



Bulletin

Bulletin No. PC 3
File: Purchasing

FOB Terms

DEFINITIONS

Who assumes risk, claims, control, and taxes? The shipping terms delineated in your purchase order set the rules. Make yourself aware of the advantages and disadvantages of the various shipping methods and terms available. The Uniform Commercial Code, Section 2-319, establishes the terms and definitions.

Many contractors prefer to use FOB jobsite to eliminate the liability for goods damaged in transit.

The important terms to know are:

FOB: Freight on Board

FOB Destination: FOB jobsite; FOB city and state of:

FOB Point of Shipment: FOB factory; FOB origin; FOB city and state; FOB seller's point

Freight Allowed¹: Shipments will move freight equivalent to the charges buyer pays to the carrier. These charges will be deducted from the total cost of the goods when paying the seller's invoice.

Freight Prepaid: Seller will pay transportation charges to the carrier and that buyer will remit the full amount of the invoice without deduction of freight.

Note in particular the area of "Freight Prepaid" vs. "Freight Allowed;" consider these in your cash flow planning.

Are you aware that when a shipment is FOB factory, you can choose the carrier and routing regardless of who pays the freight charges?

When equipment arrives damaged, are you obligated to pay the seller? Consult the terms of your purchase order.

FOB FACTORY

(Manufacturer's point of shipment)

Advantages

- The buyer can select a carrier.
- The buyer may pay the carrier and eliminate a possible mark-up on freight.
- Freight may be nontaxable.²

Disadvantages

- The title passes when manufacturer passes merchandise to carrier.

¹ In many cases vendors are actually quoting and shipping equipment under the terms "FOB Factory-full freight allowed" meaning you are assuming title at shipment, but prepaying the freight. However, the amount equivalent to the charges buyer pays to the carrier will be deducted from the total cost of the goods when paying seller's invoice. The specific meaning should be obtained from the vendor.

- Invoice date is effective at time of placement on carrier.
- Risk in shipment is borne by the buyer.
- Claims must be filed, litigated and settled by the buyer.
- Insurance: A good procedure is to check with your insurance agent about your coverage on in-transit material where title has passed. Many serious problems can arise in the event of carrier bankruptcy, refusal to pay claims, etc. Special coverage is available at a nominal rate. Also, problems with concealed damage may arise.
- Possibility increases of collect shipments.

FOB JOBSITE

(City, State, etc.)

Advantages

- Title passes when equipment is delivered.
- Invoice is due at time of receipt on jobsite.

Disadvantages

- Seller may include a mark-up on freight.
- Risk of shipment is borne by the seller.
- Damage claims, etc., are the responsibility of the seller.
- Freight may be taxable.
- Buyer may not select carrier.
- Buyer must trace shipment through seller.

In summary, know and understand the freight terms and tax consequences. Do your homework carefully in the preparation of your purchase order. Remember that, since it is the basic instrument, it will be interpreted against you, the maker. Therefore, be clear and explicit in the definition of terms and conditions.

² It is necessary to check with your local taxing authority to determine if freight is taxable. Since many states do not tax freight, it is imperative to have the cost of the freight separated out.

EXAMPLE:

Quoted Price of Equipment	\$50,000
Less Freight and Delivery Charges	<u>5,000</u>
Net Taxable Cost of Equipment	\$45,000
Sales tax @ 5% (¥\$45,000)	2,250
Add Freight	<u>5,000</u>
Amount Billed and Paid	\$52,250

In many cases vendors are actually quoting and shipping under terms "FOB Factory-full freight allowed" pre-paying the freight.