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Úřad práce ČR

Blok No. 8:

Incoterms

Content

- General background (GB) – definition, history, structure, delivery, scope, limitations
- Impact of Incoterms on accounting and VAT treatment – revenues and expenses (recognition, measurement), VAT (definitions, tax treatment)

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GB - definition

- International terms of sale, often called simply INCOTERMS – Being an integrated part of international sale contracts, pro forma invoices or purchase orders, INCOTERMS are probably the world's best-known import/export tool. They stand for universal trade terminology developed by the International Chamber of Commerce (ICC) aimed to clarify: (1) who in international supplies of goods is responsible for what expenses (in essence, it is a way of letting the buyer know what is 'included' in the sales price, e.g. transport costs, insurance costs, duties etc.); and (2) where all risks for the consequences of loss of or damage to the goods supplied are transferred from the seller to the buyer (i.e. place of delivery). International terms of sale are an area of concern for many businesses that are just beginning to export, because international terms of sale differ greatly from those used in domestic sales. Although originally INCOTERMS were designed for international sales contracts, they also can be used in domestic ones.

  INCOTERMS have been longest known and understood in Europe. This may be due historically to the large number of exporting countries in Europe and the fact there is a high amount of intra-European trade. ICC is encouraged to see that understanding and use of INCOTERMS has been growing exponentially around the world and nowadays there is

GB - history

hardly a country in the world whose traders are unfamiliar with the idea of INCOTERMS.

- INCOTERMS are in fact based on venerable precedents in international trade customs, as evidenced by an 1812 British court decision involving FOB. In the 19th century, as international trade expanded rapidly, usage of terms such as FOB and CIF became a common international trade practice that arose from the need to clearly specify, in international transactions, the respective risks and responsibilities of seller-exporter and buyer-importer. International traders in those early times were not compelled by any laws to use terms such as FOB or CIF – rather, these terms were voluntarily adopted as a convenient shortcut for negotiating international contracts. Thus, custom of usage of international trade terms arose because they filled a practical business need.

  ICC recognizes that the practice of international trade is not static, but rather evolves with developments in technology and other global changes. So, for example, when in the 1960s and 1970s the rapid expansion of containerized and multimodal transport substantially changed the conduct of international trade, ICC updated INCOTERMS to meet these new transport practices.

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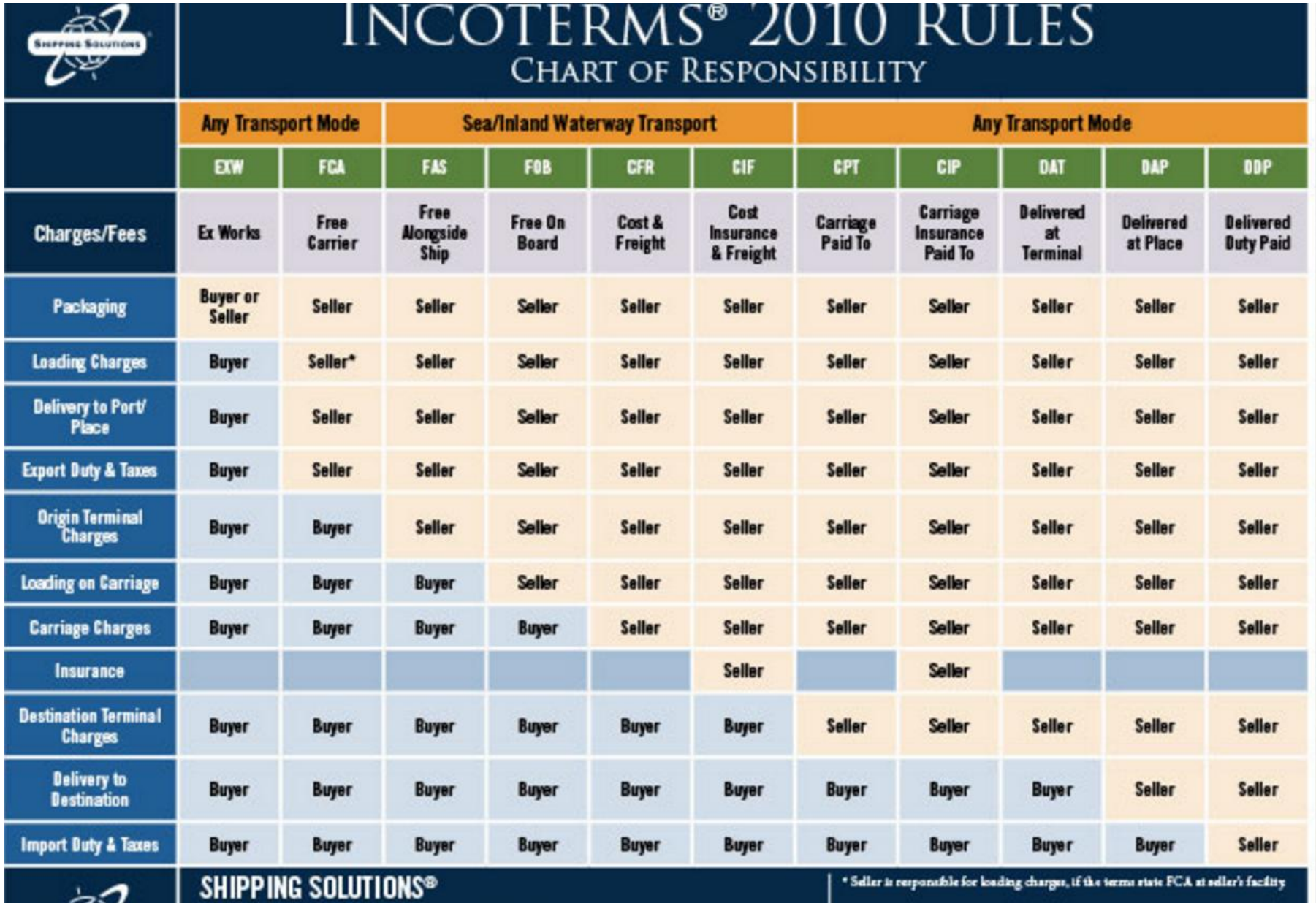
GB - structure

- There are 11 INCOTERMS in the current version of the rules known as 'Incoterms® 2010' (ICC Publication No. 715) – 7 rules that may be used for any mode or a combination of different modes of transport (frequently known as 'multimodal' transport), and 4 rules that may be used only for sea and inland waterway transport (frequently known as 'maritime' transport). Traders should distinguish carefully INCOTERMS rules used under different modes of transportation.

  Regardless of mode of transport, all INCOTERMS rules can be thought of as representing a stepladder of increasing responsibility from seller's premises to buyer's premises. Thus, in the rules for use with any mode or modes of transport, INCOTERMS rule that represents the minimum responsibility for the seller is EXW (Ex Works), which is generally used in cases involving delivery at the seller's factory or warehouse. A buyer on EXW terms knows that nothing 'extra' (in terms of transport, customs clearance or insurance) is included in the sales price – the buyer must handle the entire transport operation itself. At the other extreme, INCOTERMS rule DDP (Delivered Duty Paid) represents maximum responsibility on the part of the seller, with delivery generally at the buyer's premises. A buyer on DDP terms ('Delivered Duty Paid') knows that the quoted price includes all transport costs, risks and formalities up

GB - structure



INCOTERMS® 2010 RULES
CHART OF RESPONSIBILITY

	Any Transport Mode		Sea/Inland Waterway Transport				Any Transport Mode				
	EXW	FCA	FAS	FOB	CFR	CIF	CPT	CIP	DAT	DAP	DDP
Charges/Fees	Ex Works	Free Carrier	Free Alongside Ship	Free On Board	Cost & Freight	Cost Insurance & Freight	Carriage Paid To	Carriage Insurance Paid To	Delivered at Terminal	Delivered at Place	Delivered Duty Paid
Packaging	Buyer or Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading Charges	Buyer	Seller*	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Delivery to Port/ Place	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Export Duty & Taxes	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Origin Terminal Charges	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Loading on Carriage	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Carriage Charges	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller	Seller	Seller
Insurance						Seller		Seller			
Destination Terminal Charges	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller	Seller	Seller	Seller
Delivery to Destination	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller	Seller
Import Duty & Taxes	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Buyer	Seller

SHIPPING SOLUTIONS®

* Seller is responsible for loading charges, if the terms state FCA at seller's facility

GB - delivery

to the final destination. Between these two extremes, there are nine other INCOTERMS, representing a range of options for the division of costs/risks between the parties.

- Under INCOTERMS (unlike many sales laws) the place of delivery is also the place where the risk for the consequences of loss of or damage to the goods transfers from the seller to the buyer under the contract of sale. Both notions – delivery and risk - are crucial since the physical delivery and transfer of risk mark the point at which the seller performs what is usually its most significant obligation under the contract of sale, i.e. to pass the goods to the buyer.

  Since delivery and transfer of risk can be defined differently under the law applicable to the sales contract, it may often be complicated to determine under a particular sales contract when exactly the seller performs its delivery obligation and when risk passes to the buyer. This may cause misunderstandings and conflicts between the parties to the contract of sale.

  CISG fixes delivery at the place where the goods are handed over to the first carrier. It is at the point of delivery that the risk passes from the seller to the buyer (subject to some narrow exceptions). This is clarified and explained in INCOTERMS. The clear identification of the place of delivery

GB – scope

therefore avoids the confusion that could arise because different applicable laws might fix the passage of risk to diverging places.

- INCOTERMS are applied to sales contracts only. All other contracts are outside of their scope. In this context it is necessary to distinguish contract of sale and contract of carriage:
  - Contract of sale – an agreement between the seller and the buyer. INCOTERMS are part of such these contracts.
  - Contract of carriage – an agreement between the shipper and the carrier (transporter). INCOTERMS are not part of these contracts if they stand alone. However they are used in these contracts indirectly only if such contracts are linked to corresponding contracts of sale. In this case (if contract of carriage is linked to the contract of sale) the shipper may be either the seller or the buyer – depending on that who is obligated under the contract of sale to take care of transport. That side which has this obligation becomes the shipper who will have to enter into a carriage contract with a carrier (a company offering transport services, like a marine shipping line, and airline, or a freight consolidator).

Traders often do not distinguish contract of sale and contract of carriage

GB – limitations

from perspective of impact that INCOTERMS have on each of these two types of contracts. One reason for confusion is that terms in the contract of carriage may resemble the INCOTERMS (for example, in their usage of the word ‘free’) – but traders should remember that these are separate contracts with separate sets of responsibilities.

- Traders need to understand the nature clearly, extent and limitations of INCOTERMS’ coverage.
  - In most countries, INCOTERMS are NOT explicitly referred to in laws or statutes, so INCOTERMS are not ‘laws’ in the sense of rules that are developed by a government and are obligatory for all market participants.
  - INCOTERMS do not cover all possible legal or practical issues arising out of an international sale. The INCOTERMS are merely a sort of contractual shorthand that allows the parties to easily specify their understanding as to: 1) the transport costs that the seller will cover; 2) the point at which risk of loss will be transferred from seller to buyer; 3) who must handle customs formalities and pay duties; and, 4) in the case of CIF and CIP, what are the responsibilities of the seller to provide insurance cover. All other important details should be dealt with specifically in the contract of sale.

GB – limitations

INCOTERMS cover only those cases where one party has an obligation to the other party to do something. INCOTERMS do not indicate when a trader should do something because it is prudent or advisable. This is frequently misunderstood. Thus, traders will ask why the seller is not obliged to insure the merchandise under a DDP sale, since it would seem obvious that the seller has to be responsible for the goods all the way to destination. Yet this approach confuses a business need with a legal obligation – INCOTERMS refer only to the legal obligations, and are silent on matters of common business needs and usages.

- One of the key areas not governed by INCOTERMS is that of the transfer of property or title to goods. In fact, there is no international legal harmonization as regards the transfer or title or property in international transactions.

  Since the law on transfer of property rights differs from country to country, the parties to a contract of sale may wish to specifically provide for this matter in the contract, but only after determining what is permissible under the applicable law. Under many jurisdictions it is possible for the seller to retain title and ownership of the property until the purchase price is paid in full, even if this takes years. This

GB – limitations

‘retention of title’ by the seller is usually set out in a clause in the contract of sale. Thus, one typical question raised by newcomers to INCOTERMS is: Where are the provisions on transfer of property in INCOTERMS? This questions remain largely governed by national law alone. It is possible for the parties to add to their contracts, in addition to INCOTERMS, a clause that clearly establishes the place and manner of transfer of ownership/title in the goods. Drafting such clauses requires knowledge of the transfer of property laws of both countries involved, as well as their respective conflict of law rules with regard to such property laws. Seeking specialist advice is advisable.

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Impact of INCOTERMS on revenue recog-n

- For an entity, which uses INCOTERMS in its business activity, faces them while recognizing its expenses (e.g. during purchase of material) and revenues (e.g. during sales of products). when closing its accounting books an entity must not forget the principle of prudence, which states that while compiling the annual financial statements an entity should include into them not only the incomes that were achieved, but it should also take into account any foreseeable risks and possible losses relating to such recognized incomes and about which an entity knew at the date of compilation of its financial statements.

  Example: On December 31, 2015 an entity withdrew its goods from warehouse and passed them the carrier. Delivery to the customer takes 3 days.

  - Goods are supplied at condition FCA (Free Carrier). In this case an entity (seller) carries risks associated with the delivery only until the moment it passes them to the carriers, which is about take place on December 31, 2015. In practice this means that on the basis of the certified document from the carrier an entity can recognize revenue from this sale even though the customer will receive the goods after December 31. Naturally in context of this business operation on December 31 an entity also will derecognize the goods sold.

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Impact of INCOTERMS on revenue recog-n

- Goods are supplied at condition DAP (Delivered At Place). At this condition a seller pays all fees connected with delivery, that is, transport, duties, insurance etc. up to the point where delivery is made available for customer at transportation vehicle sent by the customer. In practice this means that an entity (seller) carries risks for the supply in the course of its delivery and any damage occurred due to, for example, an accident. Therefore an entity should not recognize revenue from sale in the moment of withdrawal of goods from its warehouse and passing them to the carrier on December 31, 2015. Instead the entity will recognize this revenue and derecognize the goods sold in January 2016. Thus this revenue will be already part of revenues included into annual financial statements 2016.

- As it can be seen from these examples, while compiling its financial statements an entity should always take into consideration the impact of INCOTERMS used in its business operations. However, INCOTERMS should not be taken too dramatically, but in context of sales contract of which they are a part.

Impact of INC-S on VAT – types of supplies

- Czech Republic, as well as other members of the European Union, differentiates 2 modes of sale of goods outside its territory: (1) supply of goods to another member state (aka intercommunity supply); and (2) export, that is, supply of goods to third countries.
- Intercommunity supply
  - System of imports and exports between EU member states functions in from of intercommunity acquisitions and supplies. Member states must tax the imported goods with the same VAT rates as their domestic goods. Exporters exempt their supplies from VAT. VAT should be calculated and paid by buyers (i.e. importers). VAT is paid in the state of final consumption (destination VAT model). Exports and imports of goods for personal consumption are not exempted from VAT.
  - Domestic exporters have right to reimburse (refund) VAT paid, but only in situation when such goods were purchased for the performance of their economic activities in another EU member state and if in that state entities-exporters are not registered as VAT payers, they do not have branches or head offices and do not carry out their business activities. On the same conditions, foreign entities, registered as VAT payers in other member states, have a right to refund VAT paid in the Czech Republic.

Impact of INC-S on VAT – types of supplies

- Cases of intercommunity supply:
  - Domestic supplier is VAT payer in CZ and foreign customer is VAT payer in another member state. Domestic supplier exempts its supply from VAT by means of documentary confirmation that the goods supplied have left CZ. On the issued tax document the domestic supplier does not write either VAT rate or VAT amount, but writes down a reference to VAT exemption, such as, for example, Directive 2006/112/EC. Foreign customer will recognize and pay VAT in its home country (where it is registered as VAT payer).
  - Domestic supplier is VAT payer in CZ and foreign customer is not VAT payer in any other member state (or it is the so-called person without obligation to register for VAT, that is, citizen purchasing goods for personal consumption). In this case, Czech supplier should indicate Czech VAT on the tax documents which it issues to the customer. This transaction is counted as domestic supply but not as intercommunity one.
  - Domestic supplier is not VAT payer in CZ and foreign customer is VAT payer or is not VAT payer in another member state. Since Czech supplier is not registered for VAT this transaction is not subject to

Impact of INC-S on VAT – types of supplies

VAT in CZ.

- Domestic supplier is VAT payer and it supplies its goods to another member state for foreign customer, which is not registered as VAT payer in this particular state (to which the goods are supplied), but it is registered as VAT payer in other member state. In this situation Czech supplier needs to register as VAT payer in the state to which it supplies but only if the value of such supply exceeds certain defined threshold. Such threshold is given by the aggregate value of all goods supplied during one calendar year. if the threshold is not reached, than such supply is exempted from VAT with right to recovery through procedure called “reverse charge”.

- Export/import
  - Export –
    - stands for supply of goods to third countries, that is, to non-member states of the EU. It is different regime therefore its VAT treatment is also different. Exports are exempt from VAT but only under certain conditions: exemption is granted to supplies of goods carried out by VAT payer in CZ which is may be a seller or its agent, or a buyer but only with condition that such buyer does not have legal address in CZ or does not carry out its business activities in CZ.

Impact of INC-S on VAT – types of supplies

export is considered as exempted supply with right to recovery input VAT regardless of regardless whether the recipient (buyer) is registered to VAT or not in its home country. Transaction is subject to VAT in the country of buyer. Exporter is entitled to exemption on the basis of customs declaration.

- During export there are charged export duties and export charges *Note: export duties and other charges and taxes are calculated on the basis of supply's customs value. Usually this is the so-called transaction value, i.e. price indicated on supplier's invoice.*
- *Note: as exports there are recognized deliveries of goods to free zones or free warehouses within the territory of CZ. This is evidenced by submission of export SAD or decision on the location of goods in a free warehouse or zone.*

- Import –
  - is charged with import duties, import charges, VAT, excise duties and other indirect taxes. *Note: the basis for calculation of VAT is generally everything that supplier has received as consideration in the underlying chargeable event, including the amount of excise duties import duties, other taxes or fees, subsidies to the price and incidental expenditures.*

Impact of INC-S on VAT – time of supply

- Date of chargeable event
  - Date of accounting recognition = date of taxable recognition, that is, date of chargeable event. For the sale of goods in terms of accounting recognition is not important where the goods are supplied to domestic customers or abroad. It is recognized just as a sale of goods, both in the case of domestic and foreign or EU supply. *Note: a small difference can occur in the way how an entity distinguishes such sales from the territorial aspect and records such sales on its analytical accounts (i.e. domestic sales, EU sales, exports). In the same way an entity may differentiate its trade liabilities.*
  - Date of accounting recognition ≠ date of taxable recognition, that is, date of chargeable event. VAT payer has to recognize output VAT on the date of the chargeable event and on the date of adoption of consideration transferred (payment received). In practice it means, that purchase of the goods with the date of chargeable event May 31, 2015 for which the tax document was received on June 2, 2015, such purchase will be recognized and accounted for (i.e. payment for delivery including recognition of VAT liability) on May 31, while the right to recover will arise only on June 2, that is, on the date when buyer receives tax document. The same situation occurs when buyer

Impact of INC-S on VAT – time of supply

pays advance on May 31, 2015 for which seller issues immediately confirmation of advance received. In this case seller needs to recognize VAT receivable in May. Goods are delivered on June 2, 2015 - on that day buyer issues an invoice and recognizes revenue on that day.

In the context of difference between date of accounting recognition and date of chargeable event in context of VAT there is arises problem - conversion of foreign currency into CZK. Exchange rate for accounting treatment will be different from the rate used when VAT receivable or payable is recognized, because on the tax document there is written statistical value of goods and for conversion of this value into CZK there was used special customs rate (i.e. rate recorded on the last Wednesday of each calendar month is used throughout the following calendar month. Current customs rates can be found on the website of the customs administration). If an entity for conversion of its trade liabilities in foreign currency uses the daily rate of CNB, it will use it for estimation of VAT receivables from its imports and intercommunity acquisitions. The accounting and tax price in CZK will probably be different if taxable event does not occur on the same date. On the contrary, if an entity uses fixed exchange rate the accounting and tax price will be the same (of course, if this transaction occurs within the period for which such rate is valid).

Impact of INC-S on VAT – place of supply

Note: question of exchange rate difference while correct determination of VAT receivable makes sense only in case of imports or the acquisition of goods from another member state. Exports and supplies of goods to member states are exempted from VAT that is why such question does not arise here. However if an entity issues an invoice in foreign currency, it should use appropriate exchange rate (daily or fixed) from CNB.

- Place of chargeable event - determination of correct place of chargeable event influences the way how the whole business transaction is assessed in the light of VAT - whether it is subject to tax or it is an event with place of charge in other member state or in the third country.

  Importance of place of chargeable event is crucial for determination of the law by to which VAT recognition will be managed by. In the following cases we will distinguish whether the goods are supplied: (1) without transportation; (2) with transportation; (3) with transportation, assembly and installation.

  - Goods are delivered without transportation: place of chargeable event is the place where goods are located at the time when supply takes place. Typical example is EXW term. Seller passes its goods in its plant in CZ, which is the place of chargeable event. This such supply will be regulated by Czech law. Next step is to decide whether goods are

Impact of INC-S on VAT – place of supply

intended for CZ or abroad, if abroad, then if within EU (intercommunity supply) or outside of it (export). If goods are intended for abroad (regardless if it is within EU or outside of it), such supply can be exempted from VAT, but only with condition of submission by supplier of confirmation that goods left the territory of CZ (i.e. there was real export but not supply to domestic buyer).

- Goods are delivered with transportation organized by supplier or buyer: place of chargeable event is the place where goods are located at the time when transportation starts. If transportation starts in CZ and the goods are transported to Ukraine, then place of chargeable event is CZ. But if Czech exporter proves that its goods have left the territory of CZ and EU, then it can be exempted from VAT. Another example is when Czech entity supplies goods to Russian buyer, which is registered for VAT in Poland, but goods supplied should be transported to the Slovak Republic (not to Poland, where Russian buyer has its VAT registration). Russian firm that is registered for VAT in Poland (not in Slovakia, where it is going goods). Place of chargeable event is CZ, because it is a starting point of transportation route of supply. That is why it is necessary to apply Czech law to this supply. In this context it is important to take into consideration the destination point of supply,

Impact of INC-S on VAT – place of supply

not the place where buyer has its legal address and VAT registration. In our case it is intercommunity supply to Slovakia. Next step is to decide if buyer has VAT registration in some EU member state. Russian entity has VAT registration in Poland, thus this condition is fulfilled. So this is the case when Czech supplier, VAT payer, supplies its goods to another member state for foreign customer, which is not registered as VAT payer in this particular state (to which the goods are supplied), but it is registered as VAT payer in other member state. In this situation Czech supplier needs to register as VAT payer in the state to which it supplies but only if the value of such supply exceeds certain defined threshold. Such threshold is given by the aggregate value of all goods supplied during one calendar year. If the threshold is not reached, than such supply is exempted from VAT with right to recovery.

- Goods are delivered with transportation, assembly and installation: place of chargeable event is the place where assembly and installation takes place.

Comments to individual terms:

- Under EXW term buyer has no obligation in regard of supplier to provide it additional information, for example, information

Impact of INC-S on VAT – place of supply

(confirmation) that goods have left the territory of CZ. Thus supplier may get into trouble with confirmation of evidence (i.e. that goods left the territory of CZ and/or EU). Supplier may have a signed delivery note, but if place of chargeable event is CZ than such note cannot be used as a means of proof. Therefore in case of EXW term it is better to state in the sales contract that buyer will provide supplier with written declaration that goods have been shipped to another EU member state or abroad.

In accounting system of supplier under EXW there will be no transportation and insurance expenses. Supplier has only invoice issued. The problem occurs when supplier does not know in advance whether goods supplied will be exempted from VAT as intercommunity supply or as export, because it does not have documents proving that goods have left territory of CZ and/or EU. If invoice is issued before the actual time when goods cross the borders of CZ and/or EU, for supplier it is appropriate to recognize such supply as domestic transactions, that is, charge VAT on output. If supplier sends to the buyer its invoice on the basis of buyer's confirmation that goods have left the territory of CZ, then supplier can exempt its supply immediately.

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Impact of INC-S on VAT – place of supply

- Under terms from group "F" it is easier for supplier to confirm the fact that goods have left the territory of CZ and/or EU. In the case of FOB and FAS supplier transports goods to the port of loading. In this way supplier has confirmation that goods have left the territory of CZ because it itself insures its transportation. In case of FCA term, the situation is a bit more complicated because in this case transportation is insured by buyer. That is why when under FCA supplier makes goods available in its plant, it is possible to observe analogy with EXW term. Thus supplier finds itself in confirmation trouble and its solution is the same as in case of EXW.
- Under terms from group "C" buyer arranges transport contract up to defined place of destination. Therefore supplier receives transportation contract as necessary confirmation on the basis of which goods so may exempt from VAT as intercommunity supply or export.
- Under terms from group "D" supplier is responsible for complete transportation and, if necessary, assembly and installation. Thus supplier will have all the necessary documents on the basis of which goods so may exempt from VAT as intercommunity supply or export.

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