

## Implementing Global E-Invoicing with Guaranteed Legal Certainty



A White Paper by  
Christiaan van der Valk

Christiaan van der Valk is the CEO of TrustWeaver and formerly Deputy Director of Policy and Business Practices at the International Chamber of Commerce (ICC). Christiaan has been an advisor on e-business strategy, legal, policy, best practice and commercial issues to leading companies and international organisations. He was elected a World Economic Forum (WEF) Global Leader for Tomorrow in 2000 and serves as Vice Chair to EDIFICE, the European network for B2B integration in high tech industries. He is also Co-Chair of the ICC EBITT Commission's Task Force on Security and Authentication and Chairman of Digital Trust and Compliance Europe (DTCE). He is a Member of the Supervisory Board, .nl domain registry foundation (SIDN) and holds a Law degree from the Erasmus University in Rotterdam, Netherlands.

## The Promise of Globalisation

Globalisation has spurred tremendous opportunities and challenges. It is no surprise Steve Jobs chose Tim Cook to succeed him in leading Apple. Tim Cook built Apple's supply chain into what became one of the company's greatest strategic advantages. Brands like Johnson and Johnson, ABB, Dell and Microsoft to name a few all view supply chain management as nothing less than vital to their ability to innovate and dominate global markets.

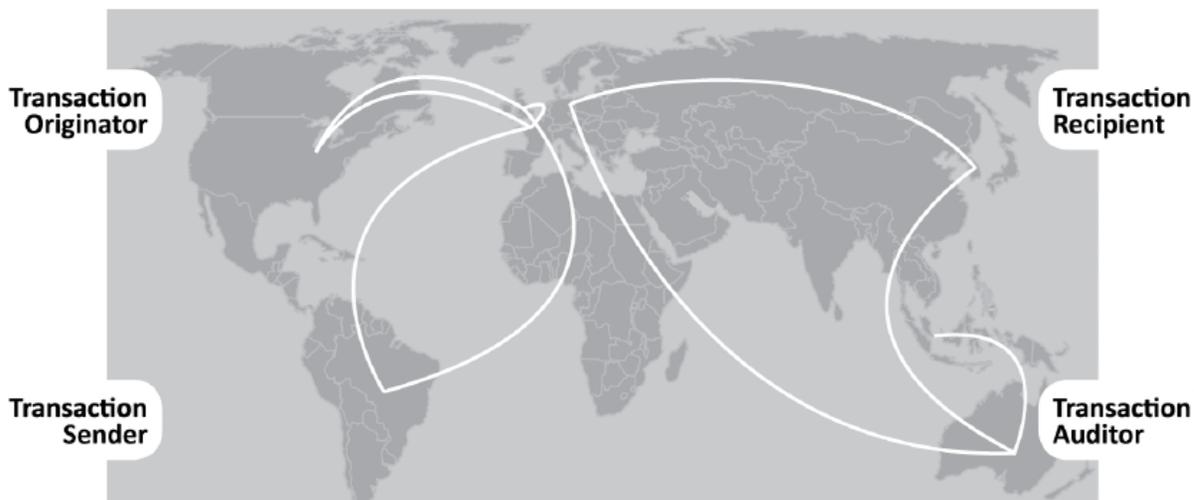
Successful supply chain management requires automation. Successful automation requires addressing what we believe is the last mile of global electronic invoicing: local tax compliance. This white paper explains the role local tax compliance plays in successful supply chain management and e-business initiatives more broadly and how leading global brands and governments are addressing this need.

## The Allure of E-Invoicing

Most multi-national corporations strive to consolidate processes and supporting IT systems. They seek fewer enterprise resource planning, supply chain management and customer relationship management platforms. Paper-based systems and processes are always a red flag.

Automated invoicing initiatives—the “poster child” of paper elimination efforts—address a very messy problem for large organisations. Eliminating paper invoices is very attractive with direct processing cost reductions of up to 90%<sup>1</sup>. For most multinational companies, some 5 – 25% of invoices are cross-border, the rest are multi-domestic. However, many corporations increasingly seek to manage invoice flows from only one or a few central locations to optimise overall process efficiency and effectiveness

## A Typical Business Transaction Flow for Multi-national Corporation



*Invoices provide trading partners and their auditors with the evidence needed to verify business transactions occurring at a unique point in time and of a certain monetary value.*

<sup>1</sup> U.S. Department of Treasury Research, 2009; various industry studies.

## Invoicing and Value Added Tax (VAT) Compliance

Many governments utilise invoices as primary evidence in determining taxes owed to them by corporations. These taxes, otherwise known as a value added tax (VAT), are reported and paid in full typically monthly or quarterly. VAT is by far the most significant indirect tax for nearly all of the world's trading nations. Roughly speaking, VAT contributes more than 30% of all public revenue.

VAT as a tax method essentially turns private companies into tax collectors. The role of the taxpayer in assessing the tax is critical, which is why these taxes are sometimes referred to as "self-assessment taxes." VAT depends on companies meeting public law obligations directly in their sales, purchasing and general business operations.

For enterprises the stakes of non-compliance with VAT laws are high. In addition to administrative sanctions that can be applied to both trading partners, buyers of goods or services may have to pay back many years of VAT deductions or 20% of total invoices paid. And since so many countries have their own requirements for what constitutes a legally compliant electronic invoice in support of VAT laws, legal certainty is challenging if not impossible for most.

## The Consequences of VAT Non-Compliance

The consequences of non-compliance with VAT requirements can be significant. As a result, most companies want to be as certain as possible that a tax audit performed in, say, six years from now at a trading partner or a subsidiary can be quick and clean to avoid risks including:

- **Protracted audits**—tax audits should generally take only a few days but many companies are audited for weeks or even months. This eats up precious expert resources and creates risks of more processes and documents being scrutinised and, potentially, found flawed or lacking.
- **Spillover effects into other areas of taxation or accounting**—once a tax administration has established that an invoice cannot be evidenced, a company may also face sanctions in other areas of law. For example, non-recognition of an invoice for tax purposes may undermine the credibility of a company's annual accounts or deductible expenses under corporate income tax.
- **Trading partner audits**—if credible evidence is lacking, the tax administration may have no choice but to verify the records and original documents of the audited company's trading partners. This can negatively affect a company's relationship with business partners.
- **Mutual assistance procedures**—tax auditors may need to call on their counterparts from other countries to obtain evidence about certain aspects of the company's operations or their compliance under local law. Such procedures tend to be long and can tie up expensive expert resources within a company for months or even years.
- **Administrative fines**—if a company cannot prove the veracity of invoices, it may be fined. Trading partners who have been drawn into a tax audit that leads to this conclusion may also be penalised.
- **Loss of right to deduct VAT**—A company that does not have sufficient evidence of purchases—that cannot prove it was in control of its processes at the time of the transactions—may need to pay back input VAT it reclaimed on such purchases. With an average VAT rate of 20%, this means a high risk of that company retroactively losing more than its profit margin.
- **Obligation to pay VAT over fraudulent invoices**—If a fraudster can easily forge invoices that are not reasonably distinguishable from a supplier's normal invoices, a tax administration that has no credible evidence to the contrary may consider such invoices to have been issued by that supplier and claim VAT if the buyer reclaimed the corresponding VAT.

## Electronic Invoicing System Challenges

Leading corporations typically attempt to address the risk of VAT noncompliance specifically by establishing the right transaction evidence in the right form as close to the time the transaction is conducted as possible. The question is: how can a complex, multi-national, multi-trading partner process be automated without major IT involvement and on-going expertise in international law?

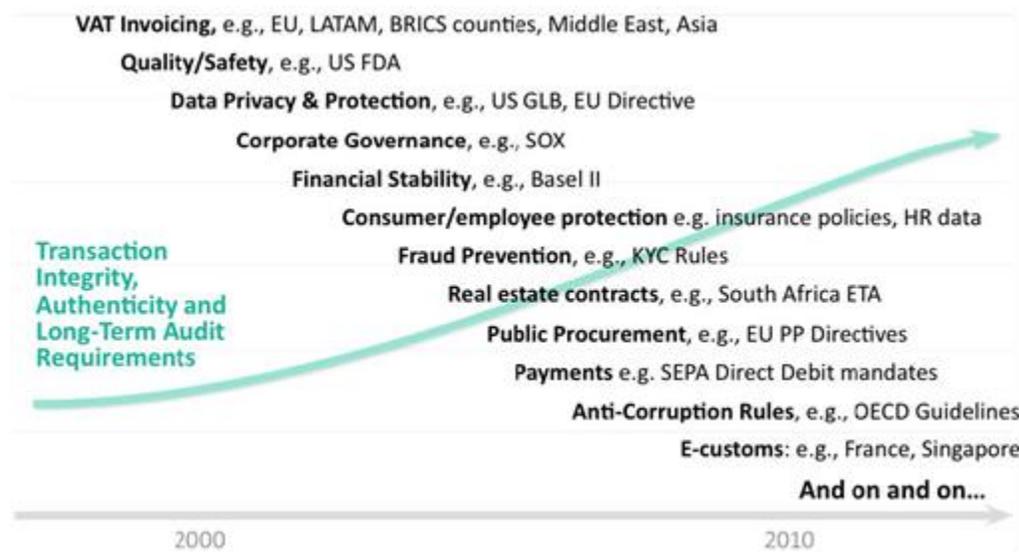
Getting trading partners to accept electronic invoicing is difficult. Since the cost of accommodating local requirements is high, getting everyone on board is challenging at best. Typical hurdles involved in scaling an electronic invoicing scheme include:

- **Issuing the invoice**, ensuring it meets local requirements such as government clearance or invoice integrity and authenticity evidence
- **Validating the invoice** for compliant issuance
- **Archiving the invoice** in a locally compliant archive for the full invoice lifecycle which can be up to 12 years

If these conditions can be satisfied at an acceptable cost, electronic invoicing becomes feasible for all trading partners.

## The Multi-Government Legislation Challenge

As governments slowly but surely legislate policies to keep up with globalisation, information technologies and many other constituent demands, corporations inevitably must utilise automation to keep up with changing laws and regulations. Multi-national corporations must find ways to keep up with different legislation in potentially dozens of countries where they have subsidiaries, sales or trading partners. As a result, many corporations find their business efficiency initiatives in direct conflict with their legal compliance objectives.



Some companies experiment with electronic contracts, invoices or other business transactions within a limited functional or geographic scope. However, they often run into “legal barriers” with risks outweighing benefits. The adoption of paperless processes across geographies, lines of business, and trading relationships becomes impossible.

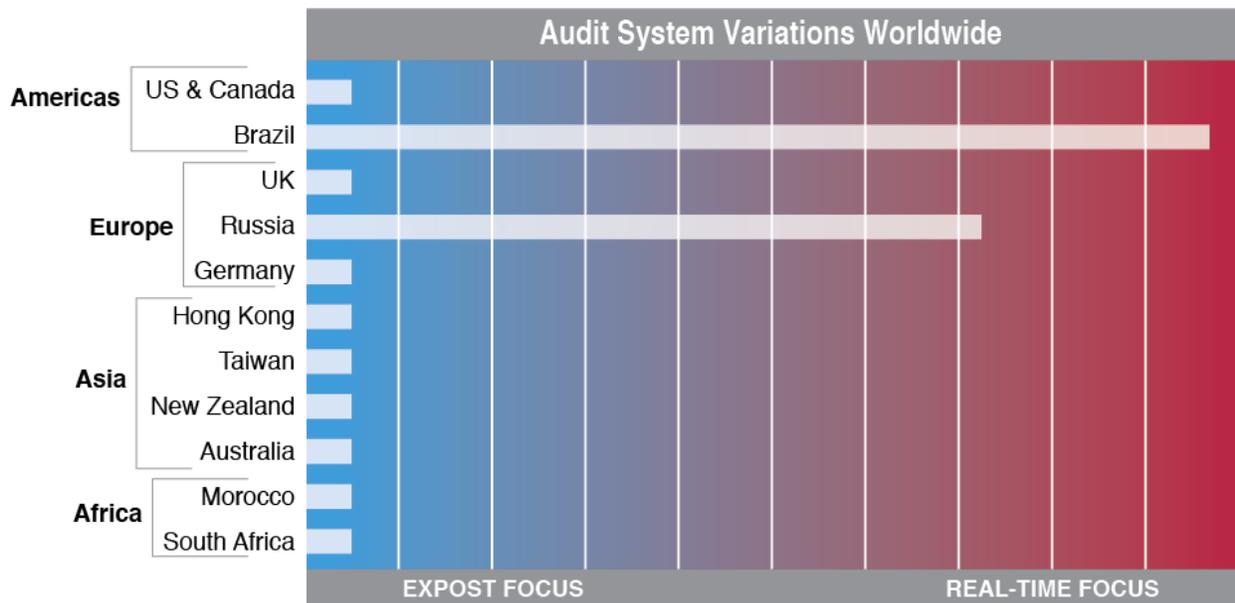
One of these legal barriers is that VAT invoice evidence must be made available for many years—a period during which many companies change staff, processes, systems, legal structure, physical establishment, production, distribution and management several times.

## Worldwide Legal Business Transaction Compliance Requirements Today

Business transaction legal compliance requirements begin with an assessment of two key aspects of any region worldwide: legal regime maturity and fundamental audit practices. The latter ranges from what are known as “Ex post audit systems,” best known in the European Union, and “Real-time reporting systems” which have evolved in regions such as Latin America and Russia.

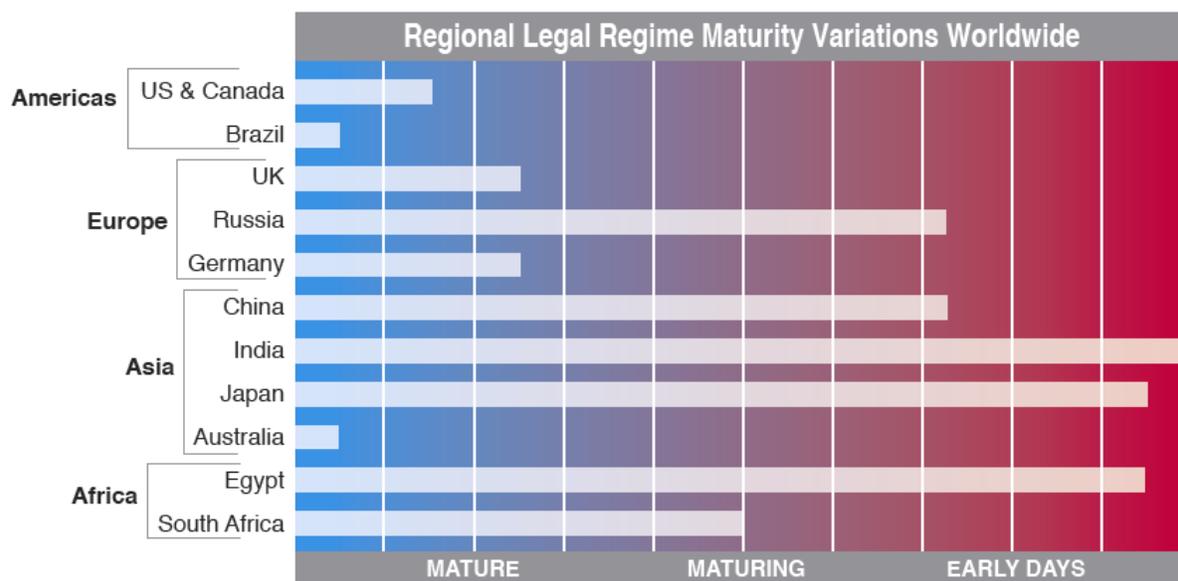
Ex post audit systems generally have few or no specific requirements as to how e-invoices are exchanged, but taxable persons must be able to prove the integrity and authenticity of invoices for, on average, seven years after the invoice was issued or booked.

In real-time reporting audit system regions, the legal life cycle of an e-invoice is typically regulated from start to finish. The tax administration directly intervenes in the process by requiring e-invoice data to be submitted to and cleared by their services—either directly or via their approved service providers. There is a simple recipe for compliance in countries with real-time audit regimes: follow clearly defined rules as presented by the tax administration. For less clear rules such as audit time periods, despite the fact that invoices are cleared in advance by the tax administration, the taxpayer typically must store evidence for five years on average.



For strongly ex-post audit system regions, audits take place on a historical basis only and most taxable persons are certain to be audited periodically.

Assessing regional maturity requires evaluating whether a legal regime and associated market for e-invoicing is relatively established or not. Mature regimes have stable frameworks with major changes occurring every ten years; minor changes every two years or so. They also have robust enterprise adoption rates. Moderately mature regions experience framework changes every five years. Immature regions experience frequent changes to their still emerging legal regime frameworks.



Other factors that go into assessing specific regional legal compliance requirements can be placed on a scale ranging from highly prescriptive—which focuses on form; to highly functional—which focuses on the result of the process.

These factors include:

- **Outsourcing options**—While outsourcing is a very widely accepted practice in business today, various levels exist that may or may not be of concern to the tax administration. Few laws today prohibit the use of third party data centres to outsource operations or application management to specialised service providers. However, when certain tax-relevant business processes including certain key decisions and controls from a VAT perspective are completely outsourced to a third party, formal conditions may apply.
- **E-invoicing compliance-specific agreements**—Electronic invoicing legislation often requires parties involved in transactions to execute certain agreements as a precondition; for example:
  - Documentation that buyers agree to receive invoices in electronic format
  - Outsourcing of e-invoice issuance, receipt or archiving to a third party

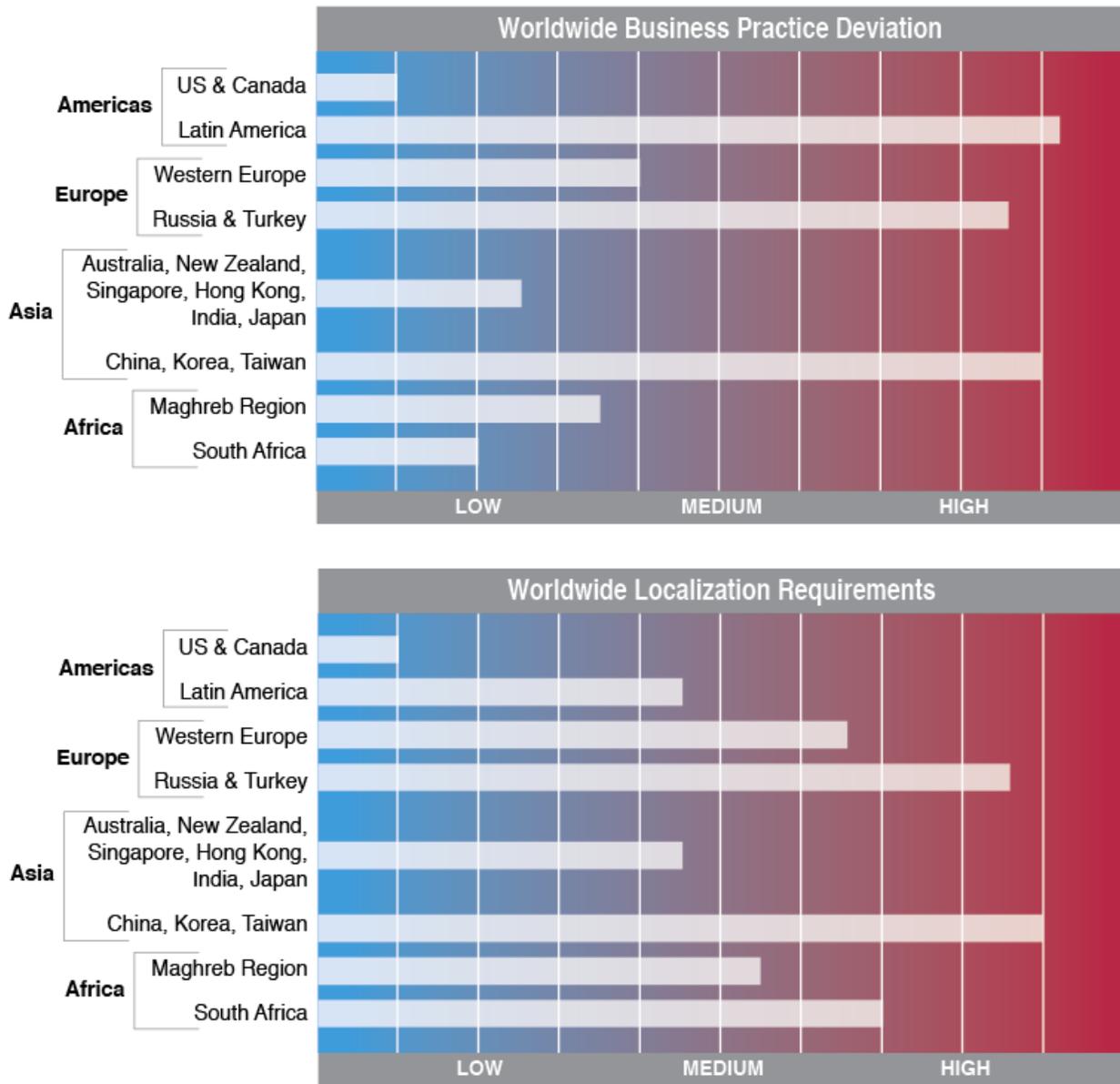
- Interchange or trading partner agreements

This range of requirements evaluates a country's attachment to form in relation to electronic invoice integrity and authenticity evidence over the course of its life cycle.

Regimes with a higher attachment to form tend to work from the assumption that there is an "original" invoice document; whereas countries at the other end of the spectrum utilise the invoice merely as information.

- **Integrity and authenticity**—This scale evaluates a country's attachment to form in relation to evidence of integrity and authenticity of electronic invoices over their life cycle. TrustWeaver has observed that regimes with a higher attachment to formality work from the assumption that there is an "original" invoice document, whereas on the other end of the scale the invoice is merely information.
- **Archiving**—There may be specific requirements for the technical, operational and process environment of the archive in which e-invoices are stored.
- **Cross-Border Processing**—There may be different levels of formality among countries' e-invoicing regimes in relation to the processing of e-invoices or e-invoice data taking place outside that country's borders.
- **Cross-Border Archiving**—Legal regimes have varying attitudes in relation to the archiving of e-invoices taking place outside that country's borders.
- **Form or Format of a B2B Invoice**—Countries vary in their approach to the required form and format of invoices. For those focused on paper invoices, very few still issue mandatory templates or pre-numbered forms. The base rule in many countries is that an invoice must be stored in the form in which it was sent or received; however, the "grey zone" between paper and electronic invoicing is often not regulated comprehensively. Whether a supplier can maintain only an electronic copy of a sales invoice issued on paper; or whether a scanned invoice can be thrown away varies. E-invoices requirements often address the technical format, either in transmission or as a capability to convert to one or a limited number of prescribed formats.
- **Minimum Invoice Content**—Nearly all countries with VAT regulate the minimum information to be contained in an invoice. While there is a base set of information that applies generally across all countries, and which generally overlaps with data that a non-tax invoice would contain for commercial efficacy, some countries require a much more comprehensive set of information. Invoice content requirements can become complex to cope with when specific notices or types of information to be included are conditional or process-specific.

The impact of the above factors can generally be measured in terms of their deviation from standard business practices and overall demand for localised business transaction legal compliance. Summaries of these two for major global regions are provided as follows:



## The Common Denominator for Technical Requirements—Electronic Signatures

What’s clear from the spectrum of regulations is that electronic signatures are typically the most commonly applicable control method guaranteeing the highest degree of legal certainty. In many countries, e-invoicing requirements are entirely built on electronic certificates and signatures from the beginning to the end of mandatory process steps.

Today, electronic signatures can easily be implemented as a basis to meet all integrity and authenticity requirements across all countries that permit e-invoicing —no matter how diverse their legal and law enforcement cultures. Standards are mature, and solutions based on

Service-Oriented Architecture are available that minimise the compliance footprint on any e-invoicing system while allowing straight-through processing in parallel to providing long-term verifiable integrity and authenticity of original invoices at a very low cost.

Several factors allow electronic signatures to form the basis for ensuring legally compliance business transactions:

**1: “Flip” the burden of proof**

Nearly all the world’s governments award exceptional evidence status to high-quality electronic signatures. In most countries, when an invoice is sealed meeting strict requirements from e-signature law, anyone challenging the integrity and authenticity of your invoices has to prove they are not real. This unique feature provides an unprecedented level of legal certainty: you don’t have to wait until the next tax audit to know if your e-invoicing investment is at risk because of legal discrepancies.

**2: Speed up the audit process**

Using electronic signatures, tax auditors can verify with a single click that invoices are authentic and have remained unchanged since they were issued. Many tax administrations reward irrefutable evidence with a significant reduction of time and intrusion required to audit other control evidence and trade or transport documentation.

**3: Achieve scale with a single process across all trading partners**

Standardising on electronic signatures allows for transaction processing to occur at high volumes using an internationally accepted method for ensuring integrity and authenticity.

**4: Comply across all borders**

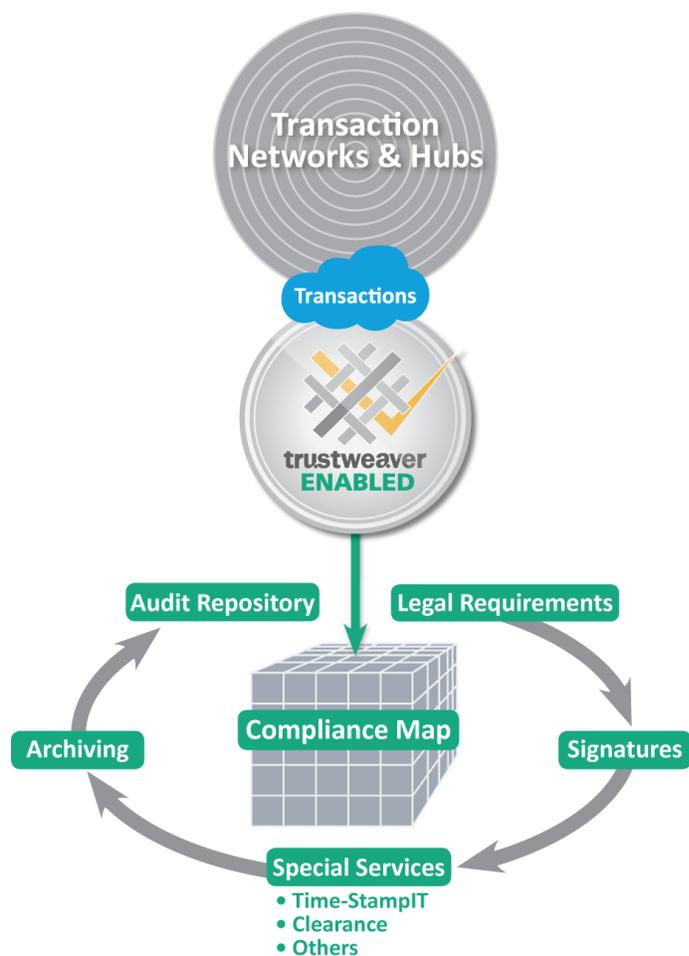
Electronic signatures are the most widely accepted legal means of ensuring integrity and authenticity of business transactions. Every country that allows electronic invoices for VAT purposes either allows or mandates electronic signatures for compliance purposes.

**5: Prevent fraud and protect your brand**

Some countries face significant threats due to illegitimate invoices submitted to processing centres. If fraudulent (“ghost”) invoices are confirmed sent by a purported supplier and the recipient cannot prove its invoices are easily distinguishable from the fake invoice, it may still face a tax liability despite the fraud. Brand damage is also possible where the press takes an interest in the story. Electronic signatures quickly detect abnormalities especially in large scale processing environments.

## A Scalable Business Transaction Legal Compliance Architecture

A well-managed invoicing process and archive, including credible evidence of invoice integrity and authenticity from issuance to the end of the storage period, is critical in minimising compliance risks. Enabling tax authorities to easily ascertain the trustworthiness of stored invoices is also key to rolling out low-risk electronic invoicing across an extended enterprise or service environment enterprise or service environment. The objective of e-invoice process design should therefore aim to ensure excellent historical evidence across lines of business, types of trading partners, countries and processes.



Automating business transaction legal compliance across hundreds or thousands of transactions requires a scalable well-documented system and contract framework capable of ensuring that widely accepted methods such as digital signatures are used correctly on both sides of the transaction in accordance with each country's regulations. Documents then carry their own "proof"—embedded forever—and guarantee transaction compliance with applicable laws for domestic or cross-border trade. The system should ensure the right controls are applied to each document. Documents should also be archived for audit purposes, meeting local requirements for security and access.

Various solutions exist on the market either in whole or in part. Most utilise available methods such as PKI for digital signatures. Few have achieved significant levels of country-by-country compliance

mapping. About 50 countries today have defined their requirements to a level where they can be automated "out of the box." The rest will be automated as their economies and regulatory environments mature, which is very likely more quickly now as a "critical mass" has been reached and the promise of globalisation continues its inevitable march.



### **About TrustWeaver**

TrustWeaver provides business transaction compliance as a service. By adding legal certainty, we allow hundreds of the world's largest enterprises to automate and consolidate business processes globally. Unlike alternative solutions, TrustWeaver's cloud solution decouples legal compliance from the process for scalable, guaranteed results spanning over 47 countries. Applications supported include VAT compliant e-invoicing, e-contracting, e-insurance policies both stand alone and in partnership with SAP, IBM, GXS and many other partner organizations. In business since 2001, TrustWeaver is headquartered in Stockholm, Sweden. For further information please visit [www.trustweaver.com](http://www.trustweaver.com)

### **About GXS**

GXS is a leading B2B integration services provider and operates the world's largest integration cloud, GXS Trading Grid®. Our software and services help more than 550,000 businesses, including 22 of the top 25 supply chains, extend their partner networks, automate receiving processes, manage electronic payments, and improve supply chain visibility. GXS Managed Services, our unique approach to improving B2B integration operations, combines GXS Trading Grid® with our process orchestration services and global team to manage a company's multi-enterprise processes. GXS has direct operations in 20 countries, employing more than 2,400 professionals. To learn more, see [www.gxs.co.uk](http://www.gxs.co.uk), [www.einvoicingbasics.co.uk](http://www.einvoicingbasics.co.uk) and read our blog at [www.gxsblogs.com](http://www.gxsblogs.com)