

New EU rules for e-invoicing by 2013: equal treatment with a twist

On Tuesday 16 March 2010, Ministers represented in the European Union Council for Economic and Financial Affairs approved the text of a new Directive supplementing VAT Directive 2006/112/EC. The resulting text is expected to be adopted by the European Parliament without substantive modifications. This TrustWeaver news flash analyses the changes concerning electronic invoicing. New insights may be gained in the coming weeks or months as Member States comment on transposition intentions.

Executive summary

As of 1 January 2013, and in some Member States before that date, companies will have more choices as to how they prove the authenticity and integrity of electronic invoices. An electronic invoice will be defined as an invoice that is issued and received in electronic format. Proof of integrity and authenticity of an invoice (paper or electronic) must be available *from the issuance of the invoice until the end of the archiving period*. Invoices must also remain legible during that time. The new Directive makes a clearer distinction, and creates an explicit hierarchy, between (1) the requirements on the invoice as a discrete object and (2) the objective of those requirements (verifying that a supply actually took place).

It is now clearly established that an invoice is *de facto compliant* if a taxable person can prove an actual transaction “through business controls establishing a reliable audit trail between an invoice and a supply”. In addition to giving companies this option, which by definition requires a tax auditor to judge an invoice on the basis of combined historical records about the underlying sales or purchase transaction, the Directive maintains the legal certainty awarded to two technical methods for ensuring integrity and authenticity of *electronic* invoices: (a) advanced electronic signatures or (b) contract-based secure EDI. Member States continue to have the ability to require the information used to prove integrity and authenticity of electronic invoices also to be stored electronically; this option takes on more importance now that methods are available to prove the veracity of an invoice on the basis of additional transaction records proving a supply; such additional records would then also have to be electronically stored and accessible for tax audit.

The requirement for a supplier to obtain the buyer’s prior acceptance of electronic invoicing remains in the Directive.

For the avoidance of doubt, all VAT-able invoices, whether zero rated or not, are governed by the requirements analyzed in this document.

Equal treatment, but as a strictly legal concept

The Commission's original proposal to delete Article 233 in its entirety has not been followed by the Member States. However, the concept of "equal treatment" has found sufficient resonance to be the starting point and one of the key principles of the new Directive. The new Directive maintains explicit requirements for the integrity, authenticity and legibility of invoices to be maintained whether they are on paper or electronic. This extension of explicit integrity and authenticity requirements to include paper invoices means that 'equal treatment' has been introduced as a *legal concept*. This clearly diverges from the more political concept of equal treatment as a way to play down the importance of integrity and authenticity of e-invoices on the argument that these features are *in practice* not relevant for paper invoices. The legal equal treatment concept, according to which both types of invoices should be free from mandatory form or method requirements, is now firmly codified: from 2013, businesses can no longer be forced to deploy any specific technology or process in relation to e-invoicing. This rule, which does away with the 'form over substance' mentality introduced with the 2001 Invoicing Directive, is reinforced by another new rule: if a taxable person can prove, through business controls establishing a reliable audit trail between an invoice and a *supply*, it follows logically that the invoice complies with the integrity, authenticity and legibility requirements. This 'substance over form' principle, which is also one of the principal topics of the associated Recitals of the new Directive, clearly articulates the objective of an invoice: it is there to prove an actual supply and therefore its intrinsic qualities as a document become unimportant if an actual supply is *otherwise* credibly demonstrated.

A reliable audit trail between an invoice and a supply

The new Art 233 text begs the question: "what business controls establish a reliable audit trail between an invoice and a supply"? Based on the legislative history and the text of the new Article 233, one conclusion is that the term "business controls" designates controls that ensure and record the veracity of the actual sales or purchase transaction being completed; this means that both parties must retain evidence, during the entire storage period, that the goods or services referenced in the invoice have been supplied and paid for, as stated in the invoice, between the named parties. More concretely, evidence of such controls will generally be a *combination* of transaction-specific documents or messages (e.g. contracts or pre-contractual communications, orders, order acknowledgements, shipment data, delivery information, payment information etc) and associated system records (logged approvals, reproducible data matching logic, mapping tables etc). Where process-only components play a significant role in establishing a strong evidence position, it will be necessary to document such controls and maintain this documentation through their evolution through time. Third party audit reports could also play a role in demonstrating the fulfillment of a sales or purchase transaction.

Existing methods of proving integrity and authenticity of an invoice

The two methods (advanced or qualified electronic signatures and secure, contract-based EDI) that since 2004 have benefited from a presumption of guaranteeing integrity and authenticity of an electronic invoice continue to do so. To avoid any misunderstanding as to the level at which these control methods intervene, the Recitals to the new Directive clarify that they cannot by themselves prove that an actual supply took place. In other words, an invoice that is exchanged using such controls can be presumed to

be intact and come from an identified issuer, but it can never by itself prove an actual supply. This, naturally, is the case with all invoices when viewed as standalone documents and the reason why tax administrations can audit businesses.

Legal certainty?

We will not know for some time how Member States will transpose the novelties introduced with the new Directive. By their very nature, because they were introduced in response to calls for greater flexibility, the new ways to prove integrity and authenticity of an invoice (“any means chosen by the trading parties” or “business controls establishing a reliable audit trail”) are open-ended; whether or not they are fulfilled depends on a business’s individual circumstances. This means that the tax auditor will, for businesses that choose to avail themselves of these options, become a more central figure in confirming the day-to-day trust that is needed in the triangular relationship between trading partners and tax administrations for the ongoing process of VAT to function smoothly. Naturally, such broad tax verifications of a business’s records and processes could always and can continue to be performed to establish the veracity of historical supplies under all compliance options; not even the most secure invoice in the world can conclusively prove an actual supply – the big difference is that under the “reliable audit trail” option such audits become the principal platform for ascertaining the validity of invoices without any reliance on proof stemming from intrinsic qualities of the invoice as an object. This greater openness of the law also means that the divergences among Member States in their audit legislation and practices becomes a greater challenge for companies seeking to build a single approach to compliant e-invoicing across the EU.

It is possible that some Member States will provide more specific guidance on what documents or audit trail information businesses must at retain to use the “reliable audit trail” option. Such definitions would however risk creating another category of specific technical control definitions, which, while enhancing predictability, would reduce the flexibility and freedom of evidence that proponents of these options have sought.

One aspect that requires further analysis in this context is the distinction between goods and services. While the preservation of evidence demonstrating historical use of sophisticated business controls such as three-way-matching of order, delivery and invoice information can be viewed as one way to prove an actual supply of goods, such mechanisms are generally not suitable or available for services. A related observation is that such business controls, if they set an acceptable level of proof upon an audit of the buyer, often do not have an equivalent on the side of the supplier. This may specifically be a concern for situations where many smaller companies supply a large purchasing organization that chooses to rely exclusively on the transaction audit trails in its internal systems; these suppliers (if they do not want to use advanced or qualified electronic signatures to ensure proof of integrity and authenticity as intrinsic qualities of the invoice file itself; they cannot unilaterally use the EDI method) will often not have comparable transaction evidence available and may as a result of the buyer’s choice of e-invoicing method need to take elaborate measures to couple records from e.g. disparate inventory management systems with stored invoices to achieve conclusive evidence of a supply on its side of the transaction. Similarly, large B2B invoice senders such as certain utilities or logistics companies will face challenges

with their heterogeneous customer bases if they wanted to use these new compliance options. Finally, it must be acknowledged that non-structured PDF remains a massively popular invoice format due to ease of creation and communication in business contexts where full automation is not (yet) possible; creating credible end-to-end traceability to an actual supply by linking such invoices with recordable business controls will be challenging for many companies.

Applicable law in intra-Community e-invoicing

The Directive also contains clearer rules on an issue that has long been controversial in relation to intra-Community e-invoicing: is the validity of the invoice governed by the country of the supplier or the buyer? The main rule is that invoicing is governed by the rules applying in the Member State in which the supply of goods or services is deemed to be made (country of supply according to Section V of the VAT Directive). A number of exceptions to this rule apply. Does this mean that only the supplier in an intra-Community supply of goods needs to worry about the validity of an invoice according to its own local standards, and the buyer can stop worrying about compliance under its VAT law? Legally speaking, the tax administration in the receiving Member State may not apply its own rules to determine that the invoice meets the integrity and authenticity requirements; however, since the right of VAT deduction is in the country of receipt, the tax administration will have a natural interest in ascertaining that the invoice is real. This means that the tax administration will need to establish whether the invoice met the integrity and authenticity requirements in the country of the supply. This has been a challenge for the pre-existing compliance methods; one can only speculate about the practicalities involved in establishing country-of-supply compliance for the less defined and standardized “reliable audit trail” option.

Conclusion: a business case for change in 2013?

More freedom of e-invoice form and method means more responsibility and less certainty. Fortunately, the Directive has also reconfirmed the technically defined and highly standardized compliance options which Member States must in all circumstances continue to accept. Businesses will therefore have a real free choice between flexibility and certainty. The general legal and tax culture of each Member State will to a large extent determine the actual compliance risk involved in choosing to rely on the new options of the Directive. In some Member States, CFOs do not lose sleep over the prospect of a full tax audit; in others, both businesses and tax administrations dread the idea of making such deep investigations the rule rather than the unpleasant exception they are today. One thing is certain: businesses will continue to strive for the highest level of legal certainty at the lowest possible cost in their specific circumstances. As regards legal certainty, we must conclude that the existing technological options are the only way to be certain in advance that e-invoices will be accepted as real and unchanged in all Member States, as well as in all in other countries with explicit e-invoicing legislation. Since these measures have become very inexpensive and easy to use, and due to the fact that the less certain methods now available will in many cases drive up the costs of reliable archiving additional transaction records for the same long storage period as invoices, it is unlikely that the business case for the newly available methods of compliance will be overwhelming for many companies.