VAT in the Digital Age

The rise and rise of e-invoicing in the EU

The release of the proposals for e-invoicing harmonisation across the European Union (EU), as contained in the 'VAT in the Digital Age' report released by the European Commission on 8 December 2022, heralds a new era of (near) real-time transaction-level reporting to tax authorities on a scale never before seen. The era of effective tax compliance by proactive transaction-based data management is fast approaching. Equally, the unmistakeable shift from manual paper-based invoicing processes to full digitalisation is within reach. These proposals, once adopted, are designed to produce a common standard of transaction reporting of all cross-border intra-EU business-to-business (B2B) transactions by sellers and buyers, and a common framework for the reporting of domestic B2B as well as business-to-consumer (B2C) transactions across the EU (where Member States apply it).

Background to VAT in the Digital Age

The European Commission has announced on 8 December 2022 its long-awaited proposal for legislative changes known collectively as the VAT in the Digital Age (ViDA) initiative.

ViDA is a set of proposals intended to modernise the EU's VAT system and the initiative's specific objectives are to:

- improve reporting requirements, unlocking the opportunities provided by digitalisation;
- promote the convergence and interoperability of IT systems;
- create a level playing field for businesses, regardless of their business model;
- reduce burden, fragmentation, and associated costs; and
- minimise the need to register for VAT in multiple EU countries.

The package is made up of three main pillars with the key measures proposed outlined below:

New Real-time Digital Reporting and e-Invoicing requirements	Updated VAT Rules for the Platform economy	Single EU VAT Registration

This publication will solely focus on the proposals relating to Digital Reporting obligations and e-invoicing.

Events leading up to the proposed e-invoicing measures

Globally, tax authorities around the world have been shifting their focus in recent years to the introduction of measures focused on digital reporting and e-invoicing. At its most basic level, these measures involve the transmission of transaction-based data to tax authorities, often on a real-time or near real-time basis. These measures have proven to be highly successful in increasing VAT collections and reducing the incidence of VAT fraud, thanks to the improvements in tax controls and the deterrent effect on non-compliance.

With the VAT gap across the European Union at levels of €93 billion in 2020*, it comes as no surprise that measures to tackle VAT fraud would be high on the European Commission's agenda. Added to this, the incidence of individual Member States implementing their own digital reporting and e-invoicing systems has only hastened the need for harmonisation.

Over time, it has become apparent that the EU VAT Directive represents a barrier towards digitalisation because Member States needed to obtain a derogation before being able to adopt digital reporting requirements (DRR) based on e-invoicing requirements.

*Source: Q&A: VAT in the Digital Age (europa.eu)

The EC's 2020 Action Plan flagged four alternative choices for reform of the digital reporting requirements, ranging from light-touch non-binding recommendations to the introduction of an EU DRR system for both intra-EU and domestic transactions. The European Commission has moved forward decisively with the third boldest option, only falling short of proposing a DRR obligation on domestic transactions but still outlining recommendations for this aspect as well.

Key measures

The primary focus of the proposals is on modernising intra-EU VAT reporting to reinforce Member States' ability to track cross-border transactions. This is because intra-EU missing trader fraud has been identified as a significant contributor to the EU VAT gap. The European Commission has set a target of reducing VAT fraud by up to €11 billion annually.*

The proposals by the European Commission strive to align and harmonise without forcing Member States to introduce these requirements at a domestic level. However, the proposals provide that if DRR is introduced for domestic transactions in a Member State, e-invoicing will be mandatory for the transactions in scope and the local systems will need to ensure interoperability with the intra-EU system on a data level. In other words, harmonisation is achievable, even at a domestic level, without requiring Member States to implement domestic DRR. For newly introduced systems, this requirement will apply immediately while existing domestic systems must converge in the medium term.

The key proposals are:

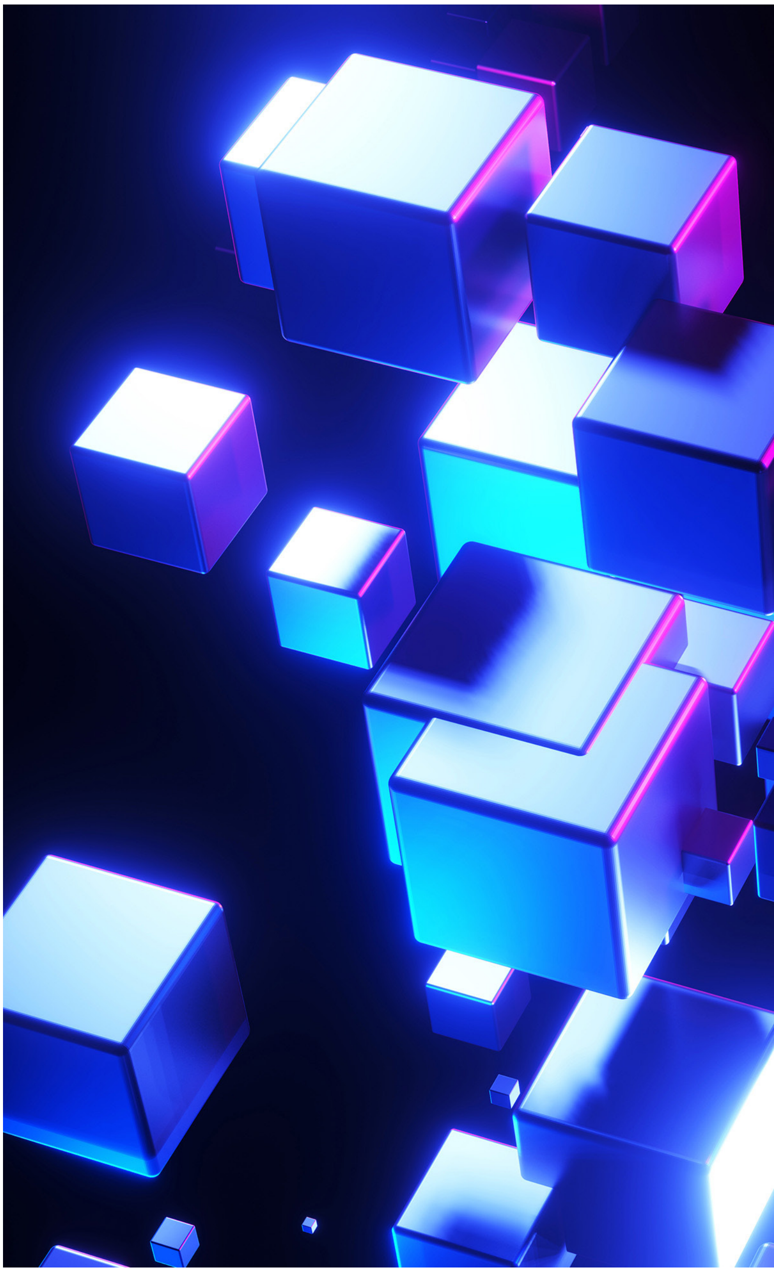
- From 2028, businesses will be required to issue structured e-invoices following a common EU standard for B2B cross-border transactions within two days of the transaction. All VAT registered suppliers in an intra-EU B2B transaction and VAT registered customers performing intra-EU acquisitions of goods will need to submit sub-sets of the transaction data to their local tax administration no later than two working days after the issuance of the invoice (or due date). Each Member State's tax authority will channel the data to a **central database**;
- Member States will have the option, but not the obligation, to introduce mandatory e-invoicing and digital reporting obligations for domestic transactions. Where they do so, they must follow the same EU standard as for cross-border reporting;
- Member States, which already have DRR, will have to bring them in line with the harmonised EU standard by 2028.

In a decisive move, the European Commission proposes significant modernisation of the EU VAT system in line with the global e-invoicing trend and benefitting from the innovations in this space. With many stakeholders following this closely – tax authorities, business associations, technology providers – the voices will be strong, and the journey will likely not be a straight line. Challenging and transformative times ahead for all involved.

Lyubov Skenderova, E-invoicing & Digital Reporting Expert Europe, KPMG UK

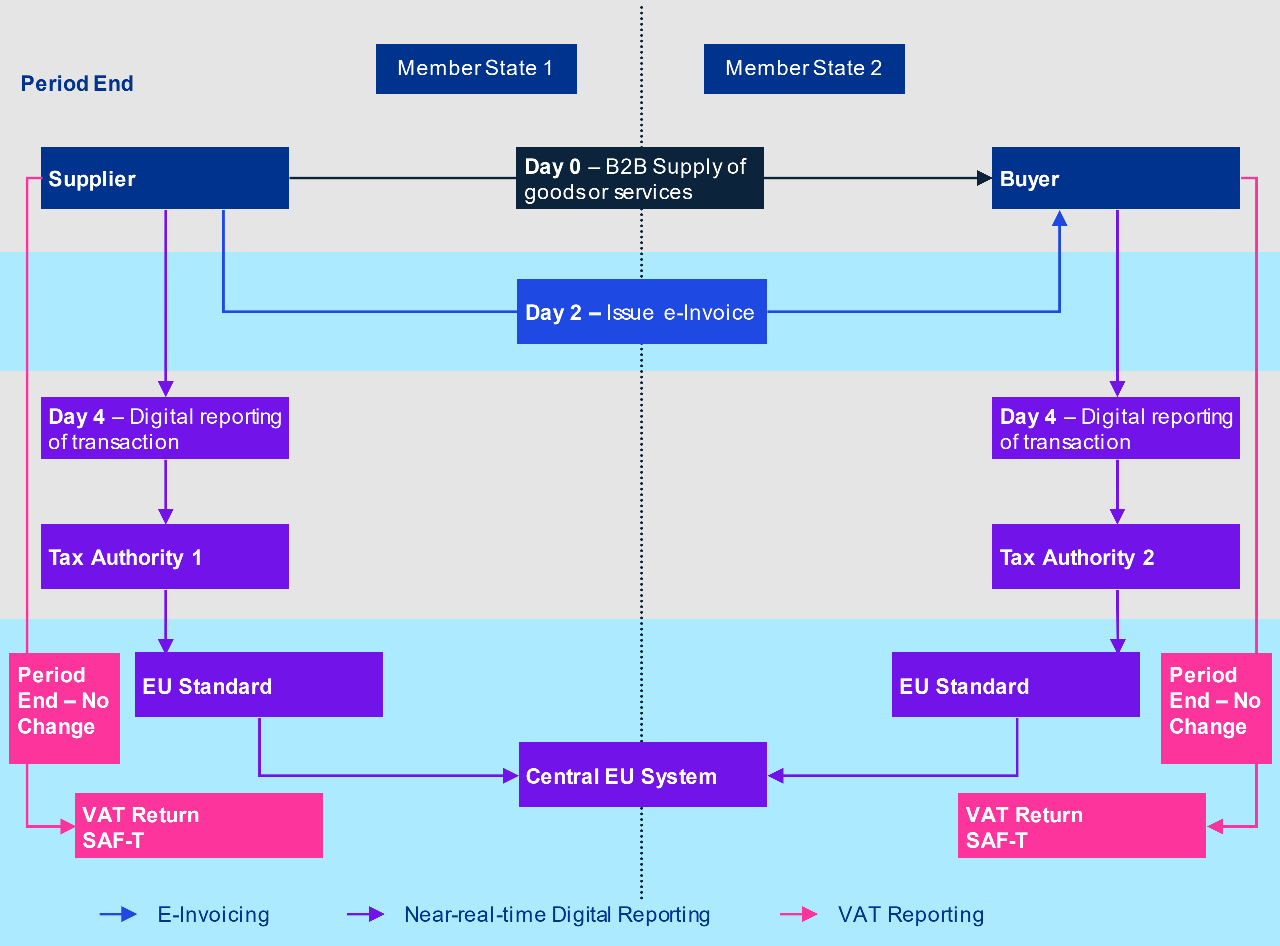
This proposal would give EU tax authorities access to almost real time data to assist them to combat potential VAT fraud.

The proposal further envisages an evaluation of the effectiveness of the reform in reducing the VAT gap and the costs to business derived from the fragmentation of the domestic systems be conducted in 2033 and, if necessary, a proposal to be made for a further harmonisation of domestic reporting.



*Source: Q&A: VAT in the Digital Age (europa.eu)

Scope of Digital Reporting and e-Invoicing proposals



Domestic B2B, B2C and export supplies – The above applies in case

- Member State decides to introduce mandatory e-invoicing and digital reporting obligations
- From 2028 if Member State already has e-invoicing or digital reporting obligations in place (e.g. Italy, Spain, Hungary)

The Detail

E-invoicing will be the general rule for the of B2B intra-EU transactions

Until now, the **two major reasons** for Member States to require a derogation before being able to adopt DRR based on obligatory e-invoicing requirements were rooted in the following VAT Directive articles:

- Article 218 which puts on an equal footing paper and electronic invoices, and
- Article 232 which requires that the issuance of electronic invoices be subject to the acceptance of the recipient.

The proposal changes this, with **Article 218** stipulating that electronic invoicing will be the default system for the issuance of invoices. The use of paper invoices will only be possible by exception. Article 232 will be deleted from the VAT Directive.

Further, the **definition of an electronic invoice in the VAT Directive** will be changed to align the concept with the one in Directive 2014/55/EU on electronic invoicing in public procurement, which regulates electronic invoicing in B2G transactions. This means that the concept of electronic invoices will be limited to structured electronic invoices. In other words, non-structured formats like PDF will not be deemed to represent electronic invoices from a VAT perspective.

The EU's ambition to tackle VAT fraud through the implementation of e-invoicing comes with tremendous responsibilities. These measures do impose significant compliance costs on all businesses, and the quid pro quo must be full harmonisation; an ability to root out bad actors from the system; as well as the responsible use, storage & protection of enormous volumes of data.

Lachlan Wolfers, Global Head of Indirect Tax & Global Head of Data, Tax & Legal, KPMG International

Several other VAT Directive articles would also be amended or eliminated to drive alignment with the proposals. Notably:

- The possibility to issue summary invoices was removed.
- Mandatory content for e-invoices and for the purposes of the submission as part of the Intra-EU DRR will be amended to improve the detection of fraud, though the inclusion of:
  - the identifier of the bank account in which the payment for the invoice will be credited
  - the agreed dates and amounts of each payment related to a transaction
  - in the case of an invoice that amends the initial invoice, the identification of that initial invoice.

Intra-EU B2B transactions will be subject to a new near-real-time reporting obligation

ViDA would replace the current reporting system for intra-EU B2B transactions (commonly referred to as EC sales list). Transactions in scope of the new EU DRR are expanded as they would include not only intra-EU B2B sales of goods and intra-EU B2B supplies of services for which the customer is liable to self-assess VAT but also intra-EU B2B acquisitions of goods. Since ViDA also proposes to expand the self-assessment requirement under Article 194 to all domestic supplies of services performed by a non-resident not registered for VAT (e.g., B2B supplies of real property), such transactions would thus also be captured by the new DRR.

An overview is provided of the features of the new digital reporting system, clarifying that Member States will provide the means for that transmission and that the information can be submitted directly by the business or by a third party on their behalf according to the European Standard. **In any case, the data formats allowed by Member States will have to guarantee the interoperability with the European standard.**

Domestic transactions will be subject to an EU-wide framework

The initiative aims to achieve the harmonization of the existing and future reporting systems for the domestic supply of goods and services. ViDA would allow Member States to adopt DRR for such transactions. However, Member States would have to comply with the features laid down for intra-EU transactions. Therefore, Member States, which already have reporting systems in place, will have to adapt them to the features of the harmonised reporting system by 2028 at the latest.

Processes for approval

The proposals will require the unanimous approval of the European Council (i.e., the EU body composed of the 27 EU Member States' heads of state or government) before they can be adopted – there has been strong support for these measures by businesses, tax authorities, and other stakeholders during the initial definition and consultation stages and the hopes are high that the scope and timeline will be ratified.

Next steps

An 8 week public consultation period has started and will continue until 06 February 2023 (earliest), which various stakeholders are strongly encouraged to participate in.

The European Parliament and the Economic and Social Committee will be consulted along the legislative procedure.

The legislative proposals will be sent to the Council for agreement.

These changes will significantly impact businesses as they will have to update their systems to be able to report on a daily basis intra-EU transactions and no longer rely on pulling monthly reports to fulfill their intra-EU reporting obligations. Businesses heavily relying on third parties to distribute their products and manage their sales (e.g., life science industry) will have to work closely with such third parties to comply with this new reporting requirement.

Kathya Capote Peimbert, Global E-invoicing & Digital Reporting Lead, KPMG

KPMG comments on the proposals

The proposals for harmonisation of digital reporting and e-invoicing will be welcomed by many businesses, given recent concerns about a lack of harmonisation leading to cost duplication and inefficiencies. Measures to both reduce the incidence of VAT fraud in the economy and support businesses in digitisation and harmonisation of invoicing processes across the EU are also laudable objectives. The key question will be whether these measures go far enough to reign in the disparate measures either already implemented by certain Member States, or scheduled for implementation, prior to these proposals coming into effect.

As with any significant reforms, the key to success will be in its effective implementation. In particular:

1. The requirement for suppliers in B2B cross-border transactions to issue e-invoices within 2 days of the supply, will likely have significant ramifications which go well beyond indirect taxes. In particular, in bringing forward invoicing process which have previously occurred later. Suppliers may see this as a potential fillip to their cashflow management activities;
2. The application of e-invoicing to cover B2B purchase transactions has the potential to create disproportionate levels of business disruption. By its very nature, this will not be as integrated into existing processes and will effectively serve as a 'tax only process'. The proposals are relatively light on detail in terms of how compliance will be met;
3. E-invoicing has the potential, in the fullness of time, to transform traditional VAT compliance processes because it provides the means by which tax authorities can pre-fill returns. Reconciliation of data from returns to source (through a 'reverse' compliance process) will become the norm. In the meantime, the focus on ensuring the accuracy of data at source is greatly enhanced by these proposals;
4. Will these trends and measures be extended in future to other transaction types (such as mandatorily requiring it for B2C sales and acquisitions) and other taxes (CIT) as well as other processes and document types (ordering, payments, transportation)?
5. Will individual Member States be reasonable in introducing domestic e-invoicing with enough notice for business and technology providers?
6. With the removal of the formal requirement for customers to accept the receipt of e-invoices and the intention for cross-border acquisitions data to be reported in near-real-time there will be increased burdens on customers to identify any errors on e-invoices and get them rejected/rectified in a timely manner for the 2-day digital reporting obligation to be met.
7. If approved, the change to the e-invoicing definition (to exclude non-structured formats like PDF) is expected to come into force from 2024. This may impact the French e-invoicing mandate as a hybrid PDF/A-3 invoice format with embedded XML is commonly used in France and was expected to be acceptable until 2027. It is generally a significant change with a relatively short timeline which will likely be disruptive to Member States and businesses.
8. Is the current EU e-invoicing EN 16931 standard adequate as a common scheme or would this create additional technological burdens on businesses? Some sector specific details, multi-purchase order invoices and Buyer Tax Representative are just some examples of business scenarios that will be difficult to accommodate with the standard in its current shape, which may cause resistance to its adoption.
9. Small and medium businesses that have VAT registrations in a single EU country but sell cross-border within the EU may be disproportionally affected by the increased costs of compliance now that they will fall in the fold of the intra-EU digital reporting
10. The European Commission has, at this stage, chosen not to propose regulations around the specific transmission channels to be used to report data to the tax authorities. This is currently left to Member States to decide on. How will harmonisation be achieved in this critical area?
11. It remains to be seen also how Member States will react to this proposal – will this speed-up their plans for introducing domestic obligations despite the non-final status of the proposal or will they remain cautious in the short term. Notably, Germany did apply for a derogation from the current VAT Directive just days before the ViDA proposal publication date.
12. What level of intervention from the local tax authorities in the e-invoice exchange between businesses will occur in future? The European Commission is seen to not favour clearance models (i.e. requiring a verification token from tax authorities before e-invoices can be issued or requiring e-invoices to be issued through a tax authority platform).

KPMG will be actively participating in discussions with the European Commission and other stakeholders on these measures and will keep you updated as the proposals progress.

If you would like to discuss further how these changes could impact your business, please do not hesitate to contact us

Key contacts

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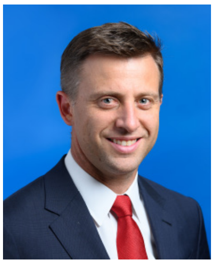

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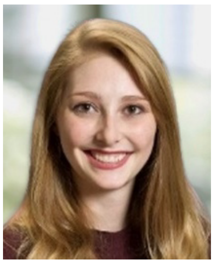

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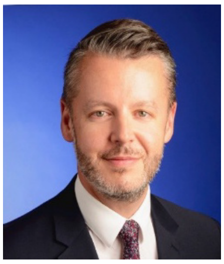

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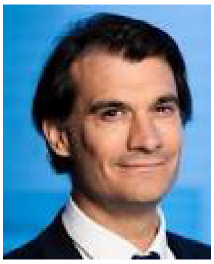

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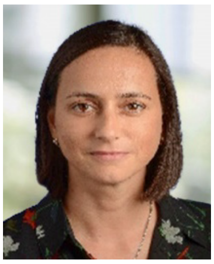

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