

FORFEITING - AN INNOVATIVE FORM OF EXPORT FINANCING

Julitta KOĆWIN*

* Institute of Economic Sciences, Faculty of Law, Administration and Economics, University of Wrocław
e-mail: jk.biotechnologia@gmail.com

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Abstract:

The paper is devoted to one of the external forms of financing export operations of enterprises. The so-called forfeiting is hardly known as a service in Poland and it is rarely offered by Polish banks. Exporters, who it is meant for, usually know little about it. Using forfeiting, an enterprise may grant a trade loan to its commercial partner, thus increasing its competitiveness and then the loan may be transformed into cash. The article discusses the aetiology, definition, function and basic types of forfeiting, as well as legal regulations concerning this service, stressing especially that the provisions of the Polish law actually do not regulate forfeiting. In practice, application of tax law leads to disputes and doubts, especially that there are no sufficient explanations provided by the Ministry of Finance.

Key words:

definition forfeiting, export financing, forfeiting market, realization forfeiting

INTRODUCTION

Forfeiting is still a not very well known service in Poland because it is not included in the offer of the majority of Polish banks and exporters, who are the addressees of such offers, usually choose not to use it. Regardless of the benefits related to this form of financing, especially in the case of long-term export transactions connected with capital goods. Forfeiting can be used by: legal persons, organisational entities without legal personality and natural persons conducting business activity.

The most commonly form of forfeiting used on the Polish market is a documentary letter of credit with deferred payment. Exporters can use a documentary letter of credit as a financial guarantee instead of insurance whose costs are rising, in this way they can transfer the solvency risk from an importer to a bank. The use of the letter of credit makes it easier for an importer to negotiate longer payment dates and especially to

maintain the right to a deferred payment¹. The discussed form of financing is especially useful at the time of crisis on financial markets because it counteracts the decrease in business trading.

The study was based on the research hypothesis stating that the analysis of the Polish financial law shows that there is no explicit definition of forfeiting which would refer to advantages, disadvantages and forms of taxation used in forfeiting agreements. The dispersion of regulations related to forfeiting services and their ambiguity undoubtedly influences the fact that they are not frequently offered by financial institutions. This situation restricts the use of forfeiting to finance business activity and especially its use as an innovative form of export financing in accordance with regulations supporting foreign trade development adopted by highly developed countries. The monographic method was used to verify the hypothesis and study documents.

The adoption of the above mentioned research premises sets a goal for this study, which is recommendation of forfeiting as an alternative form of company finance management, especially for companies involved in export activity. Due to the fact that the legal regulations related to forfeiting in Poland can be found in numerous documents, the article focuses especially on Polish legal and organisational regulation connected with forfeiting; its structure and goals; possible uses of forfeiting; selection of a given form of forfeiting; determination of the risk factor when selling or purchasing forfeiting receivables.

1. THE NOTION OF FORFEITING

The etymology of the word “forfeiting” is ambiguous, the name was promoted in the United States, however, it does not originate from the circle of English language culture. There are various hypotheses related to the genesis of this term².

In fact the name “forfeiting” comes from a French word “à forfait”, which means “with no right of recourse”³.

Forfeiting is a form of financing business activity of an enterprise. It is a purchase of short- or medium-term export receivables of the assignor (forfaiteur) excluding the right of recourse of the assignee (forfaitiste), i.e. the exporter⁴. Hence it is a purchase

¹ Comp. G. Pojnar, *Forfeiting poprawia płynność eksportera*, “Dziennik Gazeta Prawna”, 19 April 2011, No. 76, [online] [access: 29.12.2012].available on the Internet: http://biznes.gazetaprawna.pl/artykuly/506457,forfeiting_poprawia_plynnosc_eksportera.html

² For example “Der Spiegel” states that forfeiting dates back to the times of the ex-Soviet Union. When Richard Nixon visited Moscow in May 1972 the volume of American wheat supplies to the USSR was established by politicians. Next, due to severe droughts, the Soviet Union had to buy wheat also in Europe. Due to a lack of foreign currency, Russia did not pay immediately and used a medium-term promissory note of its state trade bank endorsed by the Soviet Union, the bill was to be discounted by European banks. Discounting meant buying the receivables (due payments) arising from the purchase, however, endorsement (acceptance) led to false (artificial) forfeiting. Como. *Korn für Moskau*, “Der Spiegel” 1972, No. 44, 23 October 1972, p. 26.

³ Comp. K. Kreczmańska, *Faktoring w teorii i praktyce*, Warszawa 2000, p. 59.

⁴ Comp. E. Głogowski, M. Münch, *Nowe usługi finansowe*, Warszawa 1996, p. 166.

of a claim with a total transfer of the risk of debtor's solvency, which means that the assignor takes over the responsibility for the debtor's insolvency and the related risk.

In a situation when a debtor makes a payment before the due date, an assignor cannot require an assignee to return the amount paid earlier. The only source of settling assignor's (forfeiter's) claims is the recipients of goods or services. However, this does not mean that a forfeiter has no right to settle claims with reference to an assignee. There are certain legal actions a forfeiter can choose to undertake with reference to an assignee if it turns out that, e.g. the assignee misled the forfeiter or made a false statement in relation to the claim.

The list of situations in which a forfeiter has the right to recourse (the so called recourse in the law of torts) should be indicated in a forfeiting agreement. However, as usual, there are certain exceptions from this rule. For instance some institutions offer a service called forfeiting where a forfeiter holds the right of recourse with reference to an assignee. This does not mean, however, that a forfeiter has no rights of claim to an assignee⁵.

A forfeiting agreement is an innominate contract (it is not regulated by the civil code), which means that it is not regulated by any legal regulations and is concluded on the basis of the freedom of contract. In the legal doctrine it is a causal, mutual, consensual agreement for a specified period, also a payment is involved in the case of this agreement. A forfeiting agreement, regardless of the characteristics typical of an assignment of claims, is an innominate contract, however, the position of the doctrine inclines to treating a forfeiting agreement as a sales of receivables agreement (Supreme Administrative Court/Administrative Procedure Code 1487/94). The reason why is that it bears some similarity to an agreement for assignment of a debt and order. It is used pursuant to:

- a) freedom of contract – Art. 353 of the Civil Code;
- b) assignment of claims regulations – Art. 509, item 1 of the Civil Code;
- c) personal obligation of a third person (in this case a bank) to fulfil the commitment related to no right of recourse, i.e. taken over the risk – Art. 391 of the Civil Code;
- d) Consolidate Customs and Practice of Documentary Letters of Credit⁶ which resolves disputes related to letters of credit and security bonds in forfeiting transactions;
- e) the convention on a consolidate act on drafts and notes, Official Journal of Laws 1937, No. 26 item 175.

⁵ M. Wójcik, *Forfeiting jako alternatywna forma zarządzania finansami*, Biuletynu Euro Info 2009, Enterprises Europe Network at PARP, Warszawa 1.10.2009, [online] [access: 29.12.2012] available on the Internet: <http://www.een.org.pl/index.php/handel-zagraniczny/articles/forfeiting-jako-alternatywna-forma-zarzadzania-finansami.html>.

⁶ *Jednolite Zwyczaje i Praktyka dotyczące Akredytyw Dokumentowych – version 2007*, published by MIH No. 600, ICC Polska, Association of Polish Banks, Warszawa 2007.

A forfeiting agreement can be concluded in any form, however, in practice (which is important for lawsuit related reasons) a written form is the most common one. There are some necessary annexes to a forfeiting agreement confirming the existence of a claim, such as: an original agreement form which the claim results, terms of payment and a maturity date. Hence, apart from transferring a claim to an assignor, the basic duty of the assignee is handing over all documents related to it. An assignee is also obliged to pay the so called forfeiting costs. This is done in an indirect way, an assignor deduces these costs from the purchase price. The liability of agreement parties in the case of failure to perform or improper performance of an agreement is regulated by the general provisions of the Civil Code.

In the case of forfeiting, an assignor cannot apply for recourse claims to an assignee if a debtor does not pay the obligations within due time. An assignee is liable only for legal defects of the sold obligation.

In a forfeiting transaction there are three entities, an assignee (French: *forfaitiste*), i.e. a supplier of products, goods or services; a debtor, i.e. a contracting party (importer) who pays with, e.g. a promissory note and a forfeiter (assignor), a purchaser of a claim, i.e. a forfeiting institution.

A characteristic feature of forfeiting is the fact the purchaser of receivables not only takes the economic risk, but also a political one. In general there are three types of risk in this transaction:

- economic risk related to solvency and ability to pay of a foreign importer;
- political risk encompassing such events as a war, revolution, unrest, expropriation, nationalisation, payment prohibition, moratoria and inability to exchange or transfer currency;
- risk resulting from the quality of goods, such as a guarantee and performance claims taken by an exporter⁷.

Analysing the development of this form of financing, it should be noted that initially the basis for a forfeit transaction were supplies of goods and services provided by industrialised countries to developing ones. Currently such transactions are made between highly developed economies. Thus, contrary to the initial period when transactions were mainly related to investment goods, currently it is not a necessary condition because transactions are related to all goods, raw materials and agricultural produce.

It should be emphasised that in the case of large transactions risk is shared and hence it is undertaken by a syndicate⁸, not a single assignor. The subject of a forfeiting agreement are export receivables with deferred payment. They are mainly promissory notes receivables and non-promissory notes receivables with 180 days or even 10 years to pay, in some cases there are shorter settlement periods. In practice receivables with 3 to 5 years to pay prevail. Such longer settlement periods mean that curren-

⁷ Comp. E. Glogowski, M. Münch, *op.cit.*, p. 166.

⁸ Comp. *ibidem*, p. 166.

cies used in forfeiting are usually the hard ones, such the US dollar, euro, Swiss franc, yen, British pound.

The subject of accounts receivable purchase can be only receivables related to business trading (the so called trade receivables, i.e. debts, debt burden, obligations, bills, promissory notes) so the ones which are related to two entities running business activity. There are the following types of trade receivables:

- a) cash;
- b) resulting from trade transactions;
- c) unmatured (before their due date) and within their period of prescription;
- d) medium- and long-term;
- e) undisputed, unamatured, unencumbered, whose transferability is not restricted, i.e. they can be a subject of trade. Usually trade receivables meet this condition unless contractors reserve the right to assignment in the agreement. An assignment can be completely banned or it can depend on the debtor's consent, it is also possible to indicate particular entities to the benefit of which an assignment can be made. Before purchasing accounts receivable, a forfeiter – bank should check if a transfer of claims is not restricted by legal regulations and if the nature of this obligation does not make a transfer impossible;
- f) secured by credible banks in the following forms: promissory note guarantee, letter of credit with deferred payment, guarantee, a promissory note or a bill of exchange accepted by the bank.

The system of payment guarantee used in the case forfeiting claims purchased by a forfeiter with no right of recourse, pursuant to which the whole risk of debtor's insolvency is transferred to a forfeiter, is presented in Figure 1. It is based on a forfeiting agreement signed by a forfeiter – exporter bank (2) and a guarantee or an aval (4) and also delivery of required documents by an importer bank (5). In a forfeiting transaction there are two forms of collaterals of claims: a guarantee, usually issued by an international bank, or an aval, the payment of the value of a secured promissory note or a bill of exchange.

Generally forfeiting relates to all existing or future accounts receivable of an entrepreneur and his/her contractor or all contractors. However, it should be noted that a purchase is related to single transactions particular, i.e. as a rule it is connected with one, individual, existing claim. By nature it focuses mainly on accounts receivable from foreign entities and are connected with export of goods or services and, hence, on account receivables from foreign entities. Accounts receivable purchased in forfeiting encompass:

- a promissory note or a bill of exchange of a debtor or a client, they are secured with a guarantee or an aval;
- deferred payments of an irrevocable documentary letter of credit;



- other documents confirming the maturity of a claim, e.g. invoices with a trade agreement;
- trade agreement;
- claim secured with a bank guarantee/standby letter of credit;
- claim resulting from a leasing agreement.

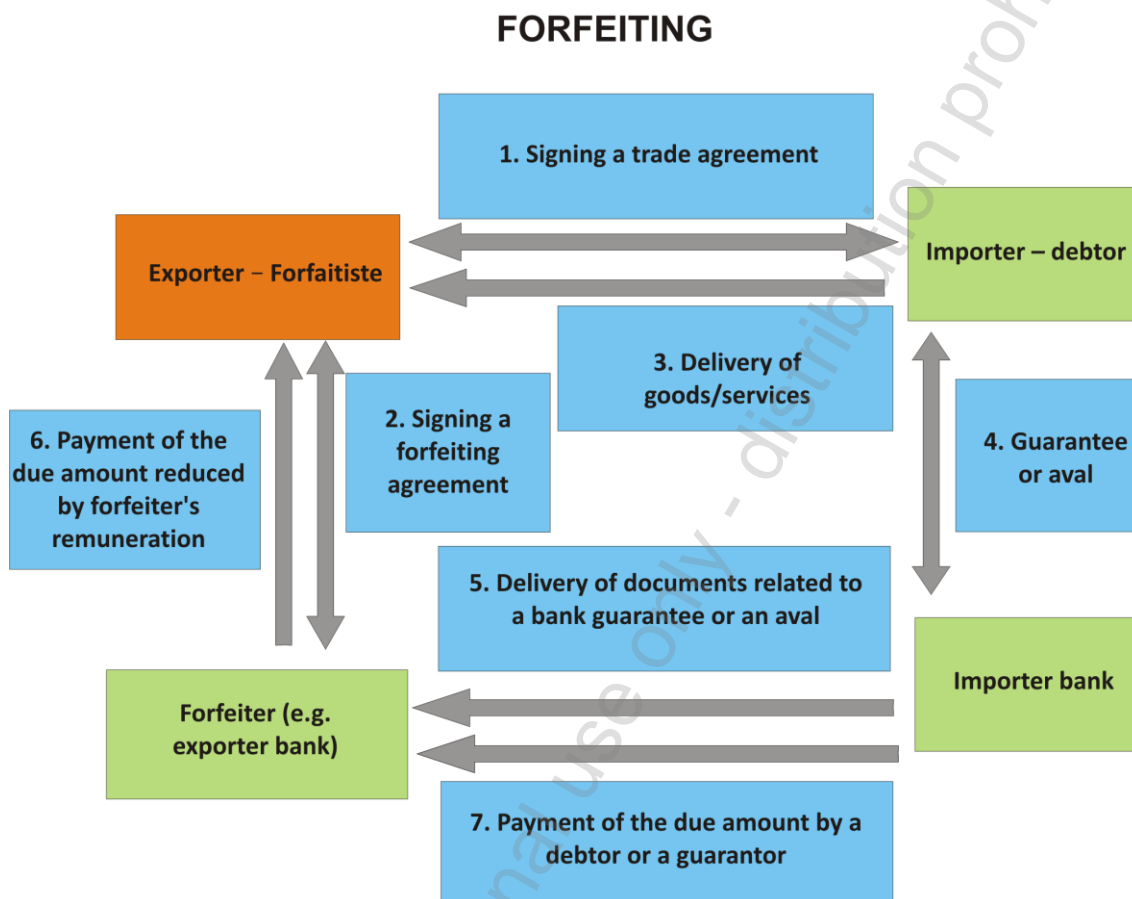


Fig. 1. Scheme of a guarantee of a claim in a forfeiting agreement

Source: *Forfeiting – Financial dictionary FinDict*, [access: 14.04.2014] available on the Internet: www.findict.pl/slownik/forfeiting

The purchase of claim takes place as a result of an immediate cash payment reduced by an interest payment for the claim validity. A discount rate is established taking into account the rate of the currency used on the EU money market and the risk related to the importer country.

Banks and forfeiting institutions require claims to be secured with a letter of credit with a deferred payment, a bank guarantee or a receiver's promissory note, a promissory note or a bill of exchange secured by a bank. In rare circumstances, in the case of renown companies, there is a possibility of resigning from these collaterals and taking over the receiver's direct risk. Forfeiting banks and institutions have at their disposal their own lists states and banks with a defined level of risk and a maximum maturity

date. Their rankings are based on the economic assessment of a given state and financial market analysis. An important element of this assessment is also political risk which is related to government stability and the activity of state authorities which can directly influence contractor's solvency or the possibility of making foreign bank transfers. Banks participating in a transaction are assessed in a similar way⁹.

Forfeiting transactions are conducted after obtaining a collateral which is satisfactory for a forfeiter. Because this way of financing is not a loan, it is impossible to use standard collaterals used in the case of traditional loans. The reason, among others, is the fact that a security of a payment should be granted by a forfeiting debtor who, however, is not bound by any agreement with a bank, apart from a legal relationship resulting from a claim. Thus the catalogue of available collaterals is limited, usually the following forms are used:

- bank guarantee issued by a debtor's bank;
- standby letter of credit (a kind of bank guarantee used e.g. in the USA) issued by a debtor's bank;
- promissory note with an aval of an importer bank – a promissory note guaranteed by a debtor's bank;
- trade agreement insurance provided by an export agency which has the guarantees of the State Treasury.

In the case of banks, the above mentioned guarantees (provided they satisfy certain conditions) allow to purchase a claim with no right of recourse from an assignee. At the same time, it is possible to avoid a tiring, and sometimes impossible analysis of the economic and financial situation of a forfeiting debtor. It is replaced with the assessment of the economic and financial situation of the issuer of a guarantee, i.e. an importer bank (debtor). This is the case when a bank guarantee, standby letter of credit or a promissory note with bank's aval are used. Financial institutions supporting foreign trade financing conduct developed cooperation with banks all over the world, thanks to this they can efficiently process forfeiting transactions (on condition that limits are available).

Another type of a guarantee used in forfeiting is an insurance policy of an export agreement issued by the so called ECA (Export Credit Agency), in Poland it is KUKE SA (Export Credit Insurance Corporation Joint Stock Company) which has the right to grant insurance with State Treasury guarantees. This type of insurance can be obtained either by an exporter, then as part of forfeiting an assignment of rights to this insurance to a bank is conducted, or the bank itself¹⁰.

Documents required to sign a forfeiting agreement encompass: debt instrument (e.g. a promissory note, bill of exchange, letter of credit with a deferred payment); a copy of an invoice; original of a forfeiting agreement.

⁹ Comp. P. Bryła, *Wierzytelność w praktyce gospodarczej*, Warszawa 1999, p. 41.

¹⁰ M. Wójcik, op. cit.

The condition of forfeiting is concluding a delivery agreement between an exporter and an importer. The agreement defines the type and volume of delivered goods (or services), loan conditions and terms of payment. In most situations an exporter has to provide financing for a client. Most often a deliverer's loan is used, later it is replaced with forfeiting by an exporter¹¹. It is possible to finance 100% of a contract. Figure 2 presents a forfeiting transaction.

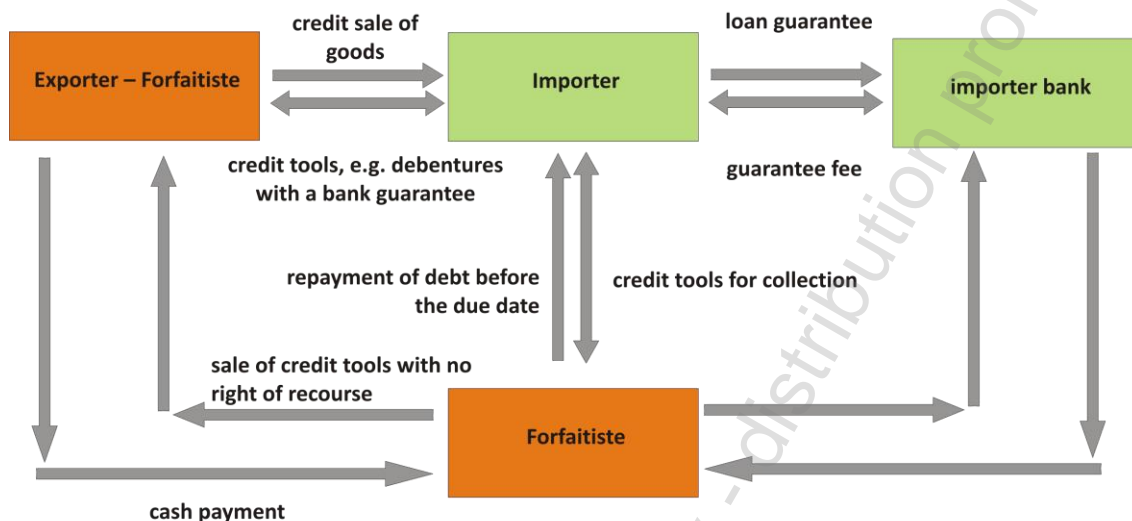


Fig. 2. Forfeiting transaction

Source: E. Glogowski, M. Münch, *Nowe usługi finansowe*, Warszawa 1996, p. 168

2. TYPES OF FORFEITING

In Poland forfeiting is used mainly in foreign trade, although some banks also offer forfeiting in domestic transactions. Primary sources distinguish a few types of forfeiting. There are various criteria in forfeiting classifications.

From the point of view of debtor's solubility risk, it is possible to distinguish the typical forfeiting in which an assignor of account receivable takes over the whole risk related to its collection and untypical forfeiting in which an assignee is burdened with various types of risk related to an account receivable.

Another criterion of division is an agent in a forfeiting transaction, here there is direct forfeiting, when a forfeiter purchases accounts receivable directly from a seller of goods and services, and indirect forfeiting when a forfeiter does not purchase accounts receivable directly from a creditor but from a different forfeiting institution, i.e. buys accounts receivable via another institution, e.g. when a foreign forfeiting company uses the service of a local forfeiter acting in the exporter's country on this company's account.

The third classification criterion is the moment when a debtor is informed about concluding an agreement. In this case there is open forfeiting when a debtor is informed

¹¹ Comp. E. Glogowski, M. Münch, op.cit., pp. 167-168.

about the conclusion of a forfeiting agreement and secret (hidden) forfeiting when a debtor is not notified about the fact that a transaction is encompassed by a forfeiting agreement, i.e. the agreement is signed without debtor's knowledge.

The subject of forfeiting are trade claims, claims related to promissory notes and leasing transactions existing at the time of these transactions, however, not mature yet, i.e. they are purchased before their maturity date. With respect to the type of a financial claim, it is possible to distinguish the following types of forfeiting:

- a) forfeiting of trade claims related to the economic turnover. The essence of this type of forfeiting is the fact that an assignee signs an agreement with a debtor pursuant to which the assignee is obliged to deliver the subject matter of the agreement and the debtor is obliged to pay for it within a fixed deadline or deadlines (payment schedule). Before the due date defined in the agreement or during the delivery of goods (or services), or even during the period payment (in the case of instalments) the assignee concludes a forfeiting agreement with a bank and pursuant to this agreement the claim is transferred to this bank. In practice negotiations with the bank should be started already at the stage of preparing the agreement, which can significantly accelerate procedures and help to construct a forfeiting agreement;
- b) in this model it is possible to distinguish certain types of forfeiting with regard to the category of a debtor. There are various specific characteristics of purchasing a claim when the payer is a State Treasury entity, another public entity or a regional government entity. This type of forfeiting recently has been relatively often used to finance agreements related to public investments, e.g. purchasing means of public transport, IT equipment (for offices and schools), building public utility facilities, etc. This type of transactions are exceptional because the insolvency risk is assessed in a different way by a forfeiter than in the case of other transactions when a debtor is an enterprise;
- c) forfeiting of claims related to promissory notes – the subject here are promissory notes and bills of exchange. In this case a forfeiting client is a company which issues a bill of exchange or is a recipient (payee) of a promissory note. The forfeiting of claims related to promissory notes differs from a traditional service offered by banks – a discount on a promissory note – in a type of a guarantee. A promissory note which is the subject of a purchase in this type of service is issued with an aval of a debtor's bank (importer). In this type of a transaction contractors decide that a payment will be secured with a promissory note or a bill of exchange. To enable purchasing (discount) of such a bill by an exporter bank (supplier), an importer (recipient) applies to its bank for a guarantee of a promissory note. This model is used in foreign transactions, then banks can discount promissory notes assessing the risk of foreign banks for which they have credit limits granted in advance¹²;

¹² M. Wójcik, op.cit.

- d) forfeiting of leasing accounts receivables is purchasing of leasing instalments, it is possible to buy all instalments, a few or just one. Thanks to a signed agreement, a lessor receives leasing instalments earlier than they would pursuant to an agreement signed with a lessee. In return a forfeiting company receives a commission and the instalments are reduced by a discount. In this case, possible types of collaterals encompass: the subject of lease (pledge or transfer of title), bank guarantee, insurance of leasing instalments¹³.

The entity using forfeiting is a lessor who by providing financing for its clients becomes their creditor. Thus pursuant to a lease agreement, a lessor has the right to request payment in the form of future leasing instalments. In forfeiting there is a change of a creditor, i.e. a lessor is replaced by a bank which from the moment of transferring the claim obtains the right to receive lease instalments from a lessee (lessees). Generally forfeiting is purchasing accounts receivable with no right of recourse from an assignee. However, when the subject are lease accounts receivable, they are frequently purchased with a right of recourse. As a result in the case when a lessee does not pay one or many lease instalments, a bank (forfeiter) has the right to request a lessee (assignee) to pay back the earlier paid amounts of money (with charged interest). The subject of a transfer can be accounts receivable resulting from both operating and financial lease¹⁴.

Most often lease forfeiting is an incomplete (not proper) form of leasing, which means that a lessor is liable in the case when a lessee stops paying lease instalments, this means a lessor has to pay the remaining lease instalments. Lease forfeiting is very frequently hidden, i.e. a lessee does not know about an agreement signed by a lessor and a forfeiting company. Lease forfeiting is a form of financing mid- and long-term lease instalments¹⁵.

Another criterion used to distinguish forfeiting is its division according to the country of origin of a contractor. According to this criterion, there is international forfeiting, if contractors come from various countries, and there is further division into export forfeiting (Polish exporter) and import forfeiting (Polish importer) as well as domestic forfeiting when both parties operate in one country.

Import forfeiting is a relatively new product on the market. It is discounting an own letter of credit by a bank which opened it. This type of settlement is beneficial for both sides of a transaction: an importer can postpone a payment to a more convenient due date, while an exporter has an opportunity to receive financial means earlier on more better conditions than in its national bank because an exporter does not bear the costs

¹³ Comp. K. Kreczmańska, *Faktoring w teorii i praktyce*, op. cit., p. 61.

¹⁴ M. Wójcik, op. cit.

¹⁵ Comp. *Jak zdobyć środki na założenie i działalność firmy*, Moja Firma, Infor.pl, [online] [access: 29.12.2012] available on the Internet: <http://mojafirma.infor.pl/poradniki/723,3565,2,Forfeiting.html>.

of confirming a letter of credit and a discount rate in the importer's country is lower than in the exporter's country¹⁶.

Export forfeiting is purchasing export accounts receivable before their maturity date together with the rights resulting from them. Such a transaction is conducted without the right of recourse from an assignee, i.e. a bank takes over all risk related to the assignor and its country of origin, at the same time the bank pays the whole due amount reduced only by an appropriate discount.

In practice, in economy there are many types of forfeiting. However, the most convenient ones from the perspective of an entrepreneur, and hence deserving attention, are as follows:

- extended forfeiting – a forfeiting institution signing an agreement is obliged provide additional benefits (e.g. obtain required permits, conduct market research in a given state or evaluate contractors' financial situation);
- forfeiting with standby arrangements – a bank is obliged to purchase future accounts receivable. A forfeiting agreement is signed before accounts receivable arise. Pursuant to this agreement a forfeiter is obliged to purchase account receivable in the future, i.e. when they arise;
- forfeiting credit facility – a forfeiter grants a revolving credit facility which allows to purchase accounts receivable within the granted limit; after a payment the limit is granted again.¹⁷ "The revolving credit facility is earmarked for financing ongoing business and a need for working capital, issuing letters of credit (to secure open letters of credit) and guarantees as well as financing payments resulting from letters of credit. The facility allows to take a loan within a defined limit and use all products provided within such a facility. Every product used within such a facility reduces the granted limit accordingly to its value"¹⁸;
- on international markets the subject of forfeiting are export accounts receivable arising as a result of trade transactions pursuant to the foreign exchange law, already existing, undisputed, unmatured, unencumbered, whose transferability is not restricted, with a defined due date counted from the purchase date, expressed in a particular currency. For instance, a note cannot have the "not to order" clause. They can have the form of promissory

¹⁶ Comp. G. Pojnar, op. cit.

¹⁷ Comp. *Forfeiting jako alternatywna forma zarządzania finansami*, Enterprise Europe Network w Polsce - Handel zagraniczny, [online] [access 23.04.2014] available on the Internet: www.een.org.pl/index.php/handel-zagraniczny-spis.html?page=17.

¹⁸ *Linia wielocelowa dla średnich firm i korporacji*, BZ WBK, [access: 23.04.2014]. available on the Internet: <https://www.bzwbk.pl/przedsiębiorstwa-i.../linia.../linia-wielocelowa.html>.

notes, bills of exchange and documentary letters of credit with deferred payment¹⁹.

There is a growing interest of customers in Poland forfeiting services, however, currently the forfeiting market resembles the early years of factoring. Forfeiting is not a standard solution offered by banks and the knowledge of this tool among Polish entrepreneurs is not significant. The forfeiting market is perceived as financing trade with a transfer of risk using a claim discount, however, it is hard to make any assessments due to a lack of any official reports and data on the subject. Nevertheless, year after year the number of this type of transactions is growing and the near future should bring more interest in a possibility of discounting secured payments, especially that this solutions offers a company the same benefits as factoring. Until recently forfeiting services were associated only with financing export transactions. However, in recent years regional governments looking for non-budgetary means to conduct planned infrastructure and medical investments are more and more interested in in the forfeiting market.²⁰

It should be emphasised that at the time of large infrastructure investments forfeiting of domestic contract accounts receivable conducted mainly by purchasing claims from regional government entities or companied owned by them, becomes especially important.²¹ Regional governments have already used the opportunity offered by forfeiting when financing investments development and modernisation of local infrastructure funded partly by the EU and partly by regional government entities. Forfeiting became for them an alternative for bank loans, credits and municipality bonds, a form of external financing of planned investments²². Recently a new form of forfeiting has been created in Poland, the so called lease forfeiting.

3. ADVANTAGES AND DISADVANTAGES OF FORFEITING

The main advantage of forfeiting is the possibility to determine costs even before signing an agreement. This benefit refers to both an exporter and importer.

Analysing forfeiting benefits of manufacturers exporting goods, one should first of all mention the improvement in financial liquidity thanks to an earlier receipt of funds. As a result, an exporter can turn over this capital and generate additional profits, which is more cost-effective than waiting for a payment, funds can be used immediately and not after three years. Apart from liquidity, another important factor is the increase in competitiveness thanks to the possibility of offering extended terms of payment.

¹⁹ U. Krzemińska, *Forfeiting*, [online] [access: 23.04.2014] available on the Internet: <http://www.edukacjaprawnicza.pl>.

²⁰ A. Wieczorek, *Forfeiting w Polsce*, "BANK" No. 2, February 2013, p. 58.

²¹ Comp. P. Galiński, *Forfeiting otwiera nowe możliwości finansowania inwestycji w samorządach*, [online] [access 25.04.2014] available on the Internet: www.samorzad.lex.pl.

²² Comp. M. Piechocki, *Forfeiting przy inwestycjach samorządowych*, "Prawo" [in:] "Rzeczpospolita" 7 June 2011, [online] [access: 29.12.2012] available on the Internet: <http://prawo.rp.pl/artukul/669812.html>.

Moreover forfeiting leads to elimination of transaction risk related to both exchange rates, political situation, etc., passage of risk refers to both accounts receivable secured with bank instruments and notes receivable in relations with accepted foreign recipients. An exporter is protected against recipient's insolvency or a refusal to pay of the bank securing the transaction and, at the same time, it can benefit from stabilisation of costs by totally or partially including them in an agreement.

In general using forfeiting leads to a growth of opportunities to increase sales without involving additional sources of financing²³.

Forfeiting accounts receivable are purchased by banks to be kept in their so called own portfolio or be sold on a secondary market. Purchasers are banks from the exporter's country, most often the ones in which an importer has a bank account or related to the importer. Accounts receivable can be resold many times. The seller's income consists of: (1) difference between a purchase and sale price and (2) interest²⁴. The received notes are combined into bundles of transferable securities and sold on a secondary market to banks looking for opportunities for deposits or to financial departments of enterprises²⁵.

Forfeiting is beneficial for both sides of a transaction, an importer can benefit from extended terms of payment, no necessity to involve additional sources of financing and a possibility to quickly conclude an agreement as well as protection against purchasing by third parties.

Importer's accounts receivable can be purchased from an exporter only by importer's bank or another bank involved in this kind of activity. This protects an importer from the consequences of purchasing a note by, e.g. a competitor who might want to influence the importer's company or compensate its obligations towards an importer at a difficult time for an importer.

A very important benefit from the importer's perspective is also the possibility to extend payment terms by additional financing. A replacement of a note receivable after its maturity date by a loan is an additional advantage which ensure stable financing level. This is especially important in more difficult market conditions and smaller revenues as well as problems with repayment of liabilities towards an exporter²⁶.

The main barrier in the development of forfeiting is its high cost related to risk (economic and political) accompanying transactions entered into by an exporter. The economic risk factors encompass: transaction currency, period of time between purchasing accounts receivable and its payment date, forfeiting security and additionally the margin of a forfeiting company and agreement implantation costs²⁷.

²³ Comp. P. Bryła, op. cit., p. 44-45.

²⁴ Comp. ibidem, p.45.

²⁵ Comp. E. Glogowski, M. Münch, op. cit., p. 169.

²⁶ Comp. P. Bryła, op. cit., p. 46.

²⁷ Comp. K. Kreczmańska, *Faktoring w teorii i praktyce*, op. cit., p. 61.

The development of forfeiting depends on the world market situation, creditworthiness of debtors' countries and credit insurance charges established by state institutions as well as global and regional political situation.

4. FORFEITING AGREEMENT TAXES

Forfeiting is a mixed innominate contract developed by the contemporary business trading in developed countries over the last few decades. The Polish law does not regulate a forfeiting agreement leaving the construction of such agreements to the will of parties concluding it. In practice, this can lead to disputes and doubts, especially that there are not any exhaustive interpretations which would not lead to any doubts and which would be provided by the Ministry of Finance²⁸.

The judicature of Polish administrative courts a forfeiting agreement is defined as purchasing of defined receivables due from an exporter and arising from sales, delivery of another service provided to an assignor (debtor) by a forfeiting institution (bank, financial institution, insurance company), the services are provided in return for a defined amount of money which is an equivalent to the claim reduced by the commission of the forfeiting institution, and in a debtor – forfeiter relation, corrected by contractual interest²⁹.

4.1. PERSONAL AND CORPORATE INCOME TAXES

Because a forfeiting agreement transfers a claim (property rights) without bez any other additional services and without an agreement to continue cooperation, it is subject to the regulations of the Corporate Income Tax Act³⁰.

According to this act the revenue on a sale of goods or property rights is their value expressed as a price in an agreement. If a price substantially differs from market value without just cause, the revenue is defined by a tax institution at the market value (Art. 14, item 1). The market value of objects or property rights is determined on the basis of market process used in trade in goods and rights of a similar type and quality with regard for their state and wear as well as the place of sale (Art. 14, item 2).

In a situation when the value expressed in a price significantly differs from the market value of goods and rights, a tax institution requests parties to change this value or to indicate the reasons for quoting a price which significantly differs from the market value. If there is no reply which would justify the price significantly differing from the market value, the tax institution calculates the value taking into account the opinion of an expert or experts. If the value defined in this way differs by 33% from the value expressed in a price, the costs of expert opinions are paid by an assignee (Art. 14, item 3).

²⁸ A. Rutka, *Opodatkowanie stron umowy forfeitingowej*, "Doradca Podatnika" 2003, No. 5, pp. 6.

²⁹ T. Kotoliński, *Umowa forfeitingu: podatek CIT, VAT, PCC*, eGospodarka.pl, 13.07.2011, [online] [access: 29.12.2012] available on the Internet: <http://www.podatki.egospodarka.pl/68347,Umowa-forfeitingu-podatek-CIT-VAT-PCC,1,65,1.html>

³⁰ Corporate Income Tax Act of 12 September 2012, consolidated text, National Journal of Laws 2011, No. 74, item 397.

In a forfeiting agreement entrepreneur's revenue arising from the sale of a claim is the price established by both parties of agreement³¹. Pursuant to the act entrepreneur's revenues are also due revenues which have not been received excluding only the value of returned goods, granted discounts and allowances (Art. 12, item 1a.3). The revenue generation date is the day when goods are handed over, dispose of property rights or delivery of a service, also partial performance of a service, not later than the day of issuing an invoice or settling a payment (Art. 12, item 3a).

Tax consequences of a sale of accounts receivable in terms of tax deductible expenses is regulated by Art. 16 item 1 point 39 of the act pursuant to which losses incurred as a result of a sale of a claim are not considered a deductible cost, unless the claim was considered a due revenue before. If a claim was a due revenue in a particular enterprise and the amount received as a result of a sale of this claim is lower than the previously indicated due revenue related to this claim, then the difference is a loss and it is a deductible cost.

When establishing a loss incurred as a result of a sale of a claim, pursuant to the act, the due value added tax is not considered a revenue (Art. 12, item 4, point 9), as a result, a loss arising from a sale of a claim can be a deductible cost only in the same ratio as the due revenue to the revenue from a sale of a claim³².

To sum up, it has to be noted that forfeiting taxation, which is a corporate income tax, leads to various legal consequences depending on a party – an assignor or an assignee.

The general rules of the generation of revenues and costs apply in defining the consequences of selling a claim using factoring or forfeiting. There are the following tax consequences for an assignee (forfaitiste):

- selling a claim does not result in generation of taxable income if the sold claim was previously recognized as due revenue;
- remuneration paid to a forfeiter can be a deductible cost;
- loss shown on such a sale can be a deductible cost, unless pursuant to Art. 12 item 3 of the Corporate Income Tax Act, a claim was previously considered due revenue (Art. 16, item 1, point 39 of the Act).

Purchasing a claim is final, which means that a forfeiter takes over the whole risk related to receiving the money back from a debtor. An assignor of a claim – forfeiter, take the following tax consequences:

- expense related to the purchase of a claim is a deductible cost only when income is generated, i.e. when a debtor pays the due amount;
- remuneration of a forfeiter received from an assignee is a taxable income³³.

4.2. VALUE ADDED TAX

³¹ T. Kotoliński, op. cit.

³² Ibidem.

³³ Z. Marczyk, *Aspekty podatkowe wybranych instrumentów finansowych*, Hogan Lovells, Kraków 7 June 2010, slide 21, 17-18.

Pursuant to the Value Added Tax Act (VAT), tax exemptions encompass services related to granting loans and credits are exempt from tax, as well as agency of these services and management of credits and loans by creditors or lenders³⁴.

According to Art. 43 item 1 point 40 of the Act tax exemptions comprise also services related to deposits of financial means, holding accounts of all sorts of payment transactions, money orders and transfers, debts, cheques and bills as well as agency of these services.

Pursuant to Art. 43 item 15 of the Act the above exemptions do not apply in the case of debt collection. A forfeiting agreement is not defined in Polish legal regulations, however, it is related to purchasing long-term accounts receivable, mainly foreign ones, which must meet strict. As a result forfeiting is subject to Art. 43 item 15 of the Act and hence is not exempt from VAT³⁵.

4.3. TAX ON CIVIL LAW TRANSACTIONS

Pursuant to the Tax on Civil Transactions Act certain transactions are subject to this tax³⁶, provided that neither of the parties related to a given transaction is subject to VAT or is exempt from this tax (Art. 2, item 4). However, trading in securities can qualify as agency of financial services. These services are exempt from VAT, however, excluding debt collection, factoring and forfeiting.

Sales of own account receivable, which were not purchased for the purpose reselling them or debt collection, is not financial service agency. In the case accounts receivable are "property rights" and their exercising cannot be considered a business activity. Since claims are property rights, they are not goods and selling them cannot be treated as a delivery of goods subject to VAT. Sales of own accounts receivable is not subject to VAT and hence it is subject to the tax on civil law transactions of 2% of the market value of a claim³⁷.

However, if a given entity purchases a claim for the purpose of reselling it or debt collecting and factoring then these transactions are not exempt from VAT and is subject to 23% tax rate. In this case the taxation base is the difference between the face value of a debt transferred to a factor and the amount paid by the factor for the debt³⁸.

The presented interpretation shows that the nature of the entity selling claims and the nature of the claim itself are of primary significance. If a given entity sells its own accounts receivable from its contractor, then this transaction is subject to the tax on civil

³⁴ Value Added Tax Act of 11 March 2004, National Journal of Laws 2004, No. 54, item 535, Art. 43.1.38.

³⁵ T. Kotoliński, op. cit.

³⁶ Tax on Civil Law Transactions Act of 9 September 2000, National Journal of Laws 2000, No. 86, item 959, Art. 1.1.1.

³⁷ Obrót wierzytelnościami – PCC czy VAT, available on the Internet: [online] [access: 30.12.2012] http://www.vat.pl/obrot_wierzytelnościami_pcc_czy_vat_komentarz_vat_interpretacje_407.php.

³⁸ Ibidem.

law transactions, and if the seller is an entrepreneur who bought it for the purpose of reselling it or debt collecting, then such a transaction is subject to VAT³⁹.

5. FORFEITING IN PRACTICE

For an exporter forfeiting is an ideal tool allowing to receive financial means earlier to improve financial liquidity while bearing relatively low costs. Additionally, it makes it possible to sell a claim with no right of recourse to an exporter, i.e. it protects the exporter from possible losses caused by an insoluble debtor. Using this tool allows to maintain or increase sales on higher risk markets. Appropriate connection of two instruments – a documentary letter of credit with deferred payment and forfeiting – allows importers to conduct even medium-term investments without such forms of financing as an investment credit⁴⁰.

In Polish conditions forfeiting is offered mainly by banks, however, in theory it takes into account also a forfeiter that is a financial institution (or financial activity is one of its business activities), but it is not a bank. A limitation resulting from the nature of this service and the way risk is perceived in such transaction by forfeiters, is that a debtor cannot be equity, organisationally or personally linked with an assignee, i.e. it cannot be its subsidiary (daughter company).

On the other hand, forfeiting of domestic contractual claims, which is financing suppliers cooperating with public sector entities, deviates from the classical definition of forfeiting. Such form of forfeiting raises controversies because it is connected with domestic, multi-million investments mainly conducted by regional government entities and not export transactions⁴¹.

The development of services related to forfeiting of domestic claims was curtailed by the minister of finance who on 23 December 2010 issued the ordinance on detailed classification of debt securities encompassed by the state debt list of debt securities, including the State Treasury debt. Pursuant to the ordinance, forfeiting was classified in the second category as: “innominate agreements with maturities longer than one year, related to financing services, supplies and construction works which lead to similar consequences as loans or credits”⁴². This clause restricts the use of forfeiting by regional governments as an instrument financing investments without the simultaneous necessity to take into consideration debt ratios. The ordinance rose many controversies. This kind of forfeiting was used to finance such investments as, e.g. a hospital and a ring road in Toruń, PGE Arena Stadium in Gdańsk⁴³.

³⁹ Ibidem.

⁴⁰ Comp. G .Pojnar, op.cit.

⁴¹ Por. E. Weronis, *Rynek usług forfeitingowych w Polsce*, [in:] *Biznes międzynarodowy w gospodarce globalnej*, No. 32, Gdańsk 2013, p.245.

⁴² Ordinance on detailed classification of debt securities encompassed by the state debt list of debt securities, including the State Treasury debt of 23 December 2010, National Journal of Laws 2010, No. 252, item 1692, section 3.2.

⁴³ Comp. E. Weronis, op.cit., pp. 246, 245.

According to the Report of the Ministry of Economy, the Polish forfeiting market still has high value. The report states that “due to the special characteristics of this service, different definitions and the related problems with transaction qualification, there are no detailed data on this subject”⁴⁴. The value of forfeiting turnover in Poland is estimated at several dozens of millions of PLN annually.

As part of activities supporting forfeiting transactions in 2007 Export Credit Insurance Corporation Joint Stock Company (KUKI S.A.), an institution acting on the Polish market, started a service “Forfeiting Program” which offered insurance of medium- and long-term export accounts receivable guaranteed by the State Treasury and bought by a bank. The offer is aimed at financial institutions purchasing accounts receivable of domestic exporters resulting from loans with two-year maturities or longer, granted by them to foreign suppliers to finance export contracts related to sales of Polish goods and services⁴⁵.

The Program was used for the first time in 2011 when a long-term insurance agreement was signed, the subject matter were claims arising from an export contract for supplies of equipment for food industry concluded by a Polish exporter with a Ukrainian contractor⁴⁶. In 2012 also one long-term insurance agreement was signed, it secured claims arising from an export contract in the mining equipment sector. Taking into account the above data, it can be said that the Forfeiting Program does not enjoy any interest. According to KUKI S.A. analysts the potential of the Polish market encompasses not more than 3-5 forfeiting transactions. In their opinion the main obstacle to the growth of interest in forfeiting is the necessity to possess appropriate know-how by an exporter and the cost of such a transaction⁴⁷. Another proof for this is the fact that only two Polish banks BGŻ SA and BRE Bank SA belong to the International Forfeiting Association - IFA.

A confirmation for the thesis adopted at the beginning of this article that “forfeiting is hardly known as a service in Poland and it is rarely offered by Polish banks” is the fact that it was not taken into account in the market offers of such banks as: Alior Bank, Credit Agricole, Deutsche Bank, PKO BP, Millennium, Getinbank, Kredyt Bank, Nordea Bank, Eurobank. It is also reflected in a comparative analysis presented in Table 1 “Comparison of bank offers including forfeiting” which is an appendix to this article.

Except for banks also specialised business entities offer forfeiting services on the Polish market, to some extent such services are also offered by financial agents.

According to the reports of the Ministry of Economy, the barrier in the development of classical foreign forfeiting (purchasing of foreign claims) is Art. 70 item 1 of the Banking Act which makes granting a credit by bank dependent on creditworthiness of a bor-

⁴⁴ *Przedsiębiorczość w Polsce*, Ministry of Economy, Warszawa September 2013, p.110.

⁴⁵ Comp. Program KUKI Forfeiting, KUKI, available on the Internet: [online] [access: 3.02.2016] http://www.kuke.com.pl/program_kuke_forfeiting.php.

⁴⁶ Comp. *Przedsiębiorczość w Polsce*, Ministerstwo Gospodarki, Warszawa August 2012, p.92.

⁴⁷ Comp. *Przedsiębiorczość w Polsce* (2013), op. cit., p.110.

rower. Pursuant to this act “creditworthiness is the ability to pay a granted credit with interest within maturity dates determined in an agreement”⁴⁸. According to the report “Polish banks have methodological difficulties such an assessment of foreign debtors”⁴⁹.

It should be mentioned that commercial banks – agreeing to finance particular investments using forfeiting – assess creditworthiness and credibility of particular clients. The goal of such an assessment is making sure that the financial situation of a client will not negatively affect timely payment of other accounts payable.

Optimistic, macroeconomic forecasts for the growth of interest in forfeiting in 2013 turned out to be wrong regardless of the growth of a few percentage points. The deteriorating financial situation and bankruptcy of numerous business entities did not contribute to a growth in the interest in this solution.

According to banks the development of forfeiting is hampered by restricted possibilities of preparing a credible assessment of debtor’s situation and lack of certainty related to proper execution of an agreement by the party selling a service. In this case the insurance of the agreement is important, e.g. in the form of bank guarantees, KUKE policy or a letter of credit. According to banking institutions, a significant obstacle in the development of this service is its relatively high cost. In an uncertain market situation exporters make offers with a minimum margin and are not ready to bear additional costs⁵⁰. Only companies with high margins can afford forfeiting. Due to intense competition, obtaining a high margin is very difficult because importers try to buy at the lowest possible prices. As a result of negotiations, exporters often resign from a part of their margins⁵¹. Apart from this, the financial situation of some companies does not allow to grant them a trade credit.

To propagate forfeiting, banks should ease transaction conditions, i.e. accept higher risk and extend the range of transactions which could use forfeiting. It should be emphasised that the cost of a service depends on risk assessment (which is fully taken over by a bank), amount (from 100 to 200m USD) and maturity (from 6 months to 7 years). The above given ranges arise from the IFA definition, however, particular financial institutions can use slightly different criteria. Another obstacle can be the fact that although a claim is bought by a bank, some obligations arising from an export contract remain exporter’s responsibility, e.g. liability for contract execution⁵².

For Polish banks forfeiting can be a significant source of income, especially in the case of financing transactions in high risk countries. Due to their equity and foreign experience, Polish banks can be competitive in comparison with international forfeiting institutions, they can also form financial consortia with world institutions to finance such transactions.

⁴⁸ The Banking Act of 29 August 1997, National Journal of Laws 2002, No. 72, item 665, art. 70.1.

⁴⁹ *Przedsiębiorczość w Polsce* (2013), op. cit., p.110.

⁵⁰ Comp. A. Wieczorek, op. cit., p. 59.

⁵¹ Comp. E. Weronis, op. cit., p. 250.

⁵² Comp. A. Wieczorek, op. cit., p. 59.

CONCLUSIONS

Analysing the advantages and disadvantages of forfeiting, it should be mentioned that in principle it does not have any disadvantages, provided that it is used with trusted contractors, and if financial analyses show that their situation is bad, entrepreneurs can quickly regain lost capital, which has a positive influence of company financial liquidity.

Economic effects of the use of forfeiting encompass, e.g. improvement of financial liquidity by turning account receivable into financial means, and in the case of transaction with no recourse, i.e. when risk is transferred, there is a possibility of minimising entrepreneur's risk resulting from trade transactions; decreasing the risk of cooperation with an incredible or insolvent contractor; transfer of trade credit risk to a forfeiter and transfer of the risk related to the contractor's country to a forfeiter in international forfeiting transactions.

It should be emphasised that this way of financing can cover both domestic claims and claims arising from import-export contract between entrepreneurs. It allows an exporter to immediately obtain money for the complete value of a concluded contract and thanks to this the net value can be calculated. Usually claims are sold with no right of recourse, i.e. a company does not bear the risk of importer's payment arising from an agreement and avoids legal procedures and costs of debt collection. This type of transaction eliminates the risk related to contract settlement – it also excludes transaction, transfer, political and currency related risks. An importer gains an opportunity to obtain a fixed interest loan and can adjust the payment of instalments to its financial situation.

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BIOGRAPHICAL NOTE

Julitta KOĆWIN – Doctor of Economic Sciences, associate professor at the Institute of Economic Sciences, Faculty of Law, Administration and Economics of the University of Wrocław. She specialises in capital investments and banking as well as external financing for SME. Her research is related to contemporary economic problems.

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