess the scheme's success. Moreover, it would make sense for those Member States implementing the pilot scheme to draw up, by 31 December 2009, a detailed report containing an overall assessment of the pilot scheme's effects, so as to allow the Commission and the monitoring group to consider the possible prolongation or termination of the scheme and decide on the relevant procedures.