# The customs implications of Incoterms and how Incoterms and customs are actually misaligned

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## Abbreviation list

| | |
|---|---|
| **AEO** | Authorized Economic Operator |
| **CCC** | Community Customs Code |
| **CFR** | Cost and Freight |
| **CIF** | Cost Insurance Freight |
| **CIP** | Carriage and Insurance Paid To |
| **CPT** | Carriage Paid To |
| **DA UCC** | Delegated Act of the Union Customs Code |
| **DAP** | Delivered at Place |
| **DAT** | Delivered at Terminal |
| **DDP** | Delivery Duty Paid |
| **ECJ** | European Court of Justice |
| **EU** | European Union |
| **EXW** | Ex Works |
| **FAS** | Free Alongside Ship |
| **FCA** | Free Carrier |
| **FOB** | Free On Board |
| **IA UCC** | Implementing Act of the Union Customs Code |
| **ICC** | International Chamber of Commerce |
| **Incoterms** | International Trade terms, Incoterms® 2010 |
| **SLA** | Service Level Agreement |
| **UCC** | Union Customs Code |
| **VAT** | Value added tax |

# 1. Introduction

The three-letter terms - the Incoterms - these trading terms are well known to everyone working in international or national trade. Indeed, everyone, regardless of the different departments they are engaged in or are familiar with; from supply chain to sales to finance. It appears to be the linking pin of the global trade world. However, it might just appear to be so, as everyone only knows a little part of the definition of the trade term. Most people know just enough for their own purposes or scope of work, as that is most relevant for them in daily business. As everyone focuses on their own definition of the trade term, the picture as a whole gets lost in translation. For example, a truck driver might only limit his understanding to where he is to deliver the goods, while a sales employee is focused on the best deal regardless of the route relevant for the truck driver. On the one hand, it is good that everyone in the chain of the transaction and the delivery of the transaction has its own expertise and focus. On the other hand, it is always good to keep perspective of the picture as a whole. Keeping in mind the entire picture is the exact reason I have chosen this topic. Incoterms are main principle conditions in international commercial contracts around the world. In each sales contract, regardless of what type of goods or products are subject to the contract, Incoterms are negotiated between the seller and the buyer. The set of three-letter trade terms reflect business-to-business practice commercial contracts for the sale of goods. The Incoterms indicate the responsibility and tasks and the extent of coverage in terms of costs and risks involved in the delivery of goods from sellers to buyers. The Incoterms exist in different stages of transfer of obligations, risks and liabilities from the seller to the buyer. In these stages, costs and risks are transferred at a different stage each time. These responsibilities and costs are related to the carriage to certain places agreed upon, insurance for loss or damage to the goods and fulfilment of customs formalities, including the payment of customs duties.[1] The risks and obligation of parties have been describes quite clear in a broad manner. However, for the bigger picture I would like to focus on an element which has been described in a very general and broad manner: customs.

As mentioned earlier, the Incoterms are global trade conditions which are known and accepted around the world. As customs also has a principal role in global trade, one may assume the two principles are probably aligned. Especially since Incoterms are also included as a standard field (‘delivery terms’) on customs declarations in the EU. However, the application of Incoterms in practice is not always in line with EU customs legislation. Therefore, this thesis concentrates on the practical implications of Incoterms and how they relate to European customs law. While the Incoterms pose and prove to be international trading conditions the one element which plays a large role in international trade, customs, seems not to have been considered thoroughly. In this thesis, the practical implications of Incoterms will be explained in more detail with emphasis on the possible additional risks to which attention ought to be paid. Although the Incoterms also have implications in non-EU countries, these are not included in detail in this thesis as these largely depend on local customs legislation. However, it must be noted that it is advisable to consult local (customs and VAT) legislation when using Incoterms for sales contracts involving trade between, to or from third countries.

[1] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 4.

## 2. Origin of Incoterms

The Incoterms have been created by the International Chamber of Commerce (ICC). The ICC was founded in 1919 in the aftermath of the First World War due to the lack of a global system of rules which governed trade, investment, finance or commercial relations.[2] A handful of entrepreneurs decided to create an organization that would represent business everywhere. The first Incoterms were published in 1936 and featured six trade terms. The global status of the ICC is confirmed by ICC becoming a signatory of UN Global Compact in 2003. In 2016, the ICC is granted the "Observer Status" at the United Nations General Assembly.[3] The terminology of the Incoterms were initially guided by the United Nations Convention on Contracts for International Sale of Goods of 11 April 1980.[4]

The main purpose for the introduction of the Incoterms was to create rules on the use of domestic and international trade terms in order to facilitate the conduct of global trade. The Incoterms are updated regularly to align with the development of international trade.[5]

The Incoterms describe the tasks, costs and risks involved in the delivery of goods. However, the Incoterms do not clarify the method of payment of the price to be paid. For the sale of goods there should be an underlying sales or commercial contract expressing the terms in the contract, the consequences of a breach of contract and the law governing the contract.[6]

## 3. Incoterms explained

Each Incoterm rule has a Guidance Note with information which can help when determining which Incoterm rule is the appropriate one for a particular sale of goods. The Incoterms also make clear that parties using the Incoterms should be aware that the interpretation of their contract may be influenced by the customs authorities of country of the port or placed used.[7]

The Incoterms are in practice used by formulating the three-letter trade terms with a specification of the place or port thereafter, following by the version of Incoterms (e.g. EXW (named place of delivery) Incoterms® 2010. The Incoterms can be categorized in two categories based on the mode of transport.

The Incoterms listed below in Table 1 are rules for any mode or modes of transport, including transport by sea and inland waterway transport. This means these trade terms can be used for all contracts, irrespective of which mode of transport is used, and irrespective of one or more modes of transport are used.

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[2] International Chamber of Commerce, Home / About us / Who are we/ History <https://iccwbo.org/about-us/who-we-are/history/>.
[3] International Chamber of Commerce, Home / About us / Who are we/ History <https://iccwbo.org/about-us/who-we-are/history/>.
[4] Electrosteel Europe sa v Edil Centro SpA C-87/10, Opinion of Advocate General J. Kokott, 3 March 2011, 7.
[5] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 4.
[6] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 6.
[7] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 4.

*Table 1*

| Three-letter trade term | Definition |
|---|---|
| EXW | EX WORKS |
| FCA | FREE CARRIER |
| CPT | CARRIAGE PAID TO |
| CIP | CARRIAGE AND INSURANCE PAID TO |
| DAT | DELIVERED AT TERMINAL |
| DAP | DELIVERED AT PLACE |
| DDP | DELIVERED DUTY PAID |

In Table 2 below, the Incoterms for sales of goods which are transported by sea and inland waterway transport are listed. For these Incoterms, a port is stated after the three-letter trade term as destination. Transport by means of sea and inland waterway transport is also possible under the Incoterms listed in Table 1.

*Table 2*

| Three-letter trade term | Definition |
|---|---|
| FAS | FREE ALONGSIDE SHIP |
| FOB | FREE ON BOARD |
| CFR | COST AND FREIGHT |
| CIF | COST INSURANCE AND FREIGHT |

## 3.1. Detailed description of each Incoterms rule

Each Incoterms rule has a Guidance Notes in which the Incoterms are further explained in more detail to ensure the accurate and efficient use of the Incoterms for the appropriate transaction. Each Incoterm is followed by a location. Up to this location, the goods must be delivered according to conditions of the used Incoterm.

### 3.1.1. EXW – Ex Works

Ex Works is the Incoterms rule with minimum obligations for the seller. Ex Works means the seller has fulfilled its delivery obligations when the goods are placed at the disposal of the buyer, at the seller's premises or at another named place. The other named place is then indicated by "EXW *named place"* Incoterms. The buyer bears all costs and risks from the point of the place of delivery, including loading.

The seller provides the goods, including the commercial contract in conformity with the sales contract. There are no further loading or customs clearance obligations for the seller but where applicable, the seller must provide the buyer, at the buyers request, risk and expense, assistance in obtaining any export licence, or other official authorization necessary for the export of goods. Where applicable, the seller must provide, at the buyer's request, risk and expense, any information in the possession of the seller required for the security clearance of

the goods. Where applicable, the buyer should obtain a customs licence or any other official authorization and carry out all customs formalities for the export of goods.[8]

If the seller does perform any activities relating to the unloading or customs clearance of the goods, this is for the risk and expense of the buyer. However, EXW does not bind the seller to perform these activities even though the seller might be in a better position to do so.

### 3.1.2. FCA – Free carrier

According to FCA, the seller has completed its delivery obligation when the goods are delivered to the carrier or another party named by the buyer at the seller's premises or another named place. The other named place is then indicated by "FCA *named place"* Incoterms*.* The seller clears the goods for export, where applicable. The seller has no obligation to perform actions related to the import formalities.

The seller provides the goods, including the commercial contract in conformity with the sales contract. The seller has the obligation to carry out the customs formalities, (i.e. obtaining an export license or other official authorizations for export purposes) for the export of goods, where applicable. These activities are performed at risk and expense of the seller. The seller must provide the buyer with necessary information related to the insurance and security clearance of the goods.[9]

If the seller and buyer agree that the seller does contract the carriage or insurance, this is at risk and expense of the buyer.

FCA might seem similar to FOB in terms of liability and risks but the difference is the moment the risk and liability shifts from the seller to the buyer. According to FCA, the risks and liabilities pass from the seller to the buyer once the goods are loaded onto the carrier appointed by the buyer. This moment could be prior to loading the vessel, which is the requirement and the point of the transfer under FOB.

### 3.1.3. CPT – Carriage paid to

Following CPT, the seller has completed its delivery obligation when the goods are delivered to the carrier or another party nominated by the seller at an agreed place. The delivery obligations are similar to FCA, however, the seller concludes the contract of carriage and bears the risks and costs of carriage for the transport to the agreed place. The seller has fulfilled its delivery obligations when the goods are handed over to the carrier. Upon request of the buyer or when customary, the seller provides the buyer with the transport documents.

The seller provides the goods, including the commercial contract in conformity with the sales contract. CPT requires the seller to fulfil the export formalities, where applicable. This also applies to possible countries which are passed through prior to delivery at the destination. In case of mandated inspection by the authorities of the country of export, the seller pays the costs of such inspection. The costs of any other mandatory pre-shipment inspections are paid by the buyer. The seller does not fulfil any import formalities prior to delivery at the destination.

[8] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 15-21.
[9] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 23-31.

The seller does provide information necessary for import formalities, including security related information, upon request of the buyer, at risk and expense of the buyer.[10]

### 3.1.4. CIP – Carriage and insurance paid to

Following CIP, the seller has completed its delivery obligation when the goods are delivered to the carrier or another party nominated by the seller at an agreed place. The seller bears the risks and costs of carriage for the transport to the named place of destination. The seller has fulfilled its delivery obligations when the goods are handed over to the carrier. The seller also contracts for insurance coverage for possible loss or damage to the goods during the carriage. The insurance may cover transport by means of one or more modes of transport. The insurance obligation is fulfilled when minimum insurance coverage is provided. In case the buyer requires additional cover, this is for expense of the buyer. The insurance covers the goods from the point of delivery, when the goods are handed over to the carrier, to at least the named place of destination. The seller provides the buyer with the insurance policy.

The seller provides the goods, including the commercial contract in conformity with the sales contract. The seller is required to clear the goods for export, where applicable, including all costs of customs formalities, all duties, taxes and other charges payable. This also applies to possible countries which are passed through prior to delivery at the destination.
The seller is not obliged to clear the goods for import, pay import duties or carry out import customs formalities, this is the responsibility of the buyer. The seller does provide information necessary for import formalities, including security related information, upon request of the buyer, at risk and expense of the buyer.[11]

### 3.1.5. DAT – Delivered at terminal

The seller fulfils its delivery obligations when the goods are unloaded from the means of transport and are placed at the disposal of the buyer at the named terminal at the named port of place of destination. The seller bears all risks involved in transporting the goods and unloading them at the terminal. The seller provides the goods, including the commercial contract in conformity with the sales contract.

The seller is required to clear the goods for export, where applicable. The seller provides the goods, including the commercial contract in conformity with the sales contract. The seller is required to clear the goods for export, where applicable, including all costs of customs formalities, all duties, taxes and other charges payable. The seller is not obliged to clear the goods for import, pay import duties or carry out import customs formalities, this is the responsibility of the buyer. The seller does provide information, or render assistance, necessary for import formalities, including security related information, upon request of the buyer, at risk and expense of the buyer.[12]

### 3.1.6. DAP - Delivered at place

Following DAP, the seller delivers when the goods are placed at the disposal of the buyer on the arriving means of transport and ready for unloading at the named place of destination. The seller bears the risks involved in bringing the goods to the named place. If any costs are

[10] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 33-39.
[11] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 41-51.
[12] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 53-59.

incurred by the seller with respect to unloading of the goods, these costs cannot be recovered from the buyer. The supplier is responsible for the carriage, but has no obligation to arrange any insurance coverage.

The seller provides the goods, including the commercial contract in conformity with the sales contract. The seller is required to clear the goods for export, where applicable, including all costs of customs formalities, all duties, taxes and other charges payable. The seller is not obliged to clear the goods for import, pay import duties or carry out import customs formalities, this is the responsibility of the buyer. The seller does provide information, or render assistance, necessary for import formalities, including security related information, upon request of the buyer, at risk and expense of the buyer.[13]

The buyer is responsible for all costs relating to taking delivery of the goods, including unloading from the means of transportation.

### 3.1.7. DDP – Delivery duty paid

The seller fulfils its delivery obligations when the goods are placed at disposal of the buyer, cleared for import on the arriving means of transport and ready for unloading at the named place of destination. The seller provides the goods, including the commercial contract in conformity with the sales contract. The seller bears all costs and risks related to the transport and customs clearance of the goods, including export and import formalities. This Incoterms rule represents the maximum obligation for account of the seller. In principle, any VAT or other taxes related to the import of the goods are for the seller's account, unless expressly agreed otherwise.[14]

### 3.1.8. FAS – Free alongside ship

The seller has fulfilled its delivery obligations when the goods are placed alongside the vessel nominated by the buyer at the named port of shipment. The risks and costs of the goods are transferred from the seller to the buyer when the goods are passed alongside the ship. The seller provides the goods, including the commercial contract in conformity with the sales contract.

According to FAS, the seller clears the goods for export, where applicable. The seller is not obliged to clear the goods for import, pay import duties or carry out import customs formalities, this is the responsibility of the buyer.

The seller provides the goods, including the commercial contract in conformity with the sales contract.[15]

### 3.1.9. FOB – Free on board

The seller fulfils its delivery obligations when the goods are placed/loaded on board the ship nominated by the buyer at the named port. The risk passes from the seller to the buyer from the moment the goods are on board as soon as they pass the railing of the vessel. The seller

[13] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 61-67.
[14] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 69-75.
[15] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 79-85.

is required to clear the goods for export, where applicable. The seller is not obliged to fulfil any import formalities.

The seller provides the goods, including the commercial contract in conformity with the sales contract.[16]

FOB might seem similar to FCA in terms of liability and risks but the difference is the moment the risk and liability shifts from the seller to the buyer. According to FOB, the risks and liabilities pass from the seller to the buyer once the goods are on board of the vessel. Under FCA, this moment of transfer of risks and liabilities might be prior to loading the vessel.

### 3.1.10. CFR – Cost and freight

The seller delivers the goods on board of the vessel. The risk passes from the seller to the buyer from the moment the goods are on board of the vessel. The sellers pays the costs and freight for bringing the goods to the named port of destination. The seller had no obligation to the buyer to conclude a contract of insurance. This means that according to this rule, the risk and the costs pass at different points. The seller is required to clear the goods for export, where applicable. The seller is not obliged to fulfil any import formalities.

The seller provides the goods, including the commercial contract in conformity with the sales contract. The seller must provide the buyer with the usual transport document for the agreed port of destination at his own expense. [17]

### 3.1.11. CIF – Cost insurance freight

The seller delivers the goods on board of the vessel. The sellers pays the costs and freight for bringing the goods to the named port of destination. The seller also has the obligation to the buyer to conclude a contract of insurance based on minimum coverage. The insurance coverage by the seller is initially limited to marine policy norms. If the buyer requests more insurance coverage, this should expressly be agreed upon or make its own extra insurance arrangements. This means that according to this rule, the risk and the costs pass at different points. The seller is required to clear the goods for export, where applicable. The seller is not obliged to fulfil any import formalities.

The seller provides the goods, including the commercial contract in conformity with the sales contract. The seller must provide the buyer with the usual transport document for the agreed port of destination at his own expense.[18]

The Incoterm CIF might appear to be similar to CIP, however there is a difference between the two. Following CIP, the seller has the obligation to deliver the goods to an agreed place. The delivery obligations have been fulfilled when the goods are handed over to the carrier. According to CIF, however, the obligations have been fulfilled once the goods are on board of the vessel. The moment of delivery under CIP could therefore be prior to loading the goods on board of the vessel.

[16] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 87-93.
[17] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 95-103.
[18] International Chamber of Commerce, *ICC rules for the use of domestic and international trade terms* (International Chamber of Commerce 2010) p. 105-117.

# 4. Discrepancy between Incoterms and Customs

From a customs perspective, when goods are brought into the EU they are subject to the obligations as laid down in EU customs law, such obligations include fulfilling customs formalities and providing the correct information to customs. The responsibility for customs obligations and therefore the responsibility/liability following a sales transaction can be divided between the supplier (seller) and the customer (buyer) in that transaction. Incoterms can provide clarity on the allocation of customs obligations between the supplier and the customer and thus affect the division of customs implications.

The Incoterms have been drafted in order to facilitate trade. In practice, the Incoterms are used as delivery terms for sales contracts. These contracts are often concluded by the business as part of the negotiation stage of the contract. As the Incoterms also mention customs formalities, it seems logic that indirect tax teams would also be involved in such negotiations. However, in practice it is often seen that when a sales contract is concluded, no attention is paid to the customs obligations and whether these can be fulfilled by the seller or buyer. In my opinion, the total package of customs obligations for import to be considered are: to comply with customs rules and regulations, to provide the customs authorities with all necessary import documentation, the payment of customs duties, ensuring the correctness of the documents filed with the customs authorities for clearance of goods, to confirm that the imported products are properly marked, to ensure that import control are in place, to effectively manage the import process, to increase awareness of customs law and regulations throughout the supply chain and to build cooperative relationships that strengthen overall supply chain, border security and third parties providing services for the company.

## 4.1. Establishment of the buyer

In order to file an export declaration in the EU one must be established in the EU.[19] Some Member States can make an exception and also allow companies which are not established in the EU to act as a representative, as long as they fulfil the requirements set out in article 39 under (a-c) UCC (i.e. the AEO-criteria).[20] Any company may appoint a customs representative, who is established in the EU. There are two types of representation; direct representation[21] and indirect representation[22]. A direct representative acts in name of and on behalf of another person, while an indirect representative acts in its own name but on behalf of the person it's representing.[23] The declarant as well as the person on whose behalf the customs declaration is made are considered to be debtors.[24] In the Netherlands it was only possible to use an indirect representative for export. However, with the introduction of the customs declaration system, AGS, indirect representation also became possible for the import of goods.[25] This means a company established in a third country is still able to lodge customs declaration by using indirect representation or by fulfilling the AEO-criteria and the additional conditions of a Member State to act as a representative himself.[26]

[19] Article 1, paragraph 19(a) UCC.
[20] Article 18, paragraph 4 UCC.
[21] Article 18, paragraph 1 UCC.
[22] Article 18, paragraph 1 UCC.
[23] Article 18, paragraph 1 UCC.
[24] Article 77, paragraph 3 UCC.
[25] M. Chin-Oldenziel, Cursus Belastingrecht (EBR. 6.2.2. Wolter Kluwer, 2016) 23.
[26] Article 18, paragraph 3 and 4 UCC.

Some Incoterms are not possible to be executed in all scenarios from a customs perspective. The most straight forward example is Incoterms rule EXW, which imposes a minimum obligation on account of the seller, in the outbound scenario. As stated in paragraph 3.1.1, all costs and risks are transferred from the seller to the buyer when the goods are made available by the seller at the seller's premises or another named place. The buyer is responsible for all customs formalities. During the stage of concluding the contract, the parties ought to check whether the buyer is established in the EU or not. In case the buyer is not established in the EU, the buyer must be aware and willing to accept the additional risk following indirect representation. The buyer needs the assistance of a customs broker who will act in its own name but on behalf of the buyer. The buyer will have to rely on the customs broker for the correct completion of the customs declaration (i.e. correct commodity codes, correct customs value, correct Incoterm and correct origin). In some cases, the seller might even lodge the customs declaration on behalf of the buyer while the additional risk following this act has not been included in the negotiation of the contract. In that case, the seller would also become debtor as declarant of the customs declaration. Furthermore, in almost all cases, the exporter of goods must also be located in the country of export. This requirement has been introduced in order to be able to prosecute following any fraudulent activities related to the export.[27] This requirement from an indirect tax perspective, which comes with the use of certain Incoterms, is commonly unknown within the sales and/or purchasing departments concluding the sales contracts, including to which Incoterm this might be applicable.

For Incoterms in which the buyer is required to fulfil the customs formalities, EU companies are advised to consult local customs and VAT legislation for further local indirect tax implications.

## 4.2. Implications from a customs perspective: impractical implications FCA outbound

Incoterms rule, FCA, has debatable consequences for customs purposes due to the use of the wording "where applicable". As this could either mean that customs formalities are to be carried out in case of transactions between customs unions, or in case the seller arranges the carriage outside the customs union. The conflict between both option is that one option is most in line with customs practice and the other option is would mean a same interpretation of the wording "where applicable" as with the other Incoterms. It should be noted that the Incoterms clearly state that the obligation to comply with export/import formalities only exists "where applicable". This reference is made in the same manner throughout the Guidance Notes.

#### 4.2.2.1. "Where applicable"

As mentioned in paragraph 3.1.2, it is the obligation of the seller to, where applicable, obtain at its own risk and expense, any export license or other official authorization and carry out all customs formalities necessary for the export of the goods.[28] As a result one could argue that the term "where applicable" refers to the type of agreement the seller and buyer have made. The Guidance Notes of FCA state: "The seller has no obligation to the buyer to make a contract of carriage. However, if requested by the buyer or if it is commercial practice and the buyer does not give an instruction to the contrary in due time, the seller may contract for carriage on usual terms at the buyer's risk and expense." Taking the before mentioned into account, one could argue that the term "where applicable" is applicable to cases in which the seller has

[27] K. van Heusden, 10 criteria voor een juiste keuze – Deel 2, p.1.
[28] International Chamber of Commerce, *ICC rules for the use of domestic and international trade,* p. 24.

contracted for such carriage. This would be in line with the obligations to fulfil customs export formalities. However, this interpretation only fits this specific Incoterms rule and would therefore not be in line with a consistent application for all Incoterms. This point of view is supported by the comparison of the term “where applicable” for the Incoterms rule DDP. Following DDP, the contract of carriage to the destination and the customs formalities are always for account of the seller. The addition of the term “where applicable” would therefore have no relevance. While it would still have relevance according to the interpretation that the term “where applicable” means that this obligations is valid when goods are subject to international sales where import and/or export formalities are required. Therefore, the use of the term “where applicable” can be explained by the fact that it is possible to use the terms for both, domestic and international sales.[29]

#### 4.2.2.2. Impractical implication FCA outbound

Having concluded on the interpretation of “where applicable”, there appears to be a misalignment between the Incoterms and customs in practice is the following outbound situation. The Incoterms rule, FCA, which indicates the delivery of the goods is fulfilled by the seller at an earlier stage while the seller still is responsible for the export formalities. The carrier of the main carriage is nominated by the seller. This is quite strange as the seller does not have power over the goods from the moment the goods have been handed over to a carrier. This scenario implicates that the main carriage is arranged by the buyer, while the seller has the responsibility to declare the goods at the customs office of exit and load the goods on board the vessel. This is another indication of a process that has been considered from a commercial trade perspective but which has difficulties or additional risks from a customs perspective. As FCA would implicate the additional risk of the moment after handing the goods to the carrier which has been appointed by the buyer and the moment the goods are actually exported. Therefore, the seller does not control the goods while he still is the one to declare these goods at the customs office of exit.

## 4.3. Additional costs and risks CPT outbound

Another example of an impracticality to which attention should be paid are the Incoterms for outbound situations. For Incoterms CPT, DAT, DAP, the seller is required to fulfil the export formalities and the expenses of contract of carriage to the named destination are also for account of the seller. This means the seller, in practice, is responsible for the entry summary declaration of the goods in the country of arrival, if applicable. When concluding this Incoterms rule the seller must be aware that for some countries, depending on local legislation, a customs representative is required to be able to submit the summary entry declaration. The customs formalities for import, however, are for risk and expense of the buyer. Therefore the customs representative is only required to perform the entry summary declaration.

## 4.4. DDP and representation

Incoterm rule DDP has two sides, while it is a favourable Incoterm for the buyer of the goods, it could possibly be a more complicated Incoterm for the seller of the goods. From the perspective of the buyer of the goods, DDP is the ideal Incoterm as the goods will be delivered at the final destination and all risks and costs of the transport and customs formalities have been covered by the seller. However, for the seller these conditions might pose some

[29] International Chamber of Commerce, *ICC rules for the use of domestic and international trade,* p. 8.

challenges. The seller cannot always fulfil these conditions and/or will not always be able to foresee the implications.

The seller has to be able to fulfil the customs formalities or when the seller is unable to fulfil the customs formalities himself, someone will have to fulfil them for him. The seller also has to consider that he needs to have knowledge of the classification rules of the European Union in order to complete the customs declaration and to find out the customs tariff of the goods. If the seller is located in a non-Union country, indirect representation is the only form of representation which is possible. The seller will need the assistance of a customs broker to fulfil the customs formalities. This third party can either lodge the customs declaration in its own name or based on indirect representation, thus in its own name but on behalf of the supplier. The declarant as well as the person on whose behalf the customs declaration is made are considered to be debtors.[30] One should therefore also consider that the third party subsequently (also) becomes a debtor.

# 5. Implication of Incoterms for VAT

From a VAT perspective, a supply of goods is the transfer of the right to dispose of a good as an owner. In order to determine the correct VAT treatment of a transaction, it is important to first determine when a supply of goods takes place. Subsequently, the place of supply of the goods should be determined, in accordance with the rules included in the EU VAT Directive and local VAT legislation.

When goods are imported into the EU and are brought into free circulation, VAT duties become due. The Incoterms can in case of chain transactions indicate in which part of the chain transactions the supply of goods takes place and which supplier has the possibility to apply the 0% tariff.[31]

The main starting point when import VAT becomes relevant is when a customs declaration is filed. Therefore, for VAT purposes it is relevant who will fulfil the customs formalities. Furthermore, the location of the act is relevant, which could for example be import or triangular traffic or whether exemptions are applicable, such as export or intracommunity supplies.

## 5.1. Place of taxable transactions

For the import of goods, the place where the goods are brought into free circulation determines where import VAT is levied.[32] The next question in this case is, on whose behalf are the goods imported. If the incoterm EXW is applicable, the buyer fulfils the customs formalities and carries the risk. The buyer is responsible for import duties and import VAT.

An example is a so-called simplified ABC-supply chain transaction. In this type of supply, person A sells goods to person B and person B subsequently sells the goods to person C. However, the goods are directly supplied from A to C. In the ordinary set-up, person B must register in the country of C to be able to fulfil VAT-declaration formalities for the transport for the delivery between A-B. However, when applying the simplified ABC-scheme, the registration and VAT-declaration are not necessary, once the required conditions are fulfilled. One of these conditions is that person B, who initially is the person who must register in the final country of person C, has arranged the transport of the goods with person A. This condition can easily be proven by the used Incoterm. In this scenario, the use of Incoterm EXW would

[30] Article 77, paragraph 3 UCC.
[31] C. van Vilsteren, Incoterms en btw, Belastingzaken 2011 nummer 3, 25.
[32] Article 23 Wet Omzetbelasting.

not fulfil the condition to apply the simplified ABC-scheme. The Incoterm EXW would imply that person C arranges the transport. This would be part of the relation between B-C while the condition for a simplified ABC-scheme requires the transport to be part of the relation between A-B.

### 5.2. DDP and import VAT

A complicating question is the question who will pay the import VAT of the imported goods. In the Netherlands, the facilities of a fiscal representative and the reverse charge of VAT are often used in practice. A fiscal representative can be appointed in the Netherlands for a taxable person who neither lives in the Netherlands, nor is established in the Netherlands. The fiscal representative will represent the taxable person with respect to supplies and services for which the taxable person owes taxes in relation to intra-community acquisitions and imports. The representative acts on behalf of the taxable person with respect to all rights and obligations related to the VAT declaration and the payment of tax.[33] These facilities allow that no actual VAT is paid by the importer of the goods. However, in case of a non-Union supplier who is to deliver the goods according to DDP, this is difficult to use. The exporter is unable to act as declarant (importer of record) himself, as he is not established in the EU, while the logistic service provider will most likely want to limit its responsibility. In practice, it is more convenient if the import declaration is lodged in name of an importer who is established in the EU and who is able to reverse charge VAT as opposed to the customs broker.

## 6. Issue: Incoterms binding or not?

It appears from the origin of the Incoterms rule that the Incoterms came into existence based on the need within international trade practice. It is the ICC's mission to aim to promote international trade and investment as vehicles for inclusive growth and prosperity. Although the ICC has become a respective global organization with respect to dispute resolutions, supporting global trade and streamlining customs and border procedures and the Incoterms have become globally used trade conditions, Incoterms have not been incorporated into legislation. This would also be against the purpose of the creation of the Incoterms which was to list international, but legally non-binding, rules to interpret the contractual formulae which proved to be used frequently in foreign trade contracts. These standard rules have been created to avoid uncertainties which may arise from different interpretations as much as possible.[34] Incoterms are even included in EU customs declaration forms under "delivery terms".[35] A question that is very much relevant when using trade terms and conditions is whether the Incoterms are legally binding.

### 6.1. Delivery of the goods based on Incoterms

In a court case before the Italian national court, a question was posed with respect to the jurisdiction of a court according to the Incoterm used. In this particular case, goods were delivered EXW (seller's premises Italy) to a carrier who transported the goods to France, where the seller was also established. The main issue in this case was that the purchaser was pursued for payment in Italy. However, the purchaser objected to the jurisdiction of the Italian court as the purchaser was established in France. The seller was of the opinion that the jurisdiction of the Italian court followed from the contractual term, EXW (seller's premises Italy).

[33] Article 33g Wet Omzetbelasting 1968.
[34] Electrosteel Europe SA v Edil Centro SpA C-87/10, Opinion of Advocate General J. Kokott, 3 March 2011, 7.
[35] Annex B-01 DA, Title III.

The question was whether “the place of performance of the obligation” in the case of the sale of goods could be concluded for the used Incoterm. The “the place of performance of the obligation”, in the case of the sale of goods, is the Member State where, under the contract, the goods were delivered or should have been delivered.[36] The ECJ has judged that when the place of delivery must be determined in a contract, “*all the relevant terms and clauses in that contract, including, as the case may be, the terms and clauses generally recognises and applied in international commercial usage, such as Incoterms, in so far as they enable that place to be clearly identified.*”[37] The ECJ continues that it may be necessary to examine whether the terms and clauses are stipulations which merely lay down the conditions relating to the allocation of the risks connected to the carriage of the goods or the division of costs between the contracting parties, or whether the terms and clauses also identify the place of delivery of the goods. In this particular case, the EXW clause did not only entail to the application of the risk and costs but also to the delivery of the goods.[38] This judgement indicates the position of Incoterms in the commercial world of trade. As the rights and obligations are set out very clearly, the Incoterm could even prove the delivery conditions of a contract.

## 6.2. Customs value based on Incoterms

In the following Dutch case[39], which has also been referred to the ECJ, a company has lodged a customs declaration to release the goods for free circulation. The company has claimed preferential origin and has provided invoices which included the DDP clause. It appeared the goods were not from the claimed country and therefore the defendant received a payment notification. The question before the Supreme Court of the Netherlands is whether the customs value for the imported goods needed to be adjusted by deducting the post-clearance duties from the customs value.[40] Under the CCC[41] in this case but also under the UCC, the customs value of imported goods shall be the transaction value, the price actually paid or payable for the goods when sold for export to the customs territory of the Union.[42] The Inspector has argued that the customs duties could not be distinguished from the price paid. The defendant has concluded that the DDP clause entails that the customs duties are for the account of the buyer and have been included in the price of the goods. However, the customs duties are not included in the customs value of the goods. The Dutch Court ruled that the defendant did not prove that the declared customs value included customs duties. The defendant did not provide any other commercial documents which could prove the customs duties were part of the transaction price. The sole argument that the delivery took place in accordance to the DDP clause, was not sufficient to prove the inclusion of the customs duties in the sales price.[43] This indicates that although Incoterms are widely accepted trade terms and the conditions are globally clear, companies still need to include additional clauses in their contracts explicitly stating the implications of the Incoterm.

## 6.3. Incoterms legally binding between parties

As can be concluded from the Dutch court case mentioned in the previous paragraph (6.2), Incoterms can be considered to be an agreement between two parties. However, as the Incoterms are non-binding conditions, the agreed Incoterms must be incorporated into the contract between two parties. As the Incoterms are still quite vague, the contract should specify

[36] Article 5, paragraph 1(b) of Regulation No 44/2001.
[37] Electrosteel Europe SA v Edil Centro SpA C-87/10, 9 June 2011, 22.
[38] Electrosteel Europe SA v Edil Centro SpA C-87/10, 9 June 2011, 23.
[39] ECLI:NL:HR:2011:BP5530, ECLI:NL:HR:2009:BJ5120.
[40] ECLI:NL:HR:2011:BP5530 r.o. 4.1.
[41] Article 29, paragraph 1 CCC.
[42] Article 70, paragraph 1 UCC.
[43] ECLI:NL:HR:2011:BP5530 r.o. 6.2.

the delivery conditions in more details. A main contract is for other reasons crucial, namely as Incoterms only focus on part of the delivery terms. In this contract other elements, which are not included in the Incoterms, are recommended to be included. Such elements are, amongst others, the relation between the carrier and the insurer, the applicable law and which court has jurisdiction, the transfer of rights to dispose the goods as owner, the payment conditions and the guarantees in case of poor delivery or complaints. The fact that in practice Incoterms are always followed in the way prescribed, confirms that the underlying contract is always decisive.

## 7. My conclusion on relevance of Incoterms for customs purposes

Looking at the main purpose and aim of the initial drawing of the Incoterms, I think the introduction of Incoterms have been a successful initiative which has grown and developed so much over the years. As mentioned in the introduction, the relevance on the (inter)national trade world is immense. The Incoterms have not been designed from a solely customs perspective but from a larger picture including all costs and risks. Therefore, the customs implication of each Incoterm have not been leading in drafting the Incoterms resulting in a mere minimum description of the Incoterms rule.

My opinion has two sides. On the hand I understand why the Incoterms remain quite vague, as it would be less applicable if the terms would have been set in more detail. However, as countries have different customs and VAT legislation this might prove to be difficult in practice. This would probably have the consequence that the terms would become too complicated and there would be too many, which would have the most probable result that the Incoterms would be used less. However, as some elements, as described in this thesis are not clear or logic (at least from a customs and VAT perspective) I would suggest the wording of “Incoterms guidance terms” instead of “Incoterms conditions”. The reason for this is that some conditions cannot be completed in some scenarios, in the way they have currently been described. I do find it interesting how European courts have different opinions on Incoterms and value them differently depending on the issue at stake. For now, it would be safe to say that Incoterms mainly focus on the delivery of the goods. For all other matters, including customs and VAT provisions and to have a legally enforceable contract, a proper sales contract must be concluded.

## 8. Practical solutions in the meantime

The Incoterms are widely used around the world and have even become part of the customs procedures in many countries. Although, the Incoterms are frequently updated in new versions, it would be very unlikely if the Incoterms would be altered in order to facilitate the customs aspects more. Even if it would be possible that the Guidance Notes will include more details with respect to the customs formalities and aspects following the Incoterms, this would be a difficult task as legislation of different countries is to be consulted in order to have a complete Guidance Note.

There are practical options the business can incorporate in order to be aware of all the risks and costs involved at all times and to remain in control. The awareness and sense of responsibility with respect to the customs activities of a company is increasingly growing. An example of this so-called horizontal supervision is the increasing significance of being an Authorized Economic Operator[44]. The main essence is that companies raise awareness of the Incoterms within the company, especially within the departments which come across them on

[44] Article 38 UCC.

a daily basis. Such departments may be sales, customer services and supply chain departments.

## 8.1. Instruct the business of use Incoterms

In addition to raising awareness, the indirect tax team can also instruct the team negotiating sales and purchase contract which Incoterms to use. This instruction depends on whether the company is established in the customs territory of the Union or not, whether a fiscal representative has been appointed or not and the agreements with their logistic service provider or customs broker.

The Indirect tax team may provide certain Incoterms which the company uses or certain Incoterms which the company does not use due to the customs and/or VAT complications.

### 8.1.1. Preference of Incoterms

No Incoterm is completely perfect in general. The perfect fit for the use of certain Incoterms depends on the use of company. DDP would be a convenient Incoterm for a company who does not have the resources and/or knowledge to oversee the correct completion of the customs formalities and the administrative burden thereof. However, contracts including DDP will most likely have the additional services and work following the completion of the customs formalities, including the risk, included in the calculation of their total price. Therefore, the company has to choose for the option of completely keeping a distance from all customs formalities but having to pay for these services at the same time.

While the Incoterms according to which the buying company is responsible for the customs clearance in the EU himself, the company must have the resources and knowledge to do so himself. If the company has no knowledge and uses the services of a customs broker, the company must still provide instructions to customs broker. As the customs broker needs information of the company with respect to the goods imported in order to file a customs declaration.

## 8.2. Manage Incoterms use by customs broker

Companies can safeguard the use of Incoterms by taking these into consideration when signing new Service Level Agreements (SLA) with their customs broker. In these agreements, companies can include provisions with respect to which Incoterms is used and what duties and obligations are to be performed by the customs broker and which are not included in the services of the customs broker. Furthermore, depending on the used Incoterms, the SLA could also include specific agreements with respect to the role of the customs broker in case of representation.

It sometimes occurs that the contract prescribes the customs broker to fulfil customs formalities including the payment of customs duties. However, in practice, it occurs that the customs broker will not actually pay the customs duties himself. Only after receiving payment by the receiving company the customs broker will proceed with his duties. As this practice does not correspond with their agreement, companies should clearly anticipate on such incidents in their SLA. One could conclude that Incoterms are often not followed in practice. However, for the sake of ones control over its business, it is important that specific Incoterms are chosen or are specifically not used and that customs brokers follow the agreement in order to be as compliant as possible.

## 8.3. Use of data analytics to check current use of Incoterms

In practice many companies do not exactly know which Incoterms are used within their company. This is often the result of many different departments purchasing and selling different types of goods for different purposes. However, with the growing significance of horizontal supervision with the introduction of AEO companies ought to have control over their internal procedures. One element is the use of Incoterms within the company, as this provides insight in the obligations of the company from a customs perspective. A company's compliance depends on the Incoterms used.

By using data analytics a company can efficiently gain insight in the customs declarations filed by or on behalf of the company. Data analytics is a method of using a programming to automatically analyse the data input. Depending on the programming different analysis are carried out. An example of the relevant data that could be relevant for these analysis are customs declarations that have been lodged. The results of the analysis indicate which Incoterms have been used by the company for its customs declarations. It could occur that different Incoterms have been used than was agreed upon. By using data analytics this can be detected, this can be solved, this can be checked next time and thus be possibly be avoided next time. If a company uses the services of a customs broker, the company is also able to check whether the data of the customs declaration corresponds with their own data (e.g. commodity codes, customs value, origin). These results can also help indicate risks with respect to the use of certain customs broker or could indicate improvement is required in the communication between the customs broker and the company. A company will be able to anticipate on the existing problems and could implement this in future procedures to avoid similar incidents in the future.

# 9. Conclusion

The large scope of Incoterms globally has been confirmed in my research. Although it appears the Incoterms are still "owned" by the ICC as there are little other sources which provided a detailed description or interpretation. There indeed are impractical implications from a customs and VAT perspective. It can be concluded that most of these impracticalities see to the two most extreme Incoterms clauses, EXW and DDP. The main problem with these Incoterms is the obstacle of lodging import or export declarations and the impossibility to do so in some scenarios. The other complications are mainly related to the risks that are not mentioned or become clear from the Guidance Notes. For example risks that transfer from the seller to the buyer but not at logical moment with respect to the risk. It is important to remember that the person lodging the customs declaration also becomes debtor of the possible customs debt, even if the customs declaration was lodged on behalf of someone else. As it is too complicated to have the Guidance Notes adjusted to align with the Indirect tax perspective (of different countries and legislation), companies should have detailed contracts in which all risks are covered. When choosing which Incoterm applies in a contract, one must well consider the legal, customs and VAT standpoint. The fact that there is little case law available with respect to the legal security of Incoterms confirms the legal loophole of Incoterms.

The chosen Incoterm must also be in accordance with the actual situation. This might seem difficult to check but by using data analytics the use of Incoterms can be verified. Also, if companies do have to rely on customs brokers due to the impracticalities described in this thesis, data analytics can provide insight in the entire customs compliance process. Concluding, Incoterms pose impracticalities from a customs perspective but these can be covered by contracts, SLAs and by paying attention to what is actually happening in practice.

One should carefully consider the used Incoterms for each specific company and its resources and knowledge.

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