Upcoming legislation reinforces IBM Sterling e-Invoicing solutions sales opportunity

Value-added tax (VAT) Primer

In the European Union (EU) countries, VAT is an invoice-based tax. It is calculated per transaction. All business transactions require an invoice, these invoices become critical legal documents that must be processed and stored for 8 to 11 years in most jurisdictions. These stored invoices will be viewed by the tax auditor, and if the amount of tax on the invoice is not the same as the amount the company has paid, the company pays the difference. There are also potential fines for non-compliance with regulations and incomplete/missing evidence as well as the possibility of criminal prosecution for fraud.

- 34% incurred fines from tax authorities

- 24% fined by customers

- Average annual fines : $146,000![1]

[1]Source: A commissioned study conducted by Forrester Consulting on behalf of IBM Sterling, June, 2010

To avoid paying fines and having legal issues, companies must seek to ensure they are VAT compliant.

There are two key methods of providing evidence that VAT has been paid : the EDI Compliance approach and the Digital Signature approach. These are at the opposite ends of the spectrum.

The EDI Compliance approach relies on documented processes and puts a company in a historian or detective role when trying to prove compliance to regulations. Companies have to keep a lot of audit trails and process documentation, and then have to be able to follow the trail of the invoice, how it was created, and how it was processed electronically. They need to do this for potentially hundreds or thousands of invoices, which is a huge effort.

The digital signature approach relies on technology to demonstrate compliance. It can be used to easily prove data integrity and authenticity – that's specifically what it was created for. It is a much cleaner, simpler approach to compliance.

When these two approaches are set against the risk, cost and complexity of long term auditability and management, digital signatures come out ahead. This is the approach IBM Sterling recommends to achieve VAT compliance, but we also work with customers who have chosen EDI compliance.

Invoicing legislation continues to evolve to make the process easier

The EU electronic invoicing directives 2001/115/EC and 2006/112/EC set about reducing the burden of manual process across Europe. According to these directives, electronic invoices gain legal equivalence with paper and multiple options for compliance are defined such as digital signature and EDI as discussed earlier.

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(It is also important to note that there are global and local differences in companies' approaches to invoicing. The extent of the compliance requirements in counties like the UK are less than in countries like Germany.)

EU directive 2010/45, submitted In March of last year (2010), amends the original directive and removes some of the barriers to uptake of electronic invoicing. It ensures paper and electronic invoices can be treated equally.

The new regulations come into effect in 2013, and companies can now use "business controls" to create a reliable audit trail rather than relying on technical solutions. However the basic guidelines about integrity and authenticity remain. Freedom of choice is not the same as all choices being equal. Companies still need to determine the optimum compliance option for their business.

Invoicing options – from paper to digital

Paper
95 % of all invoices are still paper. The data needs to be manually entered into an accounts payable system which is time consuming, costly, and error prone and the original invoice must be archived. The tax authorities use these archived invoices to prove compliance.

Process
This model is useful for tax authorities that accept proof from companies who have robust, well documented processes in place. In situations where this model is in place, electronic invoicing has often been well established. Paper is still required in case of discrepancy.

EDI
EDI with contractual security processes is popular in specific regions/industries like France and Retail. This is strictly defined as per a 1994/820/EC recommendation which defines EDI as a security measure. This is not consistent with many modern EDI implementations.

Digital signature
This model eliminates the need for paper and process documentation by allowing signed electronic documents (like PDF, XML and EDI) as proof of compliance.

Conclusion

In the end, this is not about a "one-size fits all" solution. Companies need to be able to match VAT compliance options with those of their partners. To do this, companies need to look for a solution that offers flexibility and a range of compliance options. Things to consider in this search include:
- Support for all electronic options
  - Digital Signature
    - Comprehensive signature support and industry best practices
  - EDI / B2B
    - All document formats – EDI, XML, PDF, Web forms etc
    - All communication protocols – B2B protocols, email etc
- Tight integration
  - With your back end systems
  - Automate A/P and A/R processes

– Comprehensive archive / audit solution
– Flexibility to interoperate with other e-Invoicing solutions and provide "on-behalf-of" services for those without

The EDI Option vs Digital Signatures

	EDI Option	Digital Signatures
Geographic availability and relevance	Incomplete Not supported in all jurisdictions	Full
Types of e-Invoicing	Incomplete No web forms, PDF, pull systems, self-billing etc	Full
Requirements clearly defined in each country	No	Yes
Requirements differ per country	Yes	Yes
Integrity and authenticity guarantee	Partial Integrity Not guaranteed outside secure pipe	Full Regardless of archive / transport security
Durable auditability	No Additional measures required	Yes
Requirements for additional paper summary statements	Yes Different per country	No
Scales easily to multiple countries / partners	No	Yes

For more information:
http://w3-103.ibm.com/software/xl/portal/content?synKey=P990396P78214T93

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