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Proposal for a Secure Digital Reporting Standard for Intra-Community Transactions

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While the EU VAT world is holding its breath and waits for the European Commission to publish a proposal to streamline digital reporting requirements in the European Union, in this article the authors make a proposal for a secure digital reporting standard that takes into account the legitimate interests of Member States and taxable persons alike, and is compatible with the fundamental rights and principles enshrined in EU law.

1 Introduction

Countries around the world are rapidly digitalizing VAT, and so are EU Member States. A central aspect in these efforts is the digitalization of reporting requirements. Member States who unilaterally[1] introduced digital reporting requirements (DRR)[2] in recent years have reported that these have been very helpful in reducing the VAT gap and providing compliance tools to businesses.[3] Several other Member States are currently in the process of adopting similar measures.[4] In the absence of harmonization at the EU level, fragmentation is not only a risk but already a reality. Businesses who trade in several Member States are indeed being confronted with a colourful patchwork of reporting systems, which creates new challenges for businesses to comply with, ultimately hurting the EU single market.[5]

In order to avoid further fragmentation at the EU level, the European Commission announced that it will present a legislative proposal in the third quarter of 2022 under the name "VAT in the Digital Age".[6] The proposal will be based on the findings of a study that was launched in 2020[7] and of a public consultation held from 20 January to 5 May 2020.[8] As follows from the

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1. To that end, a Member State must apply for a derogation from the provisions of Council Directive 2006/112/EC of 28 November 2006 on the Common System of Value Added Tax, OJ L347 (2006), Primary Sources IBFD [hereinafter VAT Directive], which is subject to authorization by the Council on a proposal from the Commission in accordance with art. 395 VAT Directive. Currently, in the European Union, the real-time VAT reporting has been in operation in Hungary, Italy and Spain.
2. In this article, the authors refer to DRR as an obligation by taxable persons to transmit transactional information to tax authorities.
3. *See* sec. 3.3.
4. Among them are France, Germany and Poland.
5. European Commission, *Call for Evidence for an Impact Assessment*, Ares(2022)459260 (20 Jan. 2022), available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13186-VAT-in-the-digital-age_en (accessed 12 Oct. 2022).
6. Id.
7. European Commission, *VAT in the Digital Age, final report. Volume 1, Digital reporting requirements* (2022), available at https://op.europa.eu/en/publication-detail/-/publication/818e4799-0967-11ed-b11c-01aa75ed71a1/language-en/format-PDF/source-search (accessed 12 Oct. 2022).
8. The results of the public consultation have been published in the official repository, available at https://circabc.europa.eu/ui/group/cb1eaff7-eedd-413d-ab88-94f761f9773b/library/716964e7-31ad-4308-9945-d620d5f93826/details (accessed 12 Oct. 2022).

conclusions of the first part of the study, partial or total harmonization in the European Union are the most beneficial from all policy options currently being considered.[9] These options envisage common rules for digital transaction-based reporting for intra-Community transactions.

Based on available data it indeed seems that harmonized DRR for intra-Community transactions would be a positive development for the internal market: it would better exploit the opportunities that technology and big data offer to combat VAT fraud and would provide benefits to both tax administrations and businesses.

Against this background, in this article the authors seek to lay down the theoretical bases of a DRR system for intra-Community transactions which would enable Member States to better tackle VAT fraud and at the same time (i) guarantee the confidentiality of taxable persons, their customers and Member States (who may also be willing to not share sensitive information about their taxpayers); (ii) allow for interoperability and make it easier for businesses to comply; and – last but not least – (iii) be relatively balanced in terms of taxpayers' rights.

In section 2. of this article, the authors provide background information on the current (transitional) system and the issue of VAT fraud. Section 3. outlines the benefits of DRR and clarifies how (real-time) DRR is likely to improve VAT compliance and detection of VAT fraud. Subsequently, section 4. contains a proposal for a modern encryption-type DRR for intra-Community transactions, further referred to as DRR++. In that section the authors discuss why such a system would – in their view – be superior to currently existing DRR systems. The analysis also covers issues of compatibility of the DRR with the fundamental principles underlying the VAT system and primary EU law. Finally, section 5. is devoted to a reflection on implementation of the DRR under the definitive system as proposed by the European Commission in 2017.[10] Summary conclusions are offered in section 6.

2 The Transitional VAT System and the Rise of Carousel Fraud in the European Union

2. 1. The transitional VAT system

At the time of the establishment of the EU single market in 1993, i.e. a single area without internal tax borders, Member States could not agree on how to levy VAT on intra-Community transactions.[11] A last-minute "transitional" solution[12] was eventually found that would no longer require physical controls at the border: intra-Community business-to-business (B2B) supplies of goods would be exempt (with a right to deduct) from VAT in the Member State of departure of the goods (Member State of origin)[13] and intra-Community acquisitions would be taxed in the Member State of arrival of the goods (Member State of destination).[14] The VAT would be declared by the customer in the Member State of destination through its periodical returns, which relieves the supplier from the need to register in that Member State. In addition, the periodical reporting of these transactions and the exchange of information relating thereto through the VAT Information Exchange System (VIES), was meant to enable tax administrations to reconcile intra-Community supplies and acquisitions, and to ensure that VAT is effectively declared in the Member State of destination.

2.2 The rise of VAT fraud

The transitional system, which rapidly proved to be subject to massive fraud,[15] was meant to be replaced in the medium term by the Member States, when an agreement on a "definitive VAT system" would be found.[16] However, after 30 years, and although Member States are in principle obliged to take all measures appropriate for ensuring collection of all the VAT due on

9. European Commission, *VAT in the Digital Age, supra* n. 7. *See also* Group on the Future of VAT, GFV No. 123, *E-invoicing and the need for EU standards and interoperability* (6 May 2022), available at https://circabc.europa.eu/ui/group/cb1eaff7-eedd-413d-ab88-94f761f9773b/library/22204332-1b67-4de8-a57e-180ecb0849e3/details (accessed 12 Oct. 2022).
10. Proposal for a Council Directive amending Directive 2006/112/EC as regards harmonising and simplifying certain rules in the value added tax system and introducing the definitive system for the taxation of trade between Member States, COM(2017) 569 final, Primary Sources IBFD.
11. European Parliament, *Options for a Definitive VAT System*, Directorate General for Research, Working Paper, Economic Affairs Series E-5/9-1995, p. 3, available at https://www.europarl.europa.eu/workingpapers/econ/e5/default_en.htm# (accessed 12 Oct. 2022).
12. Introduced by Council Directive 91/680/EEC of 16 December 1991 supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers, OJ L376 (1991), Primary Sources IBFD, [hereinafter Directive 91/680/EEC].
13. Based on art. 138 VAT Directive.
14. Based on art. 2(1)(b) in conjunction with arts. 20 and 40 VAT Directive.
15. R. De La Feria reports that according to field experts, the feared flow of mega frauds did not emerge immediately after 1 January 1993. Criminal activity would have started 18 to 24 months later. R. De La Feria, *The New VAT General Reverse-Charge Mechanism*, 28 EC Tax Review 4, pp. 172-175 (2019). For an early analysis of MTIC and carousel fraud, *see* P. Vandendriessche, *Proof of Intracommunity Supply of Goods: Achilles' Heel of the VAT Transitory Regime*, 5 EC Tax Review 1, pp. 33-38 (1996).
16. The transitional system was meant to expire automatically on 31 December 1966. However, the transitional arrangements are automatically continued until the Council decides on the definitive system. *See* art. 281 Directive 91/680/EEC.

their territory and must fight against tax evasion and fraud,[17] they still have not moved from this so-called transitional system towards a definitive system. In the meantime, they are still losing around EUR 60 billion due to intra-Community VAT fraud on an annual basis,[18] while suffering a total VAT gap of EUR 134 billion.[19] It should be recalled here that VAT fraud erodes budgets of both Member States and the European Union, and leads to distortions of competition. It indeed affects compliant businesses and consumers and violates the very fundaments of the internal market. Moreover, the loss of tax revenue impedes the fulfilment of redistributive tasks of the Member States and thus their role in the protection of basic economic and social rights of individuals.

The most serious and economically significant form of VAT fraud[20] is so-called "missing trader intra-Community (MTIC) fraud". MTIC fraudsters misuse the VAT exemption (zero rate) on intra-Community transactions to create a more complex value chain operating cross border. When a group of companies that set up a fraudulent value chain, often consisting of both fraudsters and honest companies, lets the goods and/or services go round in a circle, this becomes what is called "carousel fraud". These schemes span multiple jurisdictions, which makes them very hard to detect for tax authorities and fraud inspectors.[21]

Surprisingly, perhaps, it is the VAT exemption for intra-Community transactions which, by design, creates an opportunity for fraud. This is because a taxable person who acquires goods from another Member State and subsequently sells them to another taxable person can easily escape meeting its obligations by not declaring VAT on its output transaction (a "missing trader" does not have any interest in declaring his output VAT, as it does not incur any real input VAT to deduct). The risk for the fraudsters is also quite limited as they need little time to "disappear" with stolen amounts of undeclared VAT and avoid responsibility. On the other hand, detection of the fraud by tax authorities can take months or years.

One way of offsetting this major issue would be to provide access for tax authorities to adequate tools to verify if the VAT reported by the suppliers in the chain corresponds to the VAT claimed as input VAT by the buyers. Having access to information on transactions and VAT due on each stage of the production and distribution chain would indeed allow for a quick identification of irregularities and consequently a detection of potential fraud. Currently, in cross-border scenarios such tools are missing as real-time information is not available through the VIES. VAT information indeed only has to be reported monthly/quarterly via the recapitulative statement (intra-Community (IC) listing).[22] Therefore, the existing reporting tools are ineffective and an adequate approach in addressing cross-border VAT fraud is missing.

Although the existing legal framework for administrative cooperation[23] in the field of VAT has recently been subject to amendments aimed at strengthening the existing tools,[24] up till today it has not reached its full potential.[25] In particular, and despite the establishment of Eurofisc as a network for the swift multilateral exchange of targeted information between Member States, the process of exchanging information has remained to a large extent cumbersome and lengthy.[26] With a view to improving this process, the Transaction Network Analysis (TNA) was developed and launched in 2019. This system has not "substantially changed the 'what', but improved the 'how'"[27] regarding the exchange of data. It automated the collection of targeted information and improved fraud detection by introducing advanced data analytics. Based on data from TNA as of 8 February 2022, the Commission reported that in 2021 the tool facilitated identification of 2,161 fraudsters and uncovered EUR 8.1 billion in fraudulent or suspicious transactions, which indicates an increase in detected fraud by over 50% as compared to

17. According to the ECJ, that obligation follows from arts. 2 and 273 VAT Directive read in conjunction with art. 4(3) Treaty on European Union (TEU), as well as from art. 325 Treaty on the Functioning of the European Union (TFEU), Primary Sources IBFD. *See*, for instance, judgments in SE: ECJ, 26 Feb. 2013, Case C-617/10, *Åklagaren v. Hans Åkerberg Fransson*, para. 25, Case Law IBFD (accessed 12 Oct. 2022); IT: ECJ, 8 Sept. 2015, C-105/14 *Taricco and Others*, paras. 36-37, Case Law IBFD; IT: ECJ, 20 Mar. 2018, Case C-524/15, *Criminal proceedings against Luca Menci, intervening parties: Procura della Repubblica*, paras. 18-19, Case Law IBFD (accessed 12 Oct. 2022).
18. *See* European Parliament, Briefing, *Missing Trader Intra-Community Fraud*, available at https://www.europarl.europa.eu/RegData/etudes/BRIE/2021/690462/IPOL_BRI(2021)690462_EN.pdf (accessed 12 Oct. 2022).
19. European Commission, *VAT gap in the EU: report 2021* (2021), available at https://data.europa.eu/doi/10.2778/447556 (accessed 12. Oct. 2022).
20. The others consisted in fraud related to trading of second-hand cars and fraud related to customs procedures 42 and 63. For a comprehensive discussion, *see* M. Lamensch & E. Ceci, *VAT Fraud: Economic Impact, Challenges and Policy Issues* (European Parliament 2018), available at https://www.europarl.europa.eu/thinktank/en/document/IPOL_STU(2018)626076 (accessed 12 Oct. 2022).
21. For a more detailed description of this type of fraud, *see* European Parliament, Briefing, *supra* n. 18.
22. Based on arts. 262-271 VAT Directive.
23. Council Regulation (EU) 904/2010 of 7 October 2010 on Administrative cooperation and combating fraud in the field of value added tax OJ L268/1 (2010), Primary Sources IBFD.
24. Council Regulation (EU) 2017/2454 of 5 December 2017 amending Regulation (EU) 904/2010 on administrative cooperation and combating fraud in the field of value added tax, OJ L348 (2017), Primary Sources IBFD [hereinafter Council Regulation (EU) 2017/2454] (amended by Council Regulation (EU) 2018/1541 of 2 October 2018 amending Regulations (EU) 904/2010 and (EU) 2017/2454 as regards measures to strengthen administrative cooperation in the filed of value added tax, OJ L259/1 (2018) and Council Regulation (EU) 2020/1108 of 20 July 2020 amending Regulation (EU) 2017/2454 as regards the dates of application in response to the COVID-19 pandemic, OJ L244/1 (2020)).
25. European Commission, Communication from the Commission to the European Parliament and the Council, *An Action Plan for Fair and Simple Taxation Supporting the Recovery Strategy*, p. 11 (15 July 2020), COM(2020) 312 final).
26. European Commission, Commission Staff Working Document Impact Assessment Accompanying the document Amended proposal for a Council Regulation – Amending Regulation (EU) 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, p. 14, SWD(2017) 428 final.
27. Id., at p. 38.

2020.[28] The potential of TNA would significantly increase where the quality and frequency of data reported would improve, as well as where there would be a possibility to match data reported by buyers and sellers in different Member States. Such matching would, however, require further (automated) exchange of data between Member States.

Moreover, at this stage it should be noted that even though MTIC and carousel fraud are the most serious forms of VAT fraud, constituting a significantly large element of the VAT gap, that gap is also a result of other types of fraud (including domestic VAT fraud), legal tax optimization, non-compliance, errors and maladministration, but also bankruptcies and financial insolvencies (the latter should not be confused with fraud).[29] VAT evasion often takes the simple form of under-declaration of output VAT liability or overclaiming deduction of input VAT, lack of registration or declaration of VAT, undervaluation of supplies or wrongful application of reduced rates, as well as more complex evasion schemes. The rapid development of e-commerce has increased such risks of cross-border VAT non-compliance and fraud, not only due to the limits of enforcement jurisdiction of the Member States, but also the lack of sufficient measures for monitoring compliance. Although, the "e-commerce VAT package",[30] which entered into force on 1 July 2021, has to a large extent successfully addressed a number of challenges, even the new rules remain susceptible to fraud.[31]

3 How Can Digital Reporting Help to Tackle VAT Fraud?

3.1 How does DRR work?

As discussed in section 2.2., prompt access to relevant information by tax authorities plays a central role in effectively combating VAT fraud. In the current system, where DRR is not used for cross-border transactions, tax authorities cannot automatically detect discrepancies between the VAT reported by the supplier and the VAT reported by the buyer. Availability of transaction data allows for enhanced and automated monitoring of compliance by taxable persons with VAT obligations.

VAT reporting obligations can be implemented either on a periodic basis (often referred to as periodical transaction control or "PTC") or continuously, on a (near) real-time basis (often referred to as continuous transaction control or "CTC "or real-time reporting).

PTC mainly refers to periodic reporting such as Standard Audit File for Tax (SAF-T), while real-time reporting refers to reporting invoice information in real time. Real-time reporting is sometimes combined with mandatory e-invoicing (see more about this topic under section 3.3.). Although several countries have achieved successes in terms of reducing the VAT gap by implementing a PTC,[32] real-time reporting seems to be a more efficient solution. Even though both PTC and CTC allow for automation of audits by the application of electronic analysis of structured data, CTC proves to be a more efficient solution for a number of reasons.[33]

A first reason is that real-time reporting can be more easily integrated with existing business processes than any form of periodic reporting. With real-time reporting, invoices need to be reported at the moment of issuance (or at least within a time frame of a couple of days), which is very close to the existing invoicing process. Furthermore, only transactional data (as opposed to SAF-T accounting data) needs to be sent. This is easier for companies as they often use different software tools for invoicing than for accounting.

A second argument in favour of implementing CTC (invoice-based) DRR can be found in the challenges several countries had/are having with the implementation of PTC, especially SAF-T, DRR. For example, countries such as Norway[34]and Poland[35]postponed its implementation multiple times.

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28. European Commission, Taxation and Customs Union, *VAT and Administrative Cooperation*, available at https://taxation-customs.ec.europa.eu/taxation-1/vat-and-administrative-cooperation_en (accessed 12 Oct. 2022).
29. European Commission, *VAT gap in the EU*, *supra* n. 19.
30. Council Directive (EU) 2017/2455 of 5 December 2017 amending Directive 2006/112/EC and Directive 2009/132/EC as regards certain value added tax obligations for supplies of services and distance sales of goods, OJ L348 (2017), Primary Sources IBFD; Council Directive (EU) 2019/1995 of 21 November 2019 amending Directive 2006/112/EC as regards provisions relating to distance sales of goods and certain domestic supplies of goods, OJ L310 (2019), Primary Sources IBFD; Council Implementing Regulation (EU) 2017/2459 of 5 December 2017 amending Implementing Regulation (EU) 282/2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, OJ L348 (2017), Primary Sources IBFD; Council Implementing Regulation (EU) 2019/2026 of 21 November 2019 amending Implementing Regulation (EU) 282/2011 as regards supplies of goods or services facilitated by electronic interfaces and the special schemes for taxable persons supplying services to non-taxable persons, making distance sales of goods and certain domestic supplies of goods, OJ L313 (2019), Primary Sources IBFD; and Council Regulation (EU) 2017/2454.
31. M. Lamensch, *Rendering Platforms Liable to Collect and Pay VAT on B2C Imports: A Silver Bullet?*, 29 Intl. VAT Monitor 2 (2018), Journal Articles & Opinion Pieces IBFD (accessed 12 Oct. 2022); M. Lamensch, *Adoption of the E-Commerce VAT Package: The Road Ahead Is Still a Rocky One*, 27 EC Tax Review 4, pp. 186-195 (2018).
32. E.g. Portugal, *see* European Commission, *VAT gap in the EU*, *supra* n. 19.
33. *See also* the conclusions of the European Commission, *VAT in the Digital Age*, *supra* n. 7.
34. M. Barth, *Introduction of SAF-T in Norway postponed to 2020. Don't panic* (PwC 2018), available at https://blogg.pwc.no/skattebloggen-en/introduction-of-saf-t-in-norway-postponed-to-2020 (accessed 12 Oct. 2022).

Third, by reporting on a frequent basis, not only the audit can be done at shorter intervals, but also the data quality is likely to increase because it forces companies to carefully assess the invoice details at the moment of issuance. When the reporting moment is only at the end of the period, it can be harder to remember or acquire the context of a transaction to validate it.

Lastly, there is a digitalization trend to be seen in many fields of taxation and an increasing usage of real-time information. The Tax Administration 3.0 initiative of the OECD is a good example of this.[36] It is, therefore, consistent with these trends to proceed in a similar way for VAT reporting obligations, in order to integrate real-time analyses in both government and business processes. This is also true for auditing, where real-time auditing is becoming more and more common. That a SAF-T type of solution cannot be a true substitute for real-time reporting is evident from the fact that Member States such as Poland, which had introduced SAF-T several years ago, are now preparing for obligatory e-invoicing to enter into force on 1 January 2024.

3.2 How does DRR help to tackle fraud and enhance compliance?

One of the fundamental benefits of receiving transactional information, is a possibility for tax authorities to (automatically) match the VAT reported per transaction with the VAT reported on the VAT return. With that, discrepancies between the VAT reported by the supplier and the VAT reported by the buyer cannot go undetected anymore. This can be achieved when either both the supplier and buyer report their invoices[37] or when the supplier reports its invoices, while the buyer is able to check if the reported invoices were correctly reported.[38] Identification of such discrepancies allows tax authorities to timely single out transactions that could potentially be fraudulent in order to target appropriate further audit measures.

In more complex models of technology-based systems used to combat VAT fraud, transaction data can be cross-checked with information provided through other channels. For example, data reported through DRR could be automatically matched against payment and transfer information provided by the banks and payment services providers. Such payment information is already being collected for the purposes of prevention of VAT fraud by some Member States.[39] As of 1 January 2024, providers of payment services in the European Union will be obliged to collect and transmit information on certain cross-border transfers and their beneficiary to tax administrations of the Member States. Information will be gathered in a centralized EU database, the Central Electronic System of Payment information (CESOP).[40] Also tracking information on the location of goods[41] can be compared with information reported in DRR in order to identify discrepancies. A potentially wider scope of the sources of information relevant for verifying facts essential for determining VAT liabilities, and compliance with the binding rules would additionally protect the DRR systems against possible manipulations and fraud.

In addition to the enhanced possibilities for tax control, DRR can also be a service to taxable persons. It can indeed be an effective tool for improved communication between the tax administration and taxable persons and for facilitated compliance. This is particularly the case where certain fiscal data on output transactions by taxable persons is further communicated to the suppliers and clients in order for them to verify the correctness of the information and to facilitate their own reporting. In such cases it helps to avoid errors and facilitates correction of those that already appeared.

Ideally, an obligation to report data through DRR should remove or reduce other declarative obligations by taxable persons or make it possible to automate them. For example, data collected on a transaction basis could then be used by tax authorities to automatically prepare a draft of a pre-filled periodic VAT declaration.[42] The burden of the compliance obligation of the DRR itself could therefore be reduced by the use by taxable persons of software tools allowing automation of the reporting.

3.3 Evidence from other jurisdictions

Real-time reporting solutions were first rolled out in Latin America, where they have often been combined with e-invoicing. Just as with any policy measure, it is difficult to find a clear causal relationship between the implementation of real-time reporting and a decrease of the VAT gap. Yet, the existing evidence allows the conclusion that DRR has a positive effect on VAT revenue. Hernández and Robalino are taking a holistic approach, comparing five studies and analysing the effects of real-time

35. Global VAT Compliance, *Poland: New SAF-T file will be postponed*, available at https://www.globalvatcompliance.com/globalvatnews/poland-new-saf-t-file-will-be-postponed/ (accessed 12 Oct. 2022).
36. OECD, *Tax Administration 3.0: The Digital Transformation of Tax Administration* (OECD 2020), available at https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/tax-administration-3-0-the-digital-transformation-of-tax-administration.pdf (accessed 12 Oct. 2022).
37. As for example in the SII system in Spain (*see further* sec. 3.3.).
38. As for example is the case of the Hungarian real-time reporting system (*see* sec. 3.3.).
39. *See*, for example, the Polish "STIR" system; M. Papis-Almansa, *The Polish Clearing House System: A stirring example of the use of new technologies in ensuring VAT compliance in Poland and selected legal challenges*, 28 EC Tax Review 1, pp. 43-56 (2019).
40. Council Directive (EU) 2020/284 of 18 February 2020 amending Directive 2006/112/EC as regards introducing certain requirements for payment service providers, OJ L62 (2020), Primary Sources IBFD.
41. Such a tracking system for certain sensitive goods has been introduced in 2017 in Poland. This so-called "SENT" system collects GPS tracking information provided by companies that transport certain sensitive goods from, to or across Poland.
42. *See*, for example, the tool Pre303 that was introduced by the Spanish tax authority which creates an automatic draft of your VAT return based on the SII data; Agencia Tributaria, Pre303 (Helpdesk form 303), available at https://sede.agenciatributaria.gob.es/Sede/en_gb/iva/pre-303.html (accessed 12 Oct. 2022).

reporting in Argentina, Brazil, Ecuador, Mexico and Uruguay. Based on empirical evidence, they found that "the implementation of electronic invoicing could spur significant increases in revenue collection in other countries of the region."[43]

Bermúdez identified more specific figures for the Mexican case, stating that the non-compliance rate was reduced from 29.08% in 2014 (the year of implementation) to 16.40% in 2016.[44] Another figure proving the successful implementation of real-time reporting in Mexico is provided by the Inter-American Center of Tax Administrations (CIAT). In a 2020 report it is stated that, while the economy grew by 75% in the last two decades, the tax collection grew by 172%.[45] Furthermore, according to the newspaper El Diario, in Chile, VAT evasion has been reduced by 50% due to the implementation of real-time reporting.[46]

Inspired by these successes, Spain was the first country in the European Union to implement a form of real-time reporting in 2017, called Suministro Inmediato de Información (Immediate Supply of Information) abbreviated as SII.[47] It is a system developed by the Spanish tax administration for electronic processing of invoice records, both issued and received. The system requires the provision of information on the invoicing records through the electronic office of the tax administration within a maximum period of four days. The term is extended to eight days for those entities whose invoices are issued by an authorized third party. The information is sent electronically. Schrauwen and Smeets[48] found that during the first year of functioning of the SII, the reported VAT-taxed activities increased by 6.5%, while the VAT revenue (with no change in the VAT rate) increased by 9.1%. This is a difference of 2.6 percentage points and relatively a 40% higher rise of VAT revenue than expected, based on economic growth. The Spanish tax administration estimates that in addition to being instrumental in combating fraud, SII caused a significant reduction of the cost of activities of tax administration.[49]

Italy implemented a different type of real-time system, being in essence an obligatory e-invoicing system, the Sistema di Interscambio (SdI) in 2019.[50] Instead of being reported ex post, the invoices issued by taxable persons have to be reported and approved by the tax administration before they can reach the recipient. The results have been positive; in Italy the VAT gap has been reduced from EUR 32 billion to EUR 27 billion in its first year of country-wide implementation according to the most recent figures provided by the Italian Ministry of Finance.[51] More specific figures from the Italian Ministry of Finance state that in 2019 the recovery of EUR 945 million through identifying and stopping false VAT credits can be directly attributed to the implementation of the SdI. Additionally, the system "has made it possible to identify companies involved in intra-Community fraud mechanisms carried out between the last months of 2019 and 2020, based on invoicing flows for non-existent transactions amounting to around EUR 1 billion."[52]

Hungary is another country that has successfully implemented a real-time invoice reporting system.[53] Whereas the VAT gap stood at 13.9% one year before the implementation of real-time reporting (in 2017), it was 6.1% in 2020 according to the Hungarian Minister of Finance, Mihály Varga.[54]

Although some of the above solutions still need to mature further to achieve their full potential (e.g. more effective data analyses), it can be concluded that DRR has a positive effect on tackling the VAT gap and increasing VAT revenue. In any case, the results obtained by jurisdictions that have implemented a DRR solution in recent years explain why many other EU Member States also want to implement such a solution.

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43. K. Hernández & J. Robalino, *Evidencias del Impacto de la Facturación Electrónica de Impuestos en América Latina*, in *Facturación Electrónica en América Latina* pp. 47-62 (A. Barreix & R. Zambrano eds., CIAT & BID 2018).
44. L.C. Bermúdez, *Facturación Electrónica: Una alternativa para el aumento del recaudo tributario* (Master thesis, Universidad de Rosario 2018), p. 24, available at https://repository.urosario.edu.co/bitstream/handle/10336/18691/BermudezHumanez-LuisCarlos-2018.pdf?sequence=3 (accessed 12 Oct. 2022).
45. CIAT, *Las TIC como Herramienta Estratégica para Potenciar la Eficiencia de las Administraciones Tributarias*, p. 309 (2020), available at https://www.ciat.org/Biblioteca/Estudios/2020_TIC-CIAT-FBMG.pdf (accessed 12 Oct. 2022).
46. Available at http://webcache.googleusercontent.com/search?q=cache:RkW7yzIOfCIJ:www.siglodata.co/s/observatorio/20181030ED-FacturacElectronica.pdf+&cd=1&hl=nl&ct=clnk&gl=nl&client=ubuntu (accessed 12 Oct. 2022).
47. ES: *Decreto Real* [Royal Decree] 596/2016, Dec. 2016; ES: *Decreto Real* [Royal Decree] 1075/2017, 29 Dec. 2017; *see* A.M.D. García & R.O. Cuello, *The Immediate Supply of Information in value added tax*, IDP Revista de Internet, derecho y política 25 (2017).
48. M. Schrauwen & O. Smeets, *NLF-W: Een pleidooi voor invoering van digitale rapportageverplichtingen in Nederland naar aanleiding van ervaringen in Spanje en Italië*, NL Fiscaal (2020), available at https://www.nlfiscaal.nl/nlfiscaal-doc/me_nlfw2020_0018 (accessed 12 Oct. 2022).
49. European Parliament, Policy Department for Budgetary Affairs Directorate-General for Internal Policies, *Possible Solutions for Missing Trader Intra-Community Fraud*, study requested by the CONT Committee, p. 52 (June 2022), available at https://www.europarl.europa.eu/RegData/etudes/STUD/2022/731902/IPOL_STU(2022)731902_EN.pdf (accessed 12 Oct. 2022).
50. IT: *Legge* del 27/12/2017 n. 205 (GU Serie Generale n. 302 del 29 Dec. 2017 – Suppl. Ordinario n. 62), art. 1 Abs. 909, 916.
51. Italian Ministry of Finance, *Relazione Sull'Economia non Osservata e Sull'Evasione Fiscale e Contributiva Anno 2021*, p. 48 (2021), available at https://www.finanze.it/export/sites/finanze/.galleries/Documenti/Varie/Relazione-evasione-fiscale-e-contributiva_25_09_finale.pdf (accessed 12 Oct. 2022).
52. Council Implementing Decision (EU) 2018/593 of 16 April 2018, authorizing the Italian Republic to introduce a special measure derogating from Articles 218 and 232 of the VAT Directive, Primary Sources IBFD, also available at https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021PC0681 (accessed 12 Oct. 2022).
53. As per HU: Act CXXVII of 2007 on Value Added Tax, items 6 and 13 of sched. 10 (entering into effect on 1 July 2018).
54. Facebook, Official Account Varga Mihály, 2021, available at https://m.facebook.com/VargaMihalyKepviselo/posts/452483666241548?_se_imp=2tvkytsBZewBCEYSX (accessed 12. Oct. 2022).

4 DRR in the European Union: What Is the Current State of Play?

There is a wide variety of real-time reporting models implemented around the world. This section will focus on real-time reporting solutions implemented (or soon to be implemented) by several EU Member States. The objective is not to provide an exhaustive description of each solution, but rather to highlight and compare their key features. At the end of this section the options currently considered by the European Commission are also briefly sketched.

The Spanish SII system requires large companies (with a revenue of EUR 6 million or more), VAT groups and companies which opted to be registered in the monthly VAT refund system to report electronically information to the tax administration. As a result, information concerning around 80% of invoices issued in Spain is reported to the tax administration. The basic information that needs to be reported on a near real-time basis (in principle within four days after issuing of the invoice) is:

- issued invoice ledger;
- received invoice ledger;
- capital asset ledger; and
- specific intra-Community transactions ledger.[55]

In other words, the information reported exceeds invoice records, which makes the file similar to a SAF-T file (yet it is not SAF-T). The Spanish government is currently discussing the introduction of obligatory e-invoicing in addition to SII.[56]

In contrast, in Italy all companies are required to report their invoices in real time. The system is referred to as a centralized clearance system, as invoices are being cleared (checked on the structure of the invoice) in a central manner (by the tax authority) before they can reach the recipient. In practice this means that when a supplier issues an invoice, it will be sent via the authorities, which first need to approve it, after which it can be sent to the buyer. Moreover, the system is combined with an e-invoicing mandate which requires all companies to make use of the Italian e-invoicing standard FatturaPA. Poland is in the process of implementing a similar system but will be using a different e-invoicing standard.[57]

The Hungarian government took a different approach with the implementation of their real-time invoice reporting system, using a dedicated platform named KOBAK. Here, only the supplier needs to report invoice information. Subsequently, the buyer needs to verify if the correct data is reported on KOBAK because “data reporting is only considered complete after the client has confirmed successful completion of the asynchronous process and has received the confirmation message [from the tax authority] for the invoice”.[58] In this way, fraud can be tackled without putting an excessive administrative burden on both the supplier and the buyer.

Two other countries with concrete real-time reporting plans are France and Belgium. France is planning to introduce a real-time reporting model together with mandatory e-invoicing in a gradual manner from 2024. In the current specifications, three different types of e-invoicing standards will be accepted (UBL, CII and Factur-X), while the system also seems open for additional standards. The partially decentralized system will allow companies to report invoice information via third-party service providers, but it will also be possible to report invoices via the public portal.[59] Less information is available about the plans of Belgium, but a policy note of the Minister of Finance, Vincent van Peteghem, shows that e-invoicing has a central place.[60]

The fact that Member States are implementing different systems, with different standards, makes it challenging for companies to comply. The European Commission acknowledges these problems and has announced that it will present a proposal for harmonization before the end of 2022. Based on the results of the “VAT in the Digital Age” study, different policy options are on the table.[61] These are discussed further below.

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55. Agencia Tributaria, *Suministro inmediato de información del IVA (S.I.I.)*, available at https://www.agenciatributaria.es/static_files/AEAT/Contenidos_Comunes/La_Agencia_Tributaria/Modelos_y_formularios/Suministro_inmediato_informacion/folleto_informativo_SII_es_es.pdf (accessed 12 Oct. 2022).
56. Summitto, *VAT Talks - Rufino de la Rosa* (25 Nov. 2021), available at https://blog.summitto.com/posts/vat_talks_rufino_de_la_rosa_ey (accessed 12 Oct. 2022).
57. The European Commission developed a Core Invoice, called EN 16391. This can serve as the basis for the implementation of e-invoicing within an EU Member States.
58. National Tax and Customs Administration, *The NAV Online Invoicing System*, p. 5 (2020), available at https://ec.europa.eu/growth/tools-databases/tris/fr/index.cfm/search/?trisaction=search.detail&year=2019&num=499&fLang=EN&dNum=4 (accessed 12 Oct. 2022).
59. Ministère de l’Économie, des Finances et de la Relance, Agence pour l’informatique financière de l’État, *Dossier de spécifications externes de la facturation électronique* (2022), available at https://www.impots.gouv.fr/sites/default/files/media/1_metier/2_professionnel/EV/2_gestion/290_facturation_electronique/dossier_de_specifications_externes_de_la_facturation_electronique_v1.1.pdf (accessed 12 Oct. 2022).
60. Chambre des représentants de Belgique: Note de politique générale, Finances 2021, available at https://www.dekamer.be/FLWB/PDF/55/2294/55K2294004.pdf (accessed 12 Oct. 2022).
61. Group on the Future of VAT, GFV No. 111, *Digital Reporting Requirements – focus on specific issues as a follow-up of the Fiscalis workshop on VAT in the Digital Age* (6 Dec. 2021), available at https://circabc.europa.eu/rest/download/1d355c07-e3af-42ef-b871-17ebd6cff9d0?ticket= (accessed 12 Oct. 2022).

Option 1 "Status quo" seems to be a quite unlikely scenario. The Commission and the Member States are aware of the flaws of the current situation with increasing fragmentation and thus burden for businesses and the limitations of the existing solutions as to effectively addressing cross-border fraud in the European Union.

Under *Option 2 "Recommendation and removal"*, the European Commission would come up with a non-binding recommendation for the implementation of DRR. At the same time, the derogation that is currently necessary to introduce mandatory B2B e-invoicing (*see* more about e-invoicing in section 3.3.) would be removed. Although this might steer countries slightly towards a harmonized direction, there is also a chance that removing the e-invoicing derogation creates even more differing systems.

Under *Option 3 "Keep the data with the taxpayers",* no DRR would be imposed. It would only be required to "record transactional data according to a predetermined format." This information could then be easily accessed by the tax authority upon request in the case of an audit. The authors argue that this is not a significant improvement compared to the status quo because (i) VAT fraud will not be more easily detected as no data is shared and (ii) businesses are only experiencing an additional reporting burden without any benefits in terms of, for example, automation.

Option 4 consists of two sub-options: *4a (partial harmonization)* and *4b (full harmonization)*.[62] Under Option 4a, at first only a harmonized DRR for intra-Community transactions would be implemented. At the same time, guidelines would be provided for domestic DRR which may steer Member States that did not yet implement a domestic solution. The Commission also states that "for Member States where DRRs for domestic transactions are already in place, the interoperability clause applies in the short-term; then national DRRs are required to converge to the EU system in the medium-term". It needs to be seen to what extent this convergence might take place in order to take into account the investments already made by some Member States to tackle VAT fraud. Under Option 4b, both the DRR for intra-Community transactions and for domestic transactions would be harmonized. Although this option may open the door to a full harmonization within the European Union, its approval within the Council is unlikely, because the Member States that already invested time and money into developing and implementing their own national DRR systems might be not willing to start a new and may veto the proposal for a full harmonization on a European scale.

Therefore, the authors consider it relevant to further elaborate on the possible first building block for the harmonization – a common DRR for intra-Community transactions (option 4a). This will be done in section 5.

5 Proposal for a Common DRR Standard in the European Union

Since, at the time of writing, there is not yet an all-encompassing blueprint of such a DRR for intra-Community transactions available, in this section the authors make a proposal for a DRR++ system for intra-Community transactions that takes into account four key elements identified by the authors: (i) basic institutional framework for intra-Community DRR; (ii) interoperability; (iii) ensuring the confidentiality of the data; and (iv) protection of taxpayers' rights.

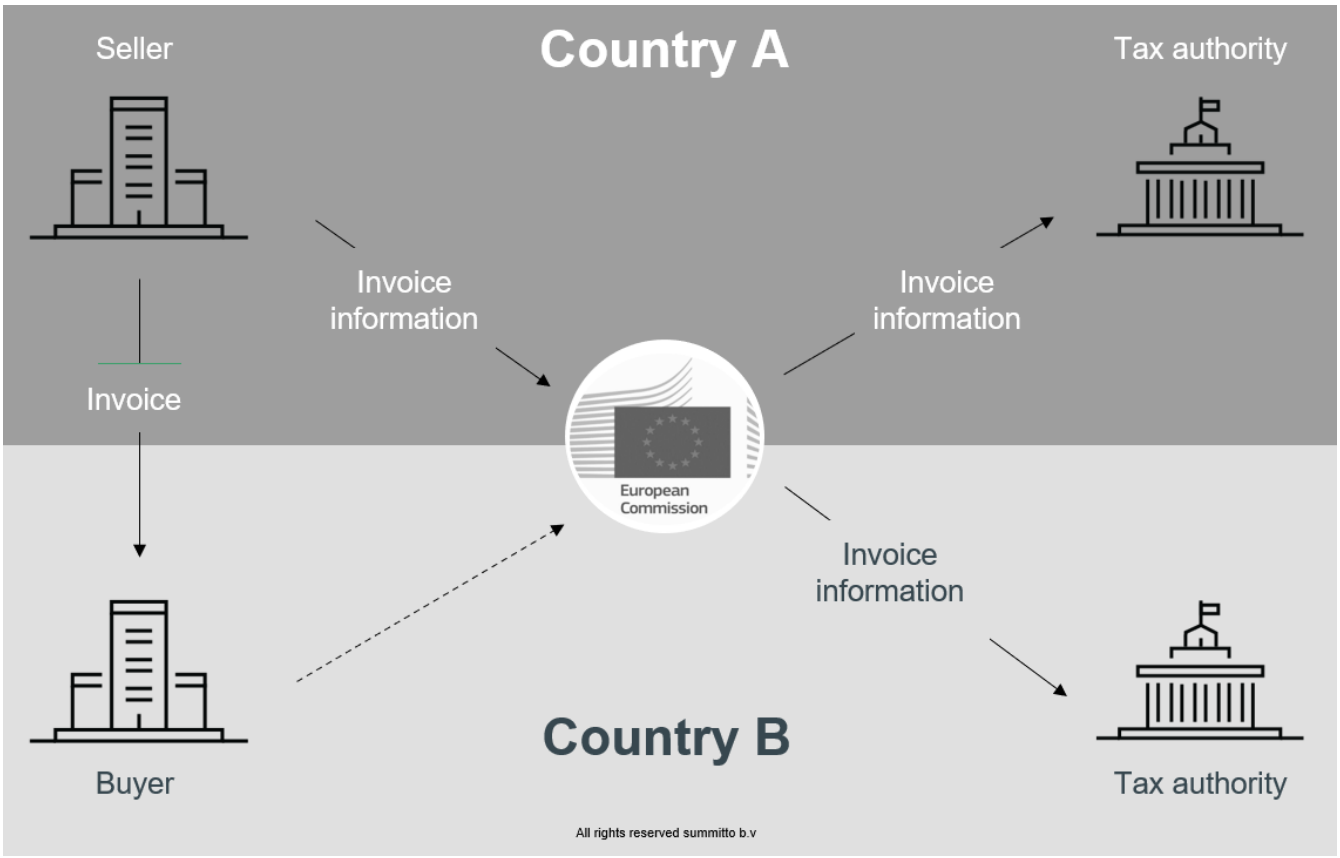
5.1 Basic framework

An essential question for any type of DRR is how the invoice data is reported to the relevant authority. There are potentially two ways to report invoice information under the envisioned DRR++ for intra-Community transactions.

The first option (*see* Diagram 1) would be that companies report directly to a database developed and controlled by the European Commission. This would mean that EU businesses would directly integrate with the systems of the European Commission. The advantage of such a set-up is that small Member States with limited resources can delegate some tax authority services to the Commission. However, some might argue that in this way also a degree of autonomy is lost. This might not be feasible or acceptable for some Member States. Furthermore, it might also be problematic for companies located in Member States that already implemented some form of DRR for domestic transactions as it will force them to be compliant with two different reporting systems. This would only deepen the already existing issue of administrative burden related to the necessity of complying with a significant number of different reporting obligations by taxable persons.

62. The preference towards option 4 has been expressed by the Group on the Future of VAT, GFV No. 123, *supra* n. 9.

Diagram 1 – Intra-Community (IC) DRR sending information directly to the European Commission

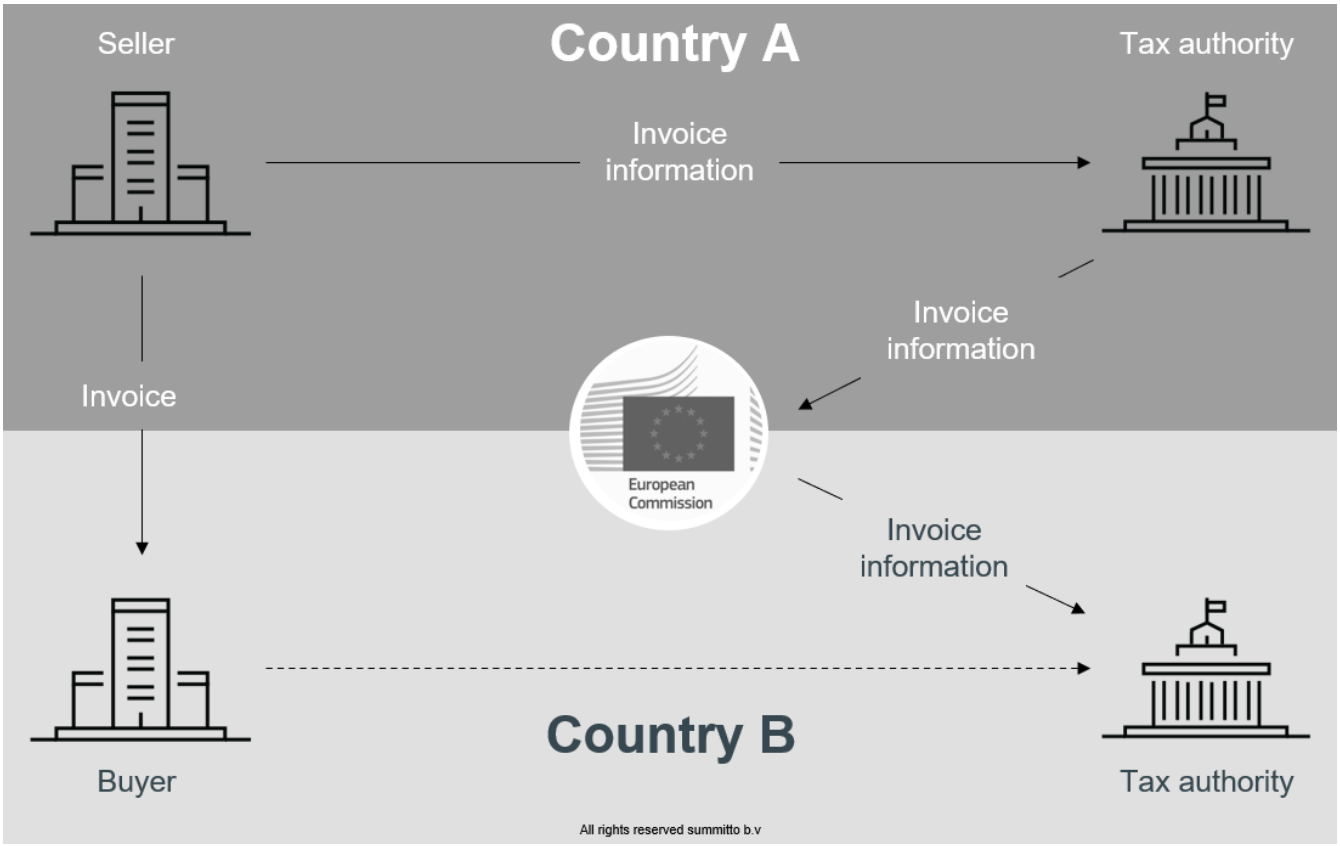


Source: The authors.

The second and preferred option (*see* Diagram 2) would be to integrate the already functioning DRR systems into the additional "layer" – the intra-Community system. In this scenario, companies would first report to their own tax authorities, after which the tax authorities would send the relevant information to the European Commission. This would allow e.g. Italian companies to report both their domestic and intra-Community transactions via the national e-invoicing platform, the SdI. Afterwards, the Italian tax authority would process the information and forward it to the system operated by the European Commission.

As to the Member States that have not yet implemented transaction-based DRR systems, their tax authorities would need to develop an appropriate system which would allow taxable persons to send their intra-Community transactions to their tax authorities. Afterwards, the tax authority would need to forward this information to the European Commission to be further transferred to the Member State of the recipient.

Diagram 2 – Intra-Community (IC) DRR sending information via national tax authority



Source: The authors.

Under such a system, the supplier (in Member State A) will first send the invoice directly to the buyer (in member State B). Afterwards, the supplier will report the invoice information to its own tax authority. The tax authority in Member State A would then forward this information to the Commission, after which the Commission would share this information with the tax authority of Member State B, where the buyer is located. This would allow for the abolishment of the recapitulative statement, which could be replaced by a pre-filled VAT return, potentially lowering the administrative burden for taxable persons.

In order for fraud to be efficiently detected, the buyer should either (i) report its acquisition or (ii) accept/deny the invoice that was reported on its VAT number. The first option seems to be too high an administrative burden, although such an obligation is already present as to acquisition by Spanish businesses in the framework of SII. However, the second option is also not uncontested (several Member States opposed this idea during a Group on the Future of VAT meeting), even though Hungary proved that such a system could be effective. Another solution would be that the buyer needs to acquire the supplier's permission to report an invoice on its VAT number. This can be compared to the exchange of a purchase order number, and can be a somewhat lighter option than the solutions previously discussed. Which option to use could be, at least at the initial phase, left up to the Member States. That way, the DRR++ would not interfere but would instead allow for collection and exchange of relevant information based on the existing systems to the extent to which such systems are interoperable.

5.2 Interoperability and efficiency

For the system to be able to operate in line with the assumptions described in section 5.1., the national DRR systems need to be interoperable. To that end, implementation of a common type of requirement at a national level in the Member States would be of importance. It would be difficult, if not impossible, to ensure interoperability between a SAF-T operated in some Member States, on the one hand, and real-time VAT reporting in other Member States, on the other. That is due to, for example,

differences in the frequency of data reporting. According to the "VAT in the Digital Age" study,[63] the preferred type of reporting requirement is obligatory e-invoicing.

E-invoicing has indeed taken a central position in the debate on electronic VAT reporting in the European Union. It was extensively discussed within the Group on the Future of VAT (GFV)[64] on 6 May 2022. It is important to stress that e-invoicing, and especially mandatory e-invoicing, is not a necessity in order to improve VAT fraud detection. E-invoicing is the exchange of invoices between companies in a computer-readable way, while the reporting aspect is what tackles VAT fraud as explained in section 2.2. The data can also be (automatically) sent via bookkeeping software packages, electronic data interchange (EDI) or even manually submitted via a web portal (which is currently available in e.g. Hungary for domestic transactions). However, if an e-invoicing standard is enforced, it should be broad enough to include data which should be reported to the tax authority.

Although most e-invoicing standards are based on the so-called Core Invoice EN 16931, different Member States have their national specifications (referred to as Core Invoice Usage Specification or CIUS). Furthermore, there are also countries that are implementing a completely different e-invoicing standard. Taking this into account, it will be extremely difficult to reach an agreement on any kind of common e-invoicing standard. The previously halted discussions around a single VAT return are a good comparative use case. Member States did not succeed in reaching an agreement on what fields should be put on this single VAT return due to national preferences. This is similar to e-invoices, where the included fields also depend on national preferences. One single e-invoicing standard would therefore not be feasible.

A standard based on the Core Invoice standard EN 16931 sent via the Peppol network could be a solution to make the system, to a certain extent, interoperable. Peppol is an e-procurement framework through which users can exchange invoices via the BIS 3.0. invoicing standard (also based on EN 16931). An EN 16931 e-invoicing standard (specific to the national context) can be easily converted so that it can be exchanged via the Peppol network. In short, the authors would not advocate one single e-invoicing standard, but would argue that the implementation of EN 16931 by all Member States is more efficient. If that is the case, these standards can easily be converted in order to create interoperability.

If harmonized DRR requirements are implemented, an important benefit for businesses might also be that this reform could steer Member States towards harmonization of their DRR for domestic transactions. Currently, it can be a daunting task to comply with the different DRR systems. By moving towards a harmonized DRR solution for intra-Community transactions, it would be easier to share best practices between Member States and start harmonizing newly implemented DRR systems for domestic transactions.

Furthermore, the implementation of DRR for intra-Community transactions would boost digitalization among companies conducting cross-border business. According to a recent European Parliamentary Research Service study, this digitalization does not only help in the fight against fraud, but would also "reduce the cost of compliance".[65] This is the case because it would allow for the automation of many compliance processes and offer tools to easily find mistakes in companies' own bookkeeping. Closely related is that, after the implementation of a DRR for intra-Community transactions, the recapitulative statement can be pre-filled or even be replaced by an online cross-check of the data that is reported.

5.3 Confidentiality of the data

Although the implementation of a DRR has many positive effects, it is important also to acknowledge the challenges. One of the big challenges of any DRR is how to optimally ensure the confidentiality of the data that is being reported.

Technology can help to ensure as little data is collected and stored as possible. Specifically, modern cryptography can allow Member States to tackle fraud without storing any actual invoice data. In this way, only fully encrypted data is stored, but tax authorities will still be able to make calculations on the encrypted data. This goes one step further than making use of "regular" encryption, as one does not need to decrypt anything to, for example, match VAT returns and spot differences between registered invoices. With modern cryptography the data can remain encrypted (both *in-transit* and *in-rest*) while still being able to detect fraud.

For example, imagine a supplier that makes use of a third party service provider, such as a digital bookkeeping system. When the supplier's service provider sends an invoice to the buyer, the invoice details are also encrypted and sent to the tax authority. The tax authority will thus only receive the data fully encrypted. At the end of each reporting period, the supplier's service provider can prove to the tax authority what the final result is of their paid and received VAT amounts. Tax authorities thereby get the benefits of a transparent DRR, namely seeing the amount of VAT everyone should pay, while ensuring the

63. European Commission, *VAT in the Digital Age*, *supra* n. 7.
64. GFV No. 123, *supra* n. 9.
65. European Parliamentary Research Service, *Fair and simpler taxation supporting the recovery strategy – Ways to improve exchange of information and compliance to reduce the VAT gap*, p. 20 (EPRS 2021), available at https://www.europarl.europa.eu/RegData/etudes/STUD/2021/694223/EPRS_STU(2021)694223_EN.pdf (accessed 12 Oct. 2022).

confidentiality of invoice data. If desired, tax authorities can request full invoice details when needed, just like they are allowed today.

National tax authorities could also choose to receive the data unencrypted, after which they encrypt the data and forward it to the European Commission in an encrypted form. This makes it possible for Member States that already implemented a solution to integrate with the newly implemented DRR for intra-Community transactions.

This also reduces the role of the European Commission as they are not holding the cleartext data but are just a facilitator of the exchange. Member States might not feel threatened by the increasing importance and reliance of EU systems. Additionally, this set-up might also make it easier for different Member States to be willing to participate in this proposal. Namely, as we have seen during the implementation of TNA, not all Member States are equally enthusiastic about sharing data with other Member States.[66] The above-mentioned approach can help Member States to exchange information without actually sharing confidential data. In fact, the same data will be shared between Member States as with the recapitulative statement by default, but in case a discrepancy is detected, the data on a transactional level can be requested from the taxable person.

5.4 The protection of taxpayers' rights

The undisputed benefits of the prompt access to transaction data for tax administrations and EU institutions could be undermined if the design and the functioning of the DRR infringed the provisions and principles stemming from EU law and from the fundamental human rights. This is why special attention should be granted to this aspect as well when designing a DRR system. The challenges which technology causes in that context can be divided into three groups of issues discussed below.

5.4.1. Compatibility of the DRR as such with the established EU legal framework for the protection of human rights

Taxpayers' rights are in essence human rights. Consisting of general principles of law, these rights are protected via multiple sources of law, including the national laws and constitutions of the Member States, the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR) with its own institutional framework including the European Court of Human Rights (ECtHR), the Charter of Fundamental Rights of the European Union (Charter),[67] as well as numerous more specific legislative EU acts protecting particular rights, most notably the General Data Protection Regulation (GDPR).[68]

Being the central source for protection of human rights in the European Union, the Charter is addressed to the Member States only when they are implementing Union law,[69] that is, when they act within the scope of Union law.[70] Introduction and operation of a DRR system, however, falls within the scope of Union law as a measure the purpose of which is to combat VAT fraud, even though the national provisions on DRR systems are currently not transposing any particular provisions of the VAT Directive.[71] The Charter has, just like the Treaties, a status of primary Union law. That means that it takes precedence not only over the national laws of the Member States,[72] but also over secondary EU legislation, including the VAT Directive and Implementing Regulation 282/2011.[73] The Court of Justice of the European Union (ECJ) is competent to review the compatibility of Union legislative and administrative action falling in the scope of Union law with the fundamental rights.[74]

A DRR system, in principle, presupposes collection, storing and analysis of a vast amount of data, including personal data. By its very nature, this implies interference with the right to privacy and the right to protect personal data.[75] Automation of audits and the use of algorithms or even artificial intelligence in decision-making processes by tax administrations causes significant challenges to the right of human dignity, non-discrimination, the right to fair trial and presumption of innocence, and the right to good administration. Although a specific regulation concerning the protection of taxpayers' rights in the context of modern and

66. A. Abukari & U. Turksen, *Countering VAT fraud in the EU: Is there a reason to be hopeful in Germany?* (Protax 2019), available at https://protax-project.eu/protax_publications/countering-vat-fraud-in-the-eu-is-there-a-reason-to-be-hopeful-in-germany/ (accessed 12 Oct. 2022).
67. Art. 52(3) Charter of Fundamental Rights of the European Union, Primary Sources IBFD [hereinafter Charter].
68. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on free movement of such data and repealing Directive 95/46/EC (General Data Protection Regulation) (Text with EEA relevance), OJ L119 (2016).
69. Art. 51(1) Charter.
70. Explanations relating to the Charter of Fundamental Rights, explanations to Article 51 of the Charter, OJ C303/17 (2007).
71. In line with the judgment of the ECJ in *Åkerberg Fransson* (C-617/10).
72. In line with the principle of supremacy of Union law.
73. In GR: ECJ, 18 June 1991, Case C-260/89, *ERT v. DEP*, the ECJ ruled that when Member States claim that a measure infringing the Treaty is justified, this justification must be assessed in the light of the fundamental freedoms.
74. Pursuant to art. 263 TFEU, the ECJ shall review the legality of legislative acts, of acts of the Council, the Commission and of the European Central Bank, other than recommendations ad opinions and of acts of European Parliament and of the European Council intended to produce legal effects vis-á-vis third parties. It shall also review the legality of acts of bodies, offices or agencies of the Union intended to produce legal effects vis-á-vis third parties.
75. IE: ECJ, 8 Apr. 2014, Case C-293/12, *Digital Rights Ireland and Seitlinger and Others*, para 33; European Court of Human Rights: *Amann v. Switzerland*, no. 27798/95, para. 70; European Court of Human Rights, *Kopp v. Switzerland*, no. 23224/94, para. 53.

technology-driven tax administration is currently missing, the existing legal framework and its dynamic interpretation allows to identify and address the potential issues.

The assessment of whether a given measure limits a taxpayer right in a justified way or illegally infringes it goes beyond a simple balancing of various values. It is a complex process consisting of several steps aiming at establishing whether the limitation is provided by law, respects the essence of the rights and freedoms, is proportional and necessary, and meets objectives of general interest recognized by the Union.[76] To that end, the existing extensive body of jurisprudence of the ECJ and the ECtHR, even though it has not specifically addressed any particular DRR system, sheds some light on these requirements.

A thorough analysis of all the issues that may potentially arise goes beyond the scope of this article.[77] For the purpose of this article, the authors decided to focus on the right of privacy[78] and protection of personal data.[79]

The ECJ has consistently held that prevention of tax evasion, avoidance and abuse is an objective recognized and encouraged by the VAT Directive. An effective fight against VAT fraud is indeed an overriding interest capable of justifying restrictions of human rights. It has also been recognized as a general interest of the Union.[80] However, for a measure aiming at safeguarding that interest to be compatible with the right to privacy and protection of personal data, it must be specifically provided in a legislative measure which lays down clear and precise rules governing the scope and application of the measure and imposes minimum safeguards so that the persons whose personal data are affected have sufficient guarantees that data will be effectively protected against the risk of abuse.[81] Personal data may certainly be collected for specific, explicit and legitimate purposes. However, tax authorities cannot collect personal data in a general and non-differentiated manner and should refrain from collecting data that is not strictly necessary for the purposes it aims at achieving.[82] The ECJ has also ruled that in order to apply a measure limiting in a legitimate way one of the fundamental rights there must be sufficient grounds to suspect that a person or persons towards whom the anti-fraud measures are directed undermine(s) the public interest in the collection of taxes and combating tax fraud.[83] Furthermore, a relevant factor determining whether an interference with the right to privacy and protection of personal data is legal is the existence of procedural safeguards and the respect of the right to defence for a person whose rights are interfered with.[84]

A restrictive reading of the conditions which should be fulfilled for a measure to be legal is evident in cases where, due to the type of data collected, it is possible to draw conclusions concerning the private lives of individuals and where the data is collected in a systematic way without differentiation as to categories of persons and their potential relation with crime or fraud, or as to time and geographical scope.[85] These requirements could possibly be softened where the retention of data was strictly necessary and safeguards existed as to the effective protection of the risk of abuse.[86]

Against that backdrop, the authors argue that using the model of DRR++ proposed and described herein could successfully address several of the issues and prevent infringement of the right to privacy and protection of personal data. Using modern encryption prevents tax authorities from actually receiving and storing invoice information in a systematic and generalized way and allows identification for the purposes of further audit of only those transactions in connection to which irregularities are detected. Such a system also protects the data against abuse and limits the possibilities of access to details and personal data which is not strictly necessary in order to prevent VAT fraud. It also allows to limit the use of the collected information to purposes that DRR serves – prevention of VAT fraud and facilitating compliance. However, the authors further note that other safeguards need to be in place in order to ensure that the underlying technology and automated analysis of data do not encompass biases, are not discriminatory and that their use does not infringe the principle of good administration and the right of defence. Furthermore, additional issues in the light of the rule of law and the fundamental principles underlying the VAT system need to be taken into consideration. These are further discussed below.

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76. Art. 52 (1) Charter.
77. M. Papis-Almansa, *The Use of New Technologies in VAT and Taxpayers' Rights in "CJEU: Recent Developments in Value Added Tax 2021"* (Linde, 2022 forthcoming), preprint available at SSRN, https://ssrn.com/abstract=4034858 (accessed 13 Oct. 2022).
78. Art. 7 Charter.
79. Art. 8 Charter.
80. For example, IT: ECJ, 5 Dec. 2017, Case C-42/17, *Criminal proceedings against M.A.S. and M.B.*, para. 34, Case Law IBFD (accessed 12 Oct. 2022); *Menci* (C-524/15), para. 44.
81. RO: ECJ, 1 Oct. 2015, Case C-201/14, *Smaranda Bara and Others v. Președintele Casei Naționale de Asigurări de Sănătate, Casa Națională de Asigurări de Sănătate and Agenția Națională de Administrare Fiscală (ANAF)*, Case Law IBFD (accessed 12 Oct. 2022); LV: ECJ, 24 Feb. 2022, Case C-175/20, *Valsts ieņēmumu dienests (Traitement des données personnelles à des fins fiscales)*.
82. *Valsts ieņēmumu dienests (Traitement des données personnelles à des fins fiscales)* (C-175/20).
83. SK: ECJ, 27 Sept. 2017, Case C-73/16, *Puškár*.
84. European Court of Human Rights, *L.B. v. Hungary*, no. 36345/16; HU: ECJ, 17 Dec. 2015, Case C-419/14, *WebMindLicences Kft. v. Nemzeti Adó és Vámhivatal Kiemelt Adó és Vám Főigazgatóság*, Case Law IBFD (accessed 12 Oct. 2022).
85. IR: ECJ, 28 May 2013, Case C-293/12, *Digital Rights Ireland and Seitlinger and Others*; SE: ECJ, 21 Dec. 2016, Joined Cases C-203/15 and C-698/15, *Tele2 Sverige AB v. Post- och telestyrelsen* and *Secretary of State for the Home Department v. Tom Watson and Others*.
86. Id.

5.4.2. The impact of the DRR on other procedural and material tax law rules in the light of the rule of law principle

Taxpayers' rights are meant to safeguard a balance between, on the one hand, a state exercising its sovereign right to tax and its administrative apparatus and, on the other hand, an individual. Stemming from the rule of law, taxpayers' rights impose limits for the power of the state authority. The authors submit that the resilience of that balanced relationship requires a revision when the power of the state or the scope of obligations imposed on a taxpayer increases. Equipping tax authorities with powerful and efficient tools for combating VAT fraud should result in adjustments to the procedural and material tax law rules, as well as their interpretation and application. For instance, a possibility to identify VAT fraud in a very short time span thanks to the implementation of DRR should result in adjustments to the statutes of limitation for the prosecution of VAT fraud. Similarly, the reliability of the technological solutions for detection of fraud should result in increased legal certainty for compliant taxpayers. The "knew or should have known" test[87] used by many tax administrations as a means for recovering forfeited VAT revenue by refusing the right to deduct to a taxable person if another taxable person in the supply chain was involved in VAT fraud is a significant risk for economic operators. Not taking every precaution that reasonably could be required from a taxable person might be sufficient to be denied to exercise rights stemming from the VAT Directive. Considering immediate access to information and far-reaching capacity as to fraud detection, the third-party liability for fraud seems obsolete. In that sense, technological solutions are capable of taking a burden off the shoulders of not only tax administrations, but also taxable persons. Taxable persons should be able to rely on the robustness of the DRR and the analysis performed, and be able to verify the reliability of the counterparty in the system and at the same time satisfy the condition of taking every precaution that reasonably could be required from them.

5.4.3. Compatibility of the DRR and the use of it by tax administrations with the fundamental principles underlying the EU VAT system

One of the fundamental principles of VAT is the principle of neutrality, which requires that the taxable persons should be relieved of the final burden of VAT in so far as the goods and services acquired by that person are used for the purposes of taxed activities of a taxable person.[88] The right of deduction is an integral part of the VAT system and in principle should not be limited.[89] The right to deduct is sustained irrespective of whether the VAT payable on the prior or subsequent sales of the goods concerned has or has not been paid to the public purse.[90] Therefore, the principle of neutrality would prevent a DRR system which would result in an automatic limiting of the right to deduct by a taxable person without tax authorities first establishing the objective evidence on which it may be concluded that the taxable person knew or should have known that the transaction relied on as a basis for the right of deduction was involved in fraud.[91] The existence of fraud can indeed not be based on an assumption. As discussed throughout this article, the use of DRR allows tax authorities to monitor instances in which output tax reported by taxable persons does not match input tax intended to be deducted by a taxable person who acquired goods or services. The mere lack of compatibility between these two amounts can inform tax authorities on potential irregularities but cannot by itself constitute a basis for denial of the right to deduct. Such lack of compatibility could be a result of an error or non-compliance with certain formal requirements by either the supplier or the recipient,[92] or have explanations in other circumstances, including insolvency and ceasing of economic activity.

6 DRR and the 2017 Definitive System Proposal

For all the reasons discussed in the previous sections the authors argue that the implementation of a DRR for intra-Community transactions (and a subsequent harmonization of domestic DRRs) has the potential to reduce the VAT gap significantly. At the same time, they claim that it could be a stepping stone towards the end of the transitional system and an actual definitive VAT system.

87. Also referred to as the "Kittel principle" or "good faith principle". This was developed by the ECJ in its case law, following the judgment in BE: ECJ, 6 July 2006, Case C-439/04, *Axel Kittel v. État belge and État belge v. Recolta Recycling SPRL*, Case Law IBFD (accessed 12 Oct. 2022). See also NL: ECJ, 18 Dec. 2014, Case C-131/13, *Staatssecretaris van Financiën v. Schoenimport „Italmoda" Mariano Previti vof and Turbu.com BV, Turbu.com Mobile Phone's BV v. Staatssecretaris van Financiën*, Case Law IBFD (accessed 12 Oct. 2022).
88. Art. 168 VAT Directive.
89. DE: ECJ, 15 Sept. 2016, Case C-518/14, *Senatex GmbH v. Finanzamt Hannover-Nord*, para. 37, Case Law IBFD (accessed 13 Oct. 2022).
90. *See* LT: Opinion of Advocate General Kokott, 15 Sept. 2022, Case C-227/21, *'HA.EN.' UAB v. Valstybinė mokesčių inspekcija*, para. 31, Case Law IBFD (accessed 13 Oct. 2022).
91. RO: ECJ, 24 Feb. 2022, Case C-582/20, *SC Cridar Cons SRL v. Administrația Județeană a Finanțelor Publice Cluj and Direcția Generală Regională a Finanțelor Publice Cluj-Napoca*, para. 35, Case Law IBFD (accessed 13 Oct. 2022); HU: ECJ, 16 Oct. 2019, Case C-189/18, *Glencore Agriculture Hungary v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, para. 36, Case Law IBFD (accessed 13 Oct. 2022).
92. M. Merkx, *Case Law Trends: Just a Formality!: Substance over Form in EU VAT and the Right to Deduct Input VAT*, 50 Intertax 6/7, pp. 556-567 (2022), available at https://kluwerlawonline.com/journalarticle/Intertax/50.4/TAXI2022051 (accessed 13 Oct. 2022).

The cornerstone of the current proposal for a definitive system is to switch towards a fully destination-based system. This means that VAT should be paid in the country where the goods or services are consumed but should also be collected by the supplier and remitted through a one-stop shop (OSS) in the Member State of establishment of the supplier. By design, intra-Community supplies would no longer be exempt (zero rated) from VAT. This does not mean that opportunities for fraud would disappear altogether, as the missing trader could become the supplier that collects the VAT (and then goes missing).[93] Even the European Commission acknowledges that this may occur.[94] In the case of suspicion of fraud, the Member State of destination would have to rely on mutual assistance instruments to require the Member State of identification to investigate and recover the unpaid revenue (where applicable) from the supplier established in its territory. Beyond the fact that charging VAT in accordance with the rules that apply in the Member State of destination will constitute a non-negligible burden for the taxable persons (although the OSS is a single point of registration, applying the rates and exemptions of the Member State of consumption might in the end make it more burdensome for them to trade within the European Union than to export),[95] the OSS system thus implies a very high level of trust between the Member States. The Member State of consumption will have to trust that the Member State of identification will take all necessary measures to ensure the correct payment of VAT, which may include assistance for auditing the taxable persons.[96] This is a structural, inherent weakness of the OSS system, but in the case of B2B intra-EU trade the revenues at stake are enormous. In practice, the Member State of consumption will periodically receive bulk payments with summary details regarding the taxable persons from the Member State of identification. Accordingly, it will take time before it realizes that insufficient amounts of VAT (might) have been declared. A request for assistance should then be sent to the Member State of identification, which might take some additional time – sufficient time for the non-compliant supplier to go missing without remitting the VAT due. The immediate loss for the Member State of consumption is unavoidable because the customer was able to immediately claim the deduction/refund of the VAT paid to the non-compliant supplier.[97]

If, however, a DRR++ solution such as described in section 5. is combined with the definitive system, the taxable intra-Community transaction will be reported in real time without having to share any confidential information.

7 Conclusion

In this article, the authors laid down the theoretical bases of a DRR++ for intra-Community transactions, which would modernize the current reporting obligations and have a significant impact on the fight against VAT fraud. Such a system would also address the currently existing challenges of the fragmented landscape of the VAT DRR obligations in the European Union and could even be an important tool to support the implementation of the definitive VAT system.

From a design perspective, the authors argue that DRR could best be implemented by first letting companies report invoice information to their own tax authorities, after which the national authorities will forward the information to the European Commission, which would then share relevant data with the Member States involved in the transactions. In this way, existing DRRs for domestic transactions would be interoperable with the new obligation and Member States would keep enough freedom to adapt it to the national context. DRR for intra-Community transactions could also offer a push towards a further harmonized EU VAT reporting regime. Furthermore, by digitalizing reporting, compliance processes can be automated and ultimately the recapitulative statement removed. Although determination of the exact scope of the types of transactions as well as the taxable persons who would be covered by the system goes beyond the ambit of this article, the authors have explained why they would prefer CTC, such as obligatory e-invoicing, over a PTC and commented on the role of the customer in such a system.

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93. In that sense, *see* M. Merkx & J. Gruson, *Definitive VAT Regime: Ready for the Next Step?*, 28 EC Tax Review 3, pp. 140-149 (2019); R. Starkenburg & N. Verbaan, *VAT and International Trade's Crossroads: Right, Left or Straight On?*, 28 EC Tax Review 5, pp. 233-244 (2019), available at https://kluwerlawonline.com/JournalArticle/EC+Tax+Review/28.5/ECTA2019028 (accessed 13 Oct. 2022); Quoting Ainsworth: "we are building half a dam in a river that still flows unimpeded around the far end of the barrier". R. Thompson Ainsworth et al., *A VATCoin Solution to MTIC Fraud: Past Efforts, Present Technology, and the EU's 2017 Proposal*, Boston University School of Law Research Paper No. 18-08, footnote 20 (2018).
94. Quoting the European Commission: "New types of frauds could also take place once the definitive VAT regime is implemented. For instance, fraudsters could exploit differences in VAT rates between Member States to create new forms of missing trader frauds". European Commission, Commission staff working document impact assessment, Amended proposal for a Council Regulation, Amending Regulation (EU) No. 904/2010 as regards measures to strengthen administrative cooperation in the field of value added tax, p. 36, SWD(2017) 428 final (30 Nov. 2017).
95. Another risk for taxable persons under the definitive regime is the issue of bad debt. In a destination-based system, where the supplier is liable to pay the VAT within a specific timescale, it is not uncommon for them to have to prefinance the VAT. If the customer subsequently fails to pay the VAT, the supplier might be able – or not – to recover the prefinanced VAT (conditions differ between Member States, in particular with respect to the "irrecoverability" of the debt).
96. This includes verification of the correct application of rates (which would be an unbearable burden should the Commission proposal in the sense of VAT rate liberalization be adopted).
97. In this respect, it should here be clarified that linking the right to deduct to the payment of the VAT by the supplier in order to avoid this situation would be a disproportionate measure that would jeopardize the neutrality of the VAT system. In fact, it is only in cases where the customer "knew or should have known" that he was helping the supplier to commit fraud (the "Kittel principle", *see supra* n. 87 and sec. 5.4.3.) that the deduction should be denied.

The authors also further elaborated on the use of modern cryptography, which would be crucial for ensuring confidentiality of invoice data and allow to effectively mitigate the risk of potential infringement of the right of privacy and protection of personal data of the taxable persons. At the same time, the encryption would not compromise the goal of detecting fraud and errors in compliance. Furthermore, the proposed DRR++ system would be helpful in finding political support for this measure as history has shown that Member States are not always keen to share data among each other.

Finally, the authors have outlined potential limitations stemming from taxpayers' rights as to the operation and use of the DRR systems. They are convinced of the need to consider the broader context of rules in which such a DRR system operates. For example, the enhanced capacity of a state to combat fraud should be reflected in the adjustment to the procedural rules and guarantees for taxpayers. The use of the DRR also has to respect the fundamental principles of the EU VAT system, including the principle of neutrality.