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Effective 2013, new VAT Directive provides greater freedom but not more certainty

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With only minor linguistic corrections, the European Union Finance and Economy Ministers today formally adopted the text of the VAT Directive modification that they first approved on 13 March 2010. Among the changes are new rules concerning the integrity and authenticity of invoices, whether in electronic or paper form (see our 16 March 2010 News item on this topic on www.trustweaver.com for a previous TrustWeaver release including an analysis of the new text).

From 2013, companies are free to choose the means by which they prove the integrity and authenticity of invoices to a tax administration; they can then no longer be penalized merely because they did not implement a specific type of control. At the same time, the generic requirements for maintaining evidence of integrity and authenticity are defined more forcefully than in the current legal regime. In the emerging EU landscape, companies have a responsibility to ask themselves for every transaction: do I, and does my trading partner, have capabilities to reconstitute this transaction in such a way as to prove in many years from now that it actually took place? Companies naturally have adequate business controls in place for creating and approving invoices –they would not stay in business long without them. However, the evidence of such processes tends to erode over time. Maintaining such evidence for 6, 7 or up to 11 years can be a significant challenge in today's fast-paced environment where people, organization charts, duties, technologies, processes, legal structures and lines of business change very frequently. Additional questions that companies have to ask themselves include:

- How can I be certain that my business process audit trails will be considered reliable by each country's tax administration? I don't want to invest in e-invoicing and find we have to make expensive changes later – how can I achieve legal certainty?
- How much additional business data do I need to store –at what cost– just as long as invoices, and how can it be tied to specific invoices to corroborate my sales or purchases?
- Even supposing I have good evidence of an invoice: can I trust that my trading partner can prove the corresponding transaction? –and if not, could his failing tax audit spill over into another expensive audit of my company?
- How long will tax audits based on business process traceability last and how deeply will it penetrate my company's administration? What is the cost of every additional day of audit, in terms of in-house and external expert assistance?

ECOFIN's adoption of the new VAT Directive is a sound legal decision based on principles of freedom of evidence and user choice. However –and this is a key point– that does not mean that all control options are equivalent from a business economics viewpoint. The reason that the EU chose advanced or qualified electronic signatures as a key method in the 2001 Directive, and continues to award them legal certainty status in the new Directive, is that this type of control benefits both tax administrations and companies:

- Conclusive evidence of integrity and authenticity is available at a simple click.
- Such evidence sticks to the invoice – therefore an invoice remains verifiable regardless of the medium it happens to be stored on or transiting through.
- Invoice integrity and authenticity evidence does not erode: by using the right electronic signatures, a company can without any additional measures maintain perfect proof for many decades if required. This alleviates the burden of maintaining documentation or multiple transaction records over long periods of time.
- Under most electronic signature laws, legal recognition of signed data is not an option but an obligation; a tax auditor challenging the validity of an invoice must disprove the validity of the signature.
- Outside of tax law, the electronic signature ensures high degrees of enforceable evidence of the invoice in e.g. commercial disputes.
- Upfront locally recognized electronic signatures can be created and maintained at a cost that is negligible compared to the savings of switching from paper to electronic invoices.

While the Directive's objectives must be met by Member States on 1 January 2013 at the latest, each EU Member State's legal, business and standards fabric will continue to influence the expectations and behavior of tax auditors. Not legal theory about freedom of choice, but a company's actual evidence position in each relevant country will determine its return on investment as regards VAT compliance. In countries (e.g. Finland, UK) that adopted a liberal regime based on the "other means" option of the 2001 VAT Directive, little will change because VAT law enforcement is a relatively consensual matter. For Member States where the tax administration has traditionally sought conclusive evidence of invoice validity –sometimes regardless of the pain and cost inflicted on the taxable person being audited– , companies will need to think twice before relying only on their business processes for proving they were in control many years ago.

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