

International Chamber of Commerce launches Incoterms® 2020: Global Trade, Indirect Tax, Legal, OME and IT consequences

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Executive summary

Incoterms® (International Commercial Terms) rules (the Incoterms®) are internationally accepted standards which define the responsibilities of sellers and buyers for the delivery of goods under sales contracts. The Incoterms® are defined by the International Chamber of Commerce (ICC) and facilitate trillions of euros in global trade each year.

On 10 September 2019, the ICC published the latest edition of the Incoterms® which will enter into force on 1 January 2020. The Incoterms® 2020 updates the Incoterms® 2010 and intends to clearly and accurately reflect present-day trade practices.

The commercial terms set by the Incoterms® are interpretive sources for properly and fairly sharing the costs and the risks arising from the delivery of the goods. The manner in which the costs and risks are being divided between trade partners, are leads and in some cases decisive criteria to determine the customs and indirect trade treatment of the delivery of goods.

This Global Tax Alert summarizes the modification to the Incoterms® and provides an overview of the Global Trade & Customs, Indirect Tax, Legal, Operational Model and Effectiveness (OME) and Information Technology (IT) consequences which arise from the launch of the Incoterms® 2020.

Detailed discussion

Launch of the Incoterms® 2020 - What's new?

The Incoterms® 2020 introduces new terms and removes and modifies existing terms.¹ The main changes to the Incoterms® are (for more detail see the legal section of this Alert):

- ▶ Additional option to issue bills of lading with an on-board notation while applying the FCA Incoterm®
- ▶ Different levels of insurance cover in CIF and CIP
- ▶ Arranging for carriage with seller's or buyer's own means of transport in FCA, DAP, DPU and DDP
- ▶ Change in the three-letter initials for DAT to DPU
- ▶ Inclusion of security-related requirements within carriage obligations and costs

The main distinction introduced in the Incoterms® 2010, that between Rules for any Mode or Modes of Transport (comprising EXW, FCA, CPT, CIP, DAP, the newly named DPU—the old DAT—and DDP), and Rules for Sea and Inland Waterway Transport, (comprising FAS, FOB, CFR and CIF) has been retained under the Incoterms® 2020.

Global Trade & Customs

From a customs perspective, the commercial terms set by the Incoterms® applied in a cross-border transaction, are used to determine whether the seller or the buyer is responsible for the export and import formalities. It also depends on the applied Incoterm® as to who will borne the import duties and cost of transport, insurance and related charges. Therefore, the applied Incoterm® in a cross-border transaction may also play a role in determining the customs value of imported goods. Depending on whether CIF or FOB arrangements are in place in the country of importation, respectively the cost of transport, insurance and related charges up to the place of importation should or should not be part of the customs value. Costs incurred after importation (e.g., import duties and transport, insurance and related charges) are never part of the customs value.

Except for the EXW and DDP Incoterms® 2020, the seller is responsible for the export formalities whereas the buyer should take care of the import formalities. Typically, companies using EXW and DDP Incoterms® experience challenges with respect to fulfilling customs formalities as follows:

- ▶ Under the EXW Incoterm®, the buyer is responsible for both the export and the import formalities. The buyer can, however, experience challenges while fulfilling his export formalities, especially if the buyer is a non-established company. According to the definition of exporter under the European Union (EU)'s customs legislation, for example, the exporter should be established in the customs territory of the EU which is often not the case for the buyer. That is typically why the Explanatory Notes to the Incoterms® 2020 with respect to EXW emphasize that FCA is more appropriate if the buyer intends to export the goods.
- ▶ According to the DDP Incoterm® rule, the seller is held to fulfill both the export and import formalities. The seller might be unable to do so in the importing country, especially if the seller is considered a non-established company in that country. To avoid the seller having to fulfil the import formalities and make sure that the place of delivery remains the place of destination, the contracting parties may opt for DAP.

Especially in these times of trade tensions, the introduction of the Incoterms® 2020 provides for the opportunity to carefully assess the Incoterms® being applied in a company's supply chain and evaluate who is responsible and liable to fulfil customs formalities and at the same time prevent over or undervaluation of the imported goods.

Indirect Tax

From a Value Added Tax (VAT) perspective, Incoterms® are very commonly used in cross-border commercial transactions and set out the responsibilities of buyers and sellers for the supply of goods under a contract. The revised Incoterms aim to provide further clarity on the tasks and costs involved in the delivery of the goods from the sellers to the buyers in a cross-border scenario. At this point, the following actions play a significant role in streamlining transactional flows and costs from a VAT perspective:

- ▶ Incorporate Incoterms® 2020 unambiguously into the contractual terms between buyer and seller by specifying the clear intention of seller and buyer.
- ▶ Analyze use of the appropriate Incoterm® to set the responsibility of transport to the identified party in a cross-border EU chain transaction.
- ▶ Eliminate inconsistencies in the contractual flow of goods and actual flow of goods.

- ▶ Review revised Incoterms® to identify potential triggers for a VAT registration or de-registration in the destination/origin country (e.g., use of FCA/DAP instead of EXW/DDP for international deliveries).
- ▶ Revisit cost discussions with the necessary parties in a transaction to identify responsibility for costs relating to transport, packaging and loading/unloading (e.g., use of FCA for international deliveries from 2020 triggers additional costs for seller).

Incoterms® 2020 are aimed at bringing stability and consistency for companies dealing in cross-border trade, both within and outside the EU. That said, this would be a suitable time to assess whether the revised Incoterms® 2020 triggers additional VAT (de) registrations and compliance costs for the business.

Legal

Incoterms® 2020 shall apply as from 1 January 2020. Users can still use Incoterms® 2010 (or earlier versions), however the new Incoterms® 2020 rules are more tailored to current market practice and can therefore be more useful to the business. However, it is necessary to be unambiguous in which version of the Incoterms® is being used (i.e., include the year of the version used after "Incoterms®").

The most important changes to the Incoterms® are:

- ▶ FCA (Free Carrier): the new rule now provides for an additional option, namely that the parties can agree that the buyer must instruct the carrier to issue to the seller, at the buyer's cost and risk, a transport document stating that the goods have been loaded if this is agreed, the seller is obligated to provide such transaction document to buyer.
- ▶ Different levels of insurance cover in CIF and CIP by default: in the Incoterms® 2010, CIF and CIP had a standard minimum level of insurance, if not agreed otherwise by the parties; for CIF and CIP a different minimum insurance cover applies under the Incoterms® 2020. Users of these terms should verify their insurance arrangements are (still) appropriate.
- ▶ DAT has been changed to DPU: DAT (Delivery at Terminal) is renamed to DPU (Delivery at Place Unloaded) to emphasize that the place of destination could be any place and not only a terminal; if the place to deliver the goods is not a terminal, the seller must make sure that the place where it intends to deliver the goods is a place where it is able to unload the goods.

- ▶ Arranging for carriage by means of own transport under the FCA, DAP, DPU (former DAT) and DDP rules now explicitly included; the Incoterms® 2010 assumed that a third-party carrier would carry the goods, however, in practice a buyer or seller would also arrange the transport by its own means; this practice has now been reflected in these rules.
- ▶ A further (and clearer) allocation of security-related requirements has been included in each Incoterm rule, the Incoterms® also set out costs incurred more clearly; parties should verify whether this in line with their arrangements.
- ▶ Clearer listing of costs: All costs related to the relevant Incoterms® are now listed under A9/B9 "Allocation of costs" to provide for a one-stop list of costs.

Operational Model and Effectiveness (OME)

Operating models of global businesses include transactions between multiple parties. Incoterms® plays a critical role in identifying and allocating the obligations, risk and costs in such transactions. This could ultimately support the justification behind operating margin and tax liabilities of the parties. Some of the key elements of operating model design and interplay with Incoterms® are:

- ▶ Alignment of functional and risk profile of the parties with the Incoterms
- ▶ Relationship between "title transfer" and "delivery" as per the Incoterms®
- ▶ Use of same or different Incoterms® and place of delivery in a series of chain transactions to reflect risk and responsibility owned by the parties
- ▶ Timing of document creation and its relationship with the "delivery" as per the Incoterms®
- ▶ Allocation and recharge of cost between the parties
- ▶ Alignment of invoice value with the Incoterms® to confirm which costs are already included in the invoice price

The Incoterms® 2020 provides an opportunity to review, validate and update the Incoterms® currently used across the business.

IT

ERP-supported processes are key for smooth execution of the transactional flows. Often Incoterms® are not aligned with the functional reality of the transactional flows. Interplay of tax, supply chain and the functional profile of the stakeholders should be correctly reflected and captured by the IT set-up. Some points of consideration are:

- ▶ Alignment of Incoterms® 2020 with the transaction flows
- ▶ Incoterms® 2020 gives a chance to revisit the Incoterms used and revise the system for obsolete or non-existing Incoterms
- ▶ The potential impact of Incoterms® on tax code determination
- ▶ Incoterms® alignment for statistical reporting in the EU (Intrastat)

Endnote

1. List of Incoterms® 2020 (alpha order):
 - ▶ CFR | Cost and Freight
 - ▶ CIF | Cost Insurance and Freight
 - ▶ CIP | Carriage and Insurance Paid To
 - ▶ CPT | Carriage Paid To
 - ▶ DAP | Delivered at Place
 - ▶ DDP | Delivered Duty Paid
 - ▶ DPU | Delivered at Place Unloaded
 - ▶ EXW | Ex Works
 - ▶ FAS | Free Alongside Ship
 - ▶ FCA | Free Carrier
 - ▶ FOB | Free On Board

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