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Gail Cole • Jul. 21, 2022

E-invoicing and real-time compliance are trending in Europe – the U.S. is paying attention

Ecommerce has enabled millions of small and midsize businesses to tap into the global market. This presents enormous opportunities. It can also create a world of tax requirements.

Tax is tax wherever you go — governments impose it, businesses and individuals pay

compliance, some U.S. states are requiring less frequent reporting.

In other words, tax is all over the map.

I sat down with Alex Baulf, senior director of Global Indirect Tax at Avalara, and Scott Peterson, vice president of Government Relations at Avalara, to dig deeper into some of the key tax compliance issues confronting international sellers. Since we couldn't cover everything, we focused on two key areas of interest:

- Electronic invoicing and real-time compliance efforts
- Streamlining audits: A tax authority in the middle of every transaction

But first, a primer on sales tax and value-added tax.

Sales tax vs. VAT

Value-added tax is the most widely used regime in the world today; approximately 170 countries impose VAT, whereas the United States is the only major economy with sales and use tax.

There are some similarities between the two. Both sales tax and VAT are an indirect tax paid by the consumer and collected by the seller, who remits and reports the tax to the appropriate tax authority. Both require businesses to register with the tax authority prior to collecting tax from customers. Determining whether you need to register is the first step toward becoming compliant in Europe and the U.S.

One key difference between sales tax and VAT is that sales tax is imposed and administered at the state and/or local level; there's no federal sales tax in the U.S. By contrast, VAT is imposed at the federal level; there's no local VAT.

Another important difference is that VAT is collected whenever value is added along

tampons are exempt in Maryland, they're subject to sales tax in Washington state. Product taxability can also vary by local jurisdiction in home-rule states like Alabama, Colorado, and Louisiana.

Europeans are certainly familiar with the concept of different rates for different products: Each country generally has a standard rate for most goods and services, a reduced rate or two for certain foods and essential services, and a zero rate. However, the VAT rate within the United Kingdom, France, or Germany typically doesn't vary based on the ship-to address like it can in California, Illinois, or dozens of other U.S. states.

There are also significant differences in how sales tax and VAT are administered and enforced, particularly with respect to real-time compliance initiatives. Alex Baulf and Scott Peterson delve into the details.

EU and U.K. forge ahead with e-invoicing and digital reporting

"Electronic invoicing and digital reporting is the clear direction of travel for tax authorities within Europe," says Baulf. Italy blazed the trail when they mandated e-invoicing for business-to-business (B2B) transactions within the country in 2019, and he believes approximately half of the EU will implement mandatory e-invoicing for B2B transactions over the next two to three years.

What's happening in France is also noteworthy. According to Baulf, "France will mandate e-invoicing starting from July 2024, and that's going to affect 4 million businesses." Though initially only the largest businesses will be required to *issue* invoices electronically, he explains, *every* business in France, regardless of size, will need to be able to *receive* invoices electronically beginning July 1, 2024. "This is a huge, huge change."

The main reason France and other European countries are so keen to institute e-

Where e-invoicing hasn't been adopted, suppliers typically mail customers a paper invoice or send them a PDF via email. "The tax authority may only see a sample of those invoices, periodically, once a year, or once every two or three years in the event of an audit," says Baulf. "They use the sample data as an indicative sample of the business as a whole, looking for general compliance trends and low-hanging fruit for noncompliance so that penalties, assessments, and interest can be issued to that taxpayer."

Sorting through all that data takes a lot of resources because it entails a lot of in-person inspections, yet it may not catch all errors or instances of fraud. "That's why e-invoicing and real-time reporting is a seismic change," notes Baulf. "It's moving from a sample to the whole data set. Every single sales transaction a business is involved in can be seen."

"The moment the tax authority receives all this granular tax and transactional data, they can then run really powerful data analytics — including artificial intelligence — against that data to uncover fraud. Having immediate visibility into transaction data allows tax authorities to target in-person investigations and audits, and also to uncover discrepancies and find tax errors."

U.S. states back away from real-time compliance for now

As in Europe, auditors in the U.S. typically use a statistical sample because it would take too long to review every invoice and exemption certificate from a three-to-four year audit period. According to Scott Peterson, "They may examine all the invoices from March and October and figure out what mistakes were made during those two months. They'll then assume the business made the same mistakes every other month and extrapolate that information into an audit finding."

Interestingly, while the EU is developing more advanced e-invoicing and real-time

made widely available in 2023.

But there's a key difference between the U.S. e-invoicing pilot and what's happening with e-invoicing elsewhere in the world. The U.S. initiative is driven by businesses seeking to improve efficiency, reduce dependency on paper, and hopefully speed up the payment cycle. "It's on a voluntary basis," notes Baulf, who attended a workshop on the topic in early May. "It's not tax driven."

E-invoicing and e-reporting initiatives in the E.U. are generally led by governments seeking to reduce the VAT gap, but there's no central government authority in the U.S. that could mandate or administer e-invoicing. And while the federal pilot project probably has value, Peterson can't see any state imposing an e-invoicing requirement on businesses right now because the current trend is to *not* [4] add more expense to businesses.

Baulf says there are other countries where governments encourage rather than require the use of e-invoices as part of a wider digitalization initiative to improve efficiency and reduce costs. "In France, the government believes it costs about 10 euros for every paper invoice issued and received, while an e-invoice costs less than a postage stamp. That's quite a large delta."

However, Baulf adds that such countries generally follow regional or global standards like Peppol. "Peppol — a delivery network and standard created within Europe — is now being scaled and used in Australia, New Zealand, Singapore, and soon Japan. But the U.S. pilot *isn't* a Peppol pilot. So, already, there's some divergence from the main trend we're seeing around the world."

Peterson finds it interesting that the EU and the U.S. are moving in such divergent directions. "We're getting away from real-time compliance in the U.S., other than

Streamlined Sales Tax. And even the Streamlined Sales Tax states are slowly moving

Among other simplifying measures, the 24 states participating in SST must have a single, state-level tax administration and provide sellers access to sales tax administration software. For qualifying businesses, the state will cover the cost of a certified service provider (CSP), like Avalara. Sellers using this type of software are protected from audit liability.

Scott Peterson was the executive director of the Streamlined Sales and Use Tax Governing Board from 2005 to 2012. "When we created SST, we believed that if the states were in the transaction from the beginning, they would no longer need to audit because they would have done all the work upfront. They would have tested throughout the years, and they have all the transaction data so they can do more testing if they want. So ultimately, they would just eventually stop auditing all businesses that use a CSP like us."

"It's taken longer than expected to arrive at this point, but we're getting there. I honestly think we're getting very close to that spot."

Peterson says SST is finally at a point where they're moving away from examining transactions. "They've tested our system to make sure that when they tell us a thing is subject to the sales tax, our system actually calculates sales tax on it."

As SST states phase out of auditing businesses that use CSPs, they can devote more audit resources to cash businesses, people with no records whatsoever, and other high-risk businesses.

"I kind of flippantly say that the state is in the middle of every transaction," adds Peterson. "They aren't physically, but they certainly are intellectually because they've told us what to say." He believes one day SST states could evaluate the data CSPs send and then build their own returns, "because that's the same stuff."

Tax authorities are on their way to being in the middle of every transaction in some

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