The Dark Age of VAT Compliance

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In the last years, we have witnessed many reforms to make the EU VAT system more consistent and business friendly. The Quick Fixes, which took effect on 1 January 2020, sought to harmonize some of the rules governing the intra-EU trade as the European Commission pointed out that businesses engaged in cross-border trade incur 11% higher compliance costs than those trading within one country. The VAT E-Commerce Package (effective 1 January 2021) will simplify cross-border e-commerce: businesses selling goods online to consumer in other Member States will no longer require multiple registrations as it will be sufficient to be identified for VAT purposes in one EU country only. The new rules for small and medium-sized enterprises (effective 1 January 2025) will allow businesses established in other Member States to benefit from the domestic registration threshold and simplified compliance obligations.
However, in the area of VAT reporting, we see a lot of developments that clearly go against the objective of creating a harmonized EU VAT area. Every Member State seems to have its own views on what data needs to be collected to check whether businesses are meeting their VAT compliance obligations and how this data should be transmitted to the tax administration. Sadly, no EU-wide best practices or compliance guidelines have emerged so far.

The first noteworthy trend that is gaining popularity in Europe is the tax administrations' demand to provide transaction data rather than aggregate amounts. More and more countries introduce the obligation to submit the standard audit file for tax (SAF-T), either periodically or on the tax authority's request. SAF-T pilot programmes are currently underway in Romania and Hungary. In January this year, Norway started requiring companies to prepare a SAF-T file upon request of the tax inspector. The Greek tax administration is planning to maintain taxpayers' electronic books (recording a company's transactions and other accounting information) on its digital platform myDATA as from 2020 or 2021

In Poland, a separate VAT return will disappear in July[1] and will be replaced with an expanded SAF-T reporting obligation. In Italy, the VAT return will remain, but it will be pre-filled by the tax administration so that the job of businesses will be not to prepare it but to check it. As from July this year, the Italian tax administration will create VAT ledgers and draft quarterly VAT returns for Italian resident businesses.

Some countries have opted for a more timely submission of transaction data. Hungary and Spain were the first EU countries to introduce (nearly) real-time reporting systems where transaction data is reported to the tax administration on a daily basis or every four days. Italy was the first European country to implement mandatory e-invoicing in business-to-business (B2B) transactions. The Italian model goes well beyond real-time reporting of transaction data as it requires businesses to have their invoices approved by the tax administration before these invoices can be sent to customers. France, Greece and Poland are also considering mandatory e-invoicing although none has announced detailed legislative proposals yet.

The benefit of real-time data submission is that the tax administration can detect suspicious transactions at an early stage and prevent fraudulent activities. However, for some countries, having transaction data in real-time is not enough: they realized that fraudulent activities may not occur at all if fraudsters will not have any opportunity to receive VAT from their customers. Poland and Italy have introduced a mandatory split payment – an alternative VAT collection method where VAT amounts are paid directly to the tax administration or to a special VAT account of the supplier. In Italy, split payment applies to payments made to public authorities since 1 January 2015. The scope of this measure was subsequently extended to companies controlled by central and local public authorities and companies listed at the stock exchange. In Poland, mandatory split payment took effect in November 2019. It is limited in scope to certain B2B supplies (e.g. electronics, metal, scrap, fuel, construction services) above PLN 15,000. Romania also briefly applied split payment until the European Commission told it to stop, claiming the measure violated the EU law.

The fragmented VAT compliance landscape clearly undermines the efforts put into creating a single European market and places a huge burden on globally operating companies with centralized tax functions. It also has a negative impact on cross-border cooperation and data sharing. How to exchange and compare country-specific tax data that consists of different elements and is available in different formats?

A coordinated approach to VAT compliance would clearly benefit all stakeholders. The core element of this approach could be a regular submission of transaction data to the tax administration. In general, there are two ways in which such granular data could be provided: reporting (companies submit reports of transaction data to the tax administration periodically or in real-time) or invoice clearance (invoices are sent to the tax authorities for approval). The former is an extra compliance burden and creates a lot of additional costs for tax departments. The latter is more aligned with the existing processes as invoices need to be issued and exchanged in commercial relations anyway. However, involving the tax authorities in the invoice exchange process may represent a far-reaching intervention in business processes and pose significant risks: if the tax administration platform is the only way to exchange invoices between business partners, there will be a risk of a single point of failure. A post-clearance model where tax administrations validate transactions after they have occurred seems to offer a safer solution.

The history of the EU VAT system shows that consensus on compliance matters is difficult (if not impossible) to reach. In 2013, the European Commission issued a proposal for a common VAT return. Sadly, EU Member States could agree on the details and the proposal was dropped. However, the growing diversity of country-specific VAT reporting requirements clearly shows that the lack of a uniform EU-wide approach to VAT compliance will not be sustainable in the long term. An American philosopher Ralph Waldo Emerson once said : "The more experiments you make the better." However, EU Member States have already tested various approaches to VAT reporting and experimented with different compliance models. Now it is the time to think about more alignment – in the interest of both businesses and the EU Single Market.

[1] The new SAT-T reporting requirement was supposed to apply to large businesses as from 1 April 2020 and to all other VAT payers as from 1 July 2020. However, the Polish government is currently considering postponing the implementation for all taxpayers until July as part of the measures to mitigate the impact of the coronavirus on the Polish economy.