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WORLD CUSTOMS ORGANIZATION
ORGANISATION MONDIALE DES DOUANES
ORGANIZACIÓN MUNDIAL DE ADUANAS

TECHNICAL COMMITTEE
ON CUSTOMS VALUATION
-
30th Session
-

VT0722E1a
(+ Annex)

O. Eng.

Brussels, 13 January 2010.

STUDY ON ROYALTIES AND LICENCE FEES : DRAFT GENERAL COMMENTARY AND CASE STUDIES SUBMITTED BY CANADA AND JAPAN

(Item VI (a) on the Agenda)

Reference documents :

VT0433E1a (TCCV/20)
VT0440E1c (TCCV/20 Report)
VT0465E1a (TCCV/21)
VT0467E1a (TCCV/21)
VT0470E1c (TCCV/21 Report)
VT0481E1a (TCCV/22)
VT0491E1a (TCCV/22)
VT0499E1c (TCCV/22 Report)
VT0513E1a (TCCV/23)
VT0514E1a (TCCV/23)
VT0528E1b (TCCV/23)
VT0529E1b (TCCV/23
VT0534E1c (TCCV/23 Report)
VT0544E1a (TCCV/24)
VT0545E1a (TCCV/24)
VT0557E1a (TCCV/24)
VT0558E1a (TCCV/24)
VT0564E1c (TCCV/24 Report)
VT0575E1a (TCCV/25)
VT0576E1a (TCCV/25)
VT0589E1a (TCCV/25)
VT0590E1a (TCCV/25)
VT0598E1c (TCCV/25 Report)
VT0608E1a (TCCV/26)
VT0609E1a (TCCV/26)
VT0619E1a (TCCV/26)
VT0620E1a (TCCV/26)
VT0626E1c (TCCV/26 Report)
VT0639E1a (TCCV/27)
VT0640E1a (TCCV/27)
VT0648E1a (TCCV/27)
VT0649E1a (TCCV/27)
VT0655E1a (TCCV/27)
VT0656E1a (TCCV/27)
VT0663E1c (TCCV/27)
VT0670E1a (TCCV/28)
VT0678E1a (TCCV/28)
VT0686E1c (TCCV/28 Report)
VT0699E1a (TCCV/29)
VT0711E1a (TCCV/29)
VT0715E1b (TCCV/29 Draft Report)

I. SECRETARIAT COMMENTS

1. At its 29th Session, the Technical Committee on Customs Valuation continued its discussions on the topic of third party royalties and licence fees. The discussions focussed on the draft General Commentary issued as Annex I to Doc. VT0711E1a.

2. Based on discussions at the 29th Session, a further draft has now been prepared as is issued as an Annex to this document. The draft incorporates some structural and editing changes suggested by the Technical Committee and the Secretariat. Certain sections are shown in square brackets where reservations were made by delegates on specific points.

For reasons of economy, documents are printed in limited number. Delegates are kindly asked to bring their copies to meetings and not to request additional copies.

3. The Technical Committee expressed contrasting opinions concerning the subject of "control" covered in paragraph 9 (b) of the previous version of the draft Commentary, Annex to doc. VT0711E1a. Some delegates preferred to delete this section, others considered that it contained an important point which should be captured within this document. Following a suggestion made at the last Session, the Secretariat has restructured the document so that the control issue is included in paragraph 10 of the revised document, along with factors listed in paragraph 9 (a) of the previous document, rather than in a separate paragraph.

4. The Technical Committee has previously agreed that the draft Case Studies submitted by Canada and Japan which had been developed by the Technical Committee, but not finalised, are to be carried forward as part of the ongoing work. For reasons of economy, the draft Case Studies are not reproduced in this document. The relevant versions are contained in Annexes I, II and III to Doc. VT0670E1a.

5. The Secretariat invites the Technical Committee to continue its discussions on this issue at the 30th Session.

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THIRD PARTY ROYALTIES AND LICENCE FEES - GENERAL COMMENTARY

1. The purpose of this document is to provide guidance regarding the interpretation and application of Article 8.1 (c) of the Agreement in cases where a royalty or licence fee is paid to a third-party licensor [unrelated to the seller].

2. Under Article 8.1 (c), royalties and licence fees are to be added to the price actually paid or payable for the imported goods where they are related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such licence fees are not included in the price actually paid or payable.

3. A common issue occurring in international trade is where the royalty or licence fee is paid to a third party, that is, a party other than the seller of the imported goods. Typically in these scenarios, the buyer/importer enters into a sales contract with the seller/manufacturer and also enters into a licence agreement with a third party licensor. In some cases, a licence agreement also exists between the licensor and seller/manufacturer.

4. For the purpose of making a determination under Article 8.1 (c), it is important to examine all the relevant documents, including royalty, licence and sales agreements. The royalty or licence agreement will generally specify what rights are being granted, the terms agreed between the licensor and licensee and details regarding the payment of the fee. The sales agreement will specify terms and conditions relating to the sale for export. The information contained in the royalty, licence and sales agreements, and other relevant documents, may give some indication of whether the payment of the royalty or licence fee should be included in the customs value under Article 8.1 (c).

5. In situations where a royalty or licence fee is paid to a third party it is considered unlikely that the fee would be included in the price actually paid or payable under Article 1. In view of this, the royalty or licence fees are deemed not to be included in the price actually paid or payable for the purposes of this Commentary. The analysis therefore focuses on the two main questions regarding the application of Article 8.1 (c) :

- is the royalty related to the goods being valued; and,
- is the royalty paid as a condition of sale of the goods being valued ?

Determining whether a licence fee is related to the goods being valued

6. There are various circumstances in which a royalty or licence fee may be considered to relate to the goods being valued. The most common is when the imported goods incorporate the intellectual property and/or are manufactured using the intellectual property covered by the licence. For example, if the imported goods incorporate the trademark for which the royalty is paid, this would indicate that the royalty relates to the imported goods. Another indication would be where rights conferred under the royalty agreement relate to the production or sale for export of the imported goods. [An example of this would be a payment for the right to manufacture, import or distribute the licensed goods.]

7. [A further indication is that the amount of the licence fee is calculated based on the buyer's/importer's net sales price of the imported goods within the territory of the country of importation. Also, the fact that the licence fees are paid as a fixed annual amount cannot indicate that the licence fee is not related to the goods being valued.]

Determining whether a licence fee is paid as a condition of sale of the goods being valued

8. With regard to the issue of whether the buyer must pay the royalty or licence fee as a condition of sale of the imported goods, a key question is whether the buyer is able to purchase the imported goods without paying the royalty or licence fee. When the licence fee is paid to a third party related to the seller of the imported goods, it is more likely that it can be demonstrated that the fee is paid as a condition of sale than when it is paid to a third party unrelated to the seller. [See Advisory Opinion 4.11 in which payment of a royalty by the buyer to a party related to the seller was considered a condition of sale]. There can be various situations where royalties are considered a condition of sale even when they are paid to a third party. Therefore, each situation must be analyzed based on all the facts surrounding the transaction and licence agreement, including relevant legal requirements and obligations.

9. The clearest indication that the buyer could not purchase the imported goods without paying the royalty or licence fee is where the sales documentation for the imported goods includes an explicit statement that the buyer must pay the royalty or licence fee as a condition of sale. Such a reference would be determinative in deciding whether a royalty or licence fee was paid as a condition of sale. [The Technical Committee recognizes, however, that it is unlikely for the sales documentation to include such an explicit provision, particularly where the royalty or licence fee is paid to a third party unrelated to the seller, and does not consider the absence of such a provision to be determinative. It is therefore usually necessary to consider other factors to determine whether payment of the royalty or licence fee is made as a condition of sale.] [The Technical Committee recognises, however, that the sales documentation may not include such an explicit provision, particularly where the licence fee is paid to a party unrelated to the seller. This may indicate that the royalty was not paid as a condition of sale. On the other hand, in the circumstances of a particular case, it may be necessary to consider other factors in order to determine whether payment of the licence fee is made as a condition of sale. (*US alternate proposal made at 29th Session).]*

10. The Technical Committee is of the view that whether the buyer is able to purchase the imported goods without paying the royalty or licence fee depends on a review of all the facts surrounding the sale and importation of the goods, including linkages between the sales and licence agreements and other pertinent information. These factors may include, inter alia, the following :

- There is a reference to the royalty or licence fee in the sales agreement or related documents

- There is a reference to the sale of the goods in the licence agreement

- The licence and sales agreements were executed on the same date which is an indicator that their execution was coordinated and that they may be linked to one another
- According to the facts, the sales agreement can be terminated as a consequence of breaching the licence agreement because the buyer does not pay the licence fee to the licensor. This would indicate a linkage between the royalty payment and the sale of the goods being valued and the royalty payment is a condition of sale
- There is a stipulation in the royalty agreement indicating that if royalties are not paid, the manufacturer is forbidden to manufacture goods incorporating the licensor's intellectual property for the importer
- [The licence agreement includes the right to manufacture and import the goods. This is a stronger indicator that the buyer must pay the royalty or licence fee in order to purchase the imported goods than when the licence agreement covers only the right to distribute the goods in the country of importation.]

- [The buyer has not been granted the licence to manufacture the goods by the licensor and purchases the goods from a seller who has been authorized by the licensor to manufacture the goods. In such a case, it is highly likely that the seller is allowed to sell the goods only to the buyer who has been approved by the licensor and will not sell the goods to the buyer if the buyer does not pay the royalty.]
- The licensor allows the buyer to purchase licensed goods only from the particular seller designated by the licensor
- The licensor allows the seller to sell licensed goods only to licensee(s)
- The buyer cannot submit purchase orders of licensed goods directly to the seller, and all the purchase orders must be submitted to the seller through the licensor
- The Licensor authorizes the terms of the sales agreement between the manufacturer and the importer
- [The licensor exercises significant control over the manufacturer and manufacturing process and/or sale of the imported goods. It is common for a licensor to exercise some quality control over the manufacture of goods that bears its trademark, e.g. the right to review samples and prototypes selected from production, the right to set quality standards, etc. In general, such quality control does not, by itself, necessarily mean that the payment of the royalty is a condition of sale. On the other hand, if the licensor exercises significant control over certain aspects of the manufacturer and manufacturing process, then this could be an indication that the payment of the royalty is a condition of sale. Indications of such control could include where the licensor provides goods and services described in Article 8.1*(b)* of the Agreement or where the licensor directs the purchaser to source goods and services from a particular supplier or manufacturer.]

11. While not exhaustive, the existence of a combination of these factors can be indicative in determining whether the payment of the royalty is considered to be a condition of sale.

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TECHNICAL COMMITTEE
ON CUSTOMS VALUATION
-
30th Session
-

VT0723E1a
(+ Annexes I to III)

O. Eng.

Brussels, 7 January 2010.

STUDY ON ROYALTIES AND LICENCE FEES

CASE SUBMITTED BY BRAZIL

(Item VI (a) on the Agenda)

Reference documents :

VT0433E1a (TCCV/20)
VT0440E1c (TCCV/20 – Report)
VT0465E1a (TCCV/21)
VT0467E1a (TCCV/21)
VT0470E1c (TCCV/21 – Report)
VT0481E1a (TCCV/22)
VT0491E1a (TCCV/22)
VT0499E1c (TCCV/22 – Report)
VT0534E1c (TCCV/23 – Report)
VT0543E1a (TCCV/24)
VT0564E1c (TCCV/24 – Report)
VT0577E1a (TCCV/25)
VT0598E1c (TCCV/25 – Report)
VT0610E1a (TCCV/26)
VT0626E1c (TCCV/26– Report)
VT0641E1b (TCCV/27)
VT0657E1a (TCCV/27)
VT0663E1c (TCCV/27– Report)
VT0671E1a (TCCV/28)
VT0679E1a (TCCV/28)
VT0686E1c (TCCV/28– Report)
VT0700E1a (TCCV/29)
VT0715E1a (TCCV/29– Draft Report)

I. BACKGROUND

1. At its 28th Session, the Technical Committee decided to defer the examination of this case to the next session due to time constraints.

2. During the intersession, the Secretariat prepared a new working document (Doc. VT0700E1a), and contacted Brazil to elicit responses to the questions raised in that document in order to facilitate further discussion at the forthcoming 29th Session of the Technical Committee.

3. In response, Brazil submitted its comments before the meeting of the Technical Committee, which were circulated as a non-paper at the 29th Session and the same is reproduced in Annexes I (Clarification and additional information from Brazil) and II (Answers from Brazil to the inquiries) to this document.

For reasons of economy, documents are printed in limited number. Delegates are kindly asked to bring their copies to meetings and not to request additional copies.

4. At its 29th Session, the Technical Committee examined this case and the details of the Technical Committee's discussions can be found in paragraphs 100 to 110 of Doc. VT0715E1a (Draft report of the 29th Session). The Technical Committee agreed to continue discussion of the case at its 30th Session and asked the Secretariat to prepare a new working document in cooperation with Brazil by incorporating the information as well as clarifications given by Brazil.

II. SECRETARIAT COMMENTS

Facts of transaction

5. Based on the information provided by Brazil, the facts of the transaction are briefly enumerated below (The transaction chart of this case prepared by the Secretariat is attached as Annex III to this document).

6. Company IMP of country of importation I, is an importer and licensee of footwear, bearing the trademark of company OWNER, the licensor in country O. The licensed goods are manufactured by Company MAN, a third-party manufacturer of country of export M. Whereas IMP and OWNER are related in terms of Article 15.4 of the Agreement (OWNER has 99% of the capital share of IMP), OWNER and MAN and IMP and MAN are not related.

7. The licence agreement between OWNER and IMP, which is set out in Annex II to Doc. VT0671E1a contains the following clauses :

- *"Licensed Goods" means footwear, apparel, accessories and equipment which bear any of the trademarks or which incorporate any of the other proprietary rights; (1.9.)*
- *OWNER grants IMP a non-transferable and exclusive license (1) to sell footwear (licensed goods) in the licensed territory (Brazil) and (2) to use the trademark and other proprietary rights in the licensed territory in connection with the advertising, marketing and sale of footwear (licensed goods); (2.1.2.)*
- *IMP agrees to pay OWNER a royalty of one percent (1%) of the net invoiced sales revenues of all licensed goods sold in the licensed territory; (10.1.)*
- *In the event IMP fails to make any payment due to OWNER under this agreement within 30 days from the date said payment is due, OWNER shall have the right to terminate this agreement by giving 10 days' prior written notice to IMP. (14.3)*

8. OWNER and MAN have concluded a supply agreement (agreement concerning manufacturing terms and conditions), which is in Annex I to VT0671E1a. The supply agreement includes the following terms:

- *This agreement concerning manufacturing terms and conditions is entered into between OWNER, acting as buying agent for its Affiliates (IMP), and MAN; (preamble)*
- *As buying agent for its Affiliates (IMP), OWNER assists IMP with manufacturer selection, purchasing, production scheduling, quality control, and transportation and logistics management; (preamble)*
- *OWNER, as buying agent for its Affiliates (IMP), and Manufacturer desire to enter into an agreement setting forth the general terms and conditions that will apply to any future purchase of Manufacturer's products by OWNER Affiliates (IMP); (preamble)*

- *The purposes of this agreement are (1) to provide for the protection of OWNER's and its Affiliates' (IMP's) confidential information and intellectual property rights and (2) to establish the general terms and conditions that will apply to any future purchases of products by OWNER Affiliates (IMP); (2.1)*

- *MAN understands and agrees that OWNER's Affiliates (IMP) have the right to approve all manufacturers recommended by OWNER for the manufacture of products. In order to induce OWNER and its Affiliates (IMP) to select MAN as an approved supplier of products to OWNER Affiliates (IMP), MAN agrees to comply with the terms of this agreement; (2.2)*

- *No obligation to purchase or to sell shall arise until a firm order is placed and accepted. If any OWNER Affiliate (IMP) elects to place a firm order with MAN, the terms and conditions set forth in this agreement shall govern all aspects of the transaction contemplated by the firm order; (2.3)*

- *Each OWNER Affiliate (IMP) shall be deemed to be a party to the contract evidenced by this agreement and any firm order placed by such Affiliate (IMP). MAN understands and agrees that OWNER is acting solely as a disclosed agent in entering into this agreement and negotiating the terms of individual transactions between OWNER Affiliates (IMP) and MAN; (2.4)*

- *MAN understands and agrees that OWNER Affiliates (IMP) make independent purchase decisions; (4.1)*

- *A OWNER Affiliate (IMP), acting either directly or indirectly through OWNER or a designated agent, may place a firm order to MAN; (4.5)*

- *The OWNER Affiliate (IMP) that placed the firm order shall be bound to purchase, and MAN shall be bound to sell, the products specified in the firm order, in accordance with the terms of the firm order and this agreement; (4.8)*

- *The purchasing OWNER Affiliate (IMP), either directly or through its designated agent, shall pay for products within 45 days after receipt of MAN's invoice or the products, whichever is later; (5.7)*

- *MAN and its Affiliates shall not at any time, without the prior written consent of OWNER or a OWNER Affiliate (IMP), manufacture for or sell to anyone, other than OWNER Affiliates (IMP), goods incorporating any OWNER Product Designs/Technology; (8.)*

- *MAN shall use the trademarks only on or in connection with products purchased by OWNER Affiliates (IMP) and in accordance with specifications provided by OWNER, in its capacity as buying agent, or an OWNER affiliate (IMP). MAN shall not sell any products bearing the trademarks to any person other than OWNER Affiliate (IMP). MAN acknowledges OWNER's Affiliates' (IMP) and their respective licensors' ownership of and exclusive right, title and interest in and to the use of each of the trademarks. MAN further acknowledges that any prior use or continued use in the future of the trademarks by MAN has inured and will continue to inure solely to the benefit of OWNER's Affiliates (IMP) and their licensor. (11.)*

9. At the 29th Session of the Technical Committee, Brazil made a presentation summarizing the information in the non-paper (Annexes I and II to this document) in order to

clarify the crucial facts of the case as well as the questions raised in Doc. VT0700E1a as follows :

- *OWNER has a key role in the activities of MAN, as OWNER has chosen and authorized to produce the goods to be sold under its trademark; (paragraph 4, Annex I)*

- *The selection of MAN and the indirect control of manufacturing is performed by OWNER, considering that OWNER is the one who signs the contracts with MAN, chooses and approves them, and determines by contract how purchase orders (firm order) should be prepared and delivered to MAN; (paragraph 5, Annex I)*

- *IMP sends its purchase orders (firm orders) to OWNER, who centralizes all affiliates orders, and deliver them directly to MAN; (paragraph 2.3, Annex II)*

- *IMP can not purchase the licensed products from a seller, which is not recommended by OWNER. IMP can only buy licensed products from manufacturers who have signed a supply agreement with OWNER; (paragraph 3.1, Annex II)*

- *The purchase orders (firm orders) for IMP, sent to OWNER, who in turn distributes them to MAN, do not mention the payment of royalties; (paragraph 4.1, Annex II)*

10. The royalty payments at issue are not included in the price actually paid or payable from IMP to MAN.

Issue for determination

11. In determining the Customs value of the imported goods, whether the royalties IMP pays to OWNER should be added to the price actually paid or payable pursuant to Article 8.1 (c) of the Agreement.

Analysis

12. The case involves the payment of royalties/licence fees by the buyer/importer to a related third party trademark owner/licensor, for the use of a trademark incorporated in the imported goods.

13. Under Article 8.1 (c), there shall be added to the price actually paid or payable for the imported goods, royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and licence fees are not already included in the price actually paid or payable.

14. In this case, since the royalty payments are not included in the price actually paid or payable under Article 1, it must be determined whether the royalties should be added under Article 8.1 (c).

15. The analysis needs to focus on two main issues regarding the application of Article 8.1 (c) :

(1) Whether the royalty is related to the goods being valued; and

(2) Whether the buyer must pay the royalty as a condition of sale for export of the goods being valued.

(1) Whether the royalty is related to the goods being valued

16. There are various circumstances in which a royalty may be considered to relate to the goods being valued. The most common is when the imported goods incorporate the intellectual property and/or are manufactured using the intellectual property covered by the licence. For example, if the imported goods incorporate the trademark for which the royalty is paid, this would indicate that the royalty relates to the imported goods.

17. In this case, based on the facts presented and the terms of the licence agreement, the royalty can be considered to relate to the goods being valued since:

- The imported goods bear the trademark owned by OWNER;
- The royalty is paid for the right to sell the licensed goods in the licensed territory and to use the trademark and other proprietary rights in the licensed territory.

(2) Whether the buyer must pay the royalty as a condition of sale

18. Brazil expressed their views in their non-paper (paragraphs 12 to 15, Annex I to this document) that the royalty payments should be regarded as a condition of sale by examining the facts of the transaction with following prohibitions and limitations imposed by OWNER to MAN and IMP:

- *MAN is prohibited from selling any product with OWNER's design or technology to other companies other than OWNER's affiliates (IMP); (paragraph 12, Annex I to this document)*
- *OWNER has the right to terminate the licence agreement with IMP, in case IMP does not make the payment of royalties to OWNER. Once the licence agreement is terminated, IMP shall no longer be an OWNER's affiliate and therefore MAN are prohibited from selling the licensed goods to IMP; (paragraph 13, Annex I to this document)*

19. The Secretariat is of the view that the issue of whether the buyer must pay the royalty as a condition of sale of the imported goods would depend on the review of all the material facts surrounding the sale and importation of the goods, including the terms of both the licence agreement and the supply agreement, besides other pertinent information.

20. The key question is as to whether or not the buyer/importer could purchase (or the seller/ exporter could sell) the imported goods without paying the royalty.

21. In this case, there is no explicit statement in the sales documentation that the royalty must be paid as a condition of the sale. However, following factors, which might be considered to establish whether the buyer could not purchase the imported goods without paying the royalty, are indentified in the facts of the transaction:

- OWNER chooses and authorizes MAN for the production of the goods to be sold under OWNER's trademark;
- IMP can only purchase the licensed goods from MAN, who has signed a supply agreement with OWNER;
- The supply agreement stipulates that MAN shall not manufacture or sell to anyone other than OWNER Affiliate (IMP) who concludes the licence agreement with OWNER.

22. Accordingly, the Secretariat would like to invite Members' views as to whether or not the facts of the transaction presented by Brazil could go to show that the royalty is paid as a condition of sale.

III. CONCLUSION

23. Members are invited to examine the case and submit their comments to the Secretariat not later than **26 February 2010**. Comments received in response to this document will be published and circulated to Members of the Technical Committee for consideration at its 30th Session.

24. For the efficient work of the Secretariat, Members are invited to send their comments in an electronic version, if possible (E-mail address: valuation@wcoomd.org).

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CLARIFICATIONS AND ADDITIONAL INFORMATION OF BRAZIL FOR ANALYSIS OF THE CASE ON PAYMENT OF ROYALTIES AND LICENSE FEES RELATED TO THE IMPORTS OF LICENSED PRODUCTS

CASE SUBMITTED BY BRAZIL

1. This material is intended to assist in the analysis of the case brought by Brazil to the Technical Committee on Customs Valuation, which suggests that the value of the royalties paid on the importation of licensed goods should be added to the Customs value, as specified in Article 8 of the Valuation Agreement, in addition to meet the requests for clarification of the mentioned Technical Committee on this subject.

2. We believe that such information should focus on enabling to conclude that the payment of royalties by the importing company (IMP) to the holder of the rights on the trademark (OWNER) are related to a condition of sale of the goods being valued, once in the current stage of analysis, it seems to be unquestionable that the payments actually relate to those goods, in conformity with paragraphs 18 and 19 of Doc VT0671E1a.

3. In this context, we must clarify and inform the following below.

<u>OWNER's role in the activities of the licensed products' manufacturers (MAN)</u>

4. OWNER has a key role in the activities of MAN it has chosen and authorized to produce the goods to be sold under its trademark.

5. Just a quick analysis of the supply agreement in Annex I of Doc VT0671E1a, signed by OWNER and MAN, to realize that the selection of MAN and the indirect control of manufacturing is performed by OWNER, considering that OWNER is the one who signs the contracts with MAN, chooses and approves them, and determines by contract how purchase orders should be prepared and delivered to MAN (Articles 2.2 and 4).

6. All MAN approved by OWNER shall conform to the supply agreement, which provides, among other things, on procedures regarding purchase orders, guarantee of information confidentiality, codes of conduct and even quality control of products (Articles 5.6 and 15.2).

<u>Comparative analysis made with Advisory Opinions 4.8 and 4.13 and Conclusion 24 of the Customs Valuation Compendium.</u>

7. At this point, it is timely to perform a comparative analysis of the case in question with those that gave rise to Advisory Opinions 4.8 and 4.13, issued by the Technical Committee on Customs Valuation, which main aspect was oriented by the decision that the royalties paid did not constitute a condition of sale.

8. In the case of Advisory Opinion 4.8, IMP is the one who provides the artwork and design work and MAN is literally identified as a manufacturer not licensed by OWNER. In the present case, MAN must produce the goods in accordance with the prototypes or samples approved by OWNER (item "ii" of Article 7.3 of the supply agreement).

9. In Advisory Opinion 4.13, in the same way, IMP is the one who provides the labels to MAN and, again, it can be seen that there is no relationship between OWNER and MAN.

10. The interferences of OWNER in the production process of MAN fully disengage this case from those that gave rise to the aforesaid advisory opinions and, thus, directly involve the characterization of a condition of sale of the royalties paid.

11. On the same token, it should be noted that Conclusion 24 of the Customs Valuation Compendium, which expresses the opinion of the Technical Committee on Customs Valuation, believes that the existence of evidence pointing to a sufficient degree that the OWNER has direct or indirect control on the production is reason enough to consider that the payment of royalties is a condition of sale.

<u>Prohibitions and limitations imposed by OWNER to MAN and IMP.</u>

12. Another determinant factor to be taken into consideration is the fact that MAN is prohibited to sell any product with OWNER's design or technology to other companies other than OWNER's affiliates, among which is IMP (Article 8 of the supply agreement).

13. Furthermore, it should be remembered that OWNER has the right to terminate the license agreement signed with IMP, in case the latter does not make, for any reason, the payment of royalties due to the OWNER within the time limit established there (Article 14.3 of the license agreement in Annex II of Doc VT0671E1a), remaining clear that, once the license agreement is terminated, IMP shall no longer be an OWNER's affiliate and therefore MAN are prohibited from selling the licensed goods to IMP.

14. Yet in the light of such termination, IMP is contractually forced to immediately stop the sale and advertising of licensed goods, beyond the use of the trademark rights (Article 16 of the license agreement).

15. Thus, the combination of all exposed with the prohibitions and limitations imposed by OWNER to MAN and IMP strengthens the argument that the royalty payments constitute a condition of sale of the goods being valued.

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ANSWERS OF BRAZIL TO THE INQUIRIES CONTAINED IN DOC. VT0700E1a

CASE SUBMITTED BY BRAZIL

1. All answers given here are based on the documents already submitted and the information collected from the own importer (IMP) in the course of supervision.

2. Answers to questions raised by the Secretariat in paragraphs 11 and 12 of Doc. VT0671E1a :

2.1 Whether a buying agency agreement exists between OWNER and IMP in relation to Section 2.1 of the supply agreement in Annex I of Doc. VT0671E1a ?

Answer :

There is not a buying agency agreement between OWNER and IMP in relation to Section 2.1 of the supply agreement in Annex I of Doc. VT0671E1a.

2.2 How are IMP and related OWNER under Article 15.4 of the Agreement ?

Answer :

OWER and IMP are related companies in accordance with Article 15.4 of the Agreement. The social contract of IMP records clearly and undoubtfully that OWNER has 99% of the capital share and therefore it constitutes a parent and subsidiary relationship.

2.3 Whether there are some other documents between IMP and MAN, which could substitute for the Sales contract?

Answer :

There are no other documents between IMP and MAN, which could substitute for the sales contract. Similarly, there is no contract of sale between IMP and MAN, or any other replacing it. It should be remembered that IMP does not deliver its purchase orders directly to MAN. In this regard, it is necessary to correct the flow transcribed in paragraph 9 of Doc. VT0671E1a, because unlike what is described there, IMP sends its purchase orders to OWNER, who, in turn, centralizes all affiliates orders, among which is IMP, and delivers them directly to MAN.

3. Answers to questions raised by Japan in Annex I to Doc. VT0679E1a :

3.1 Whether IMP could purchase the licensed products from the seller, which is not recommended by OWNER in relation to Section 2.2 of the supply agreement in Annex I of Doc. VT0671E1a ?

Answer :

No, IMP cannot purchase the licensed products from a seller, which is not recommended by OWNER in relation to Section 2.2 of the supply agreement.

IMP can only buy licensed products from manufacturers who have signed a supply agreement with OWNER. .

Furthermore, it should be noted that, in accordance with Clause 7 of the license agreement in Annex I of Doc VT0671E1a, signed by OWNER and IMP, goods purchased by IMP can be inspected by OWNER at any time and, if OWNER does not approve them, IMP has as contractual obligation the duty to immediately stop the sale of goods bearing the OWNER trademark.

3.2 Who makes the specifications, which are stated in Section 11 of the supply agreement in Annex I of Doc. VT0671E1a ?

Answer:

The specifications stated in Section 11 of the supply agreement are made by OWNER.

3.3 Whether OWNER exercises any control over the provision of a firm order related to the fourth bullet point in paragraph 9 of Doc. VT0671E1a ?

Answer :

Yes, OWNER exercises control over the provision of a firm order.

As commented in the response to the question in paragraph 3.3 above, it is necessary to correct the statement reproduced in the fourth bullet point in paragraph 9 of Doc. VT0671E1a, because, unlike to what is described there, IMP sends its orders to OWNER, who, in turn, delivers them to MAN.

4. Response to the question raised by the United States in Annex II to Doc. VT0679E1a :

4.1 Whether the firm orders placed by IMP do not contain any additional terms or conditions, as permitted under Section 2.3 of the supply agreement in Annex I of Doc. VT0671E1a, that relate to the payment of the royalty ?

Answer :

The purchase orders for IMP, sent to OWNER, who in turn distributes them to manufacturers (MAN), do not mention the payment of royalties.

The aforementioned payment is not made by the manufacturers, but by the importers. Thus, the conditions for the payment of royalties are present in the contract between OWNER and IMP (brand owner and subsidiaries).

* * *

COMMENTS BY AUSTRALIA

1. Australia thanks the Secretariat for its work in preparing the working document (VT0723E1a) and also Brazil for the clarifications provided for this case study.

2. Australia seeks clarification from Brazil regarding the following:

3. Clause 4.5 of the Manufacturing Agreement states that "a OWNER Affiliate, acting directly or indirectly through OWNER or a Designated Agent may place a Firm Order at any time by submitting the document or documents constituting the Firm Order to Manufacturer at the address set forth in the first paragraph of this Agreement…"

4. Clause 5.7 of the manufacturing agreement provides that "unless otherwise specified in the Firm Order, and subject to the other provisions of this Section 5, the purchasing OWNER Affiliate, either directly or through its Designated Agent, shall pay for Products within 45 days after receipt of Manufacturer's invoice or the Products, whichever is later".

5. The above two clauses allow an Owner Affiliate to place a firm order and to pay for products through a designated agent. "Designated agent" is defined Clause 1.3 to mean "any entity designated as an additional buying agent of a OWNER Affiliate pursuant to Section 3 of this Agreement".

6. The facts presented in this case study seem to suggest that all firm orders or purchase orders are placed by the Owner Affiliate through the Owner. For instance, third bullet point in paragraph 9 states that "IMP sends its purchase orders (firm orders) to OWNER, who centralizes all affiliates orders, and delivers them directly to MAN".

7. Given that Clauses 4.5 and 5.7 provide the possibility for the Owner Affiliate to place a firm order and to pay for the products through a designated agent, Australia seeks clarification from Brazil as to whether the Owner Affiliate has placed any firm orders or paid for the products through any designated agent?

8. Australia anticipates that it will have additional comments to make in respect of this matter at the 30th Session.

* * *

COMMENTS BY THE UNITED STATES

1. The United States thanks the Secretariat and Customs Administration of Brazil for providing further clarification regarding the facts of the case.

2. Annex II of the Agreement sets out the responsibilities of the Technical Committee on Customs Valuation ("Technical Committee"), which include examining specific technical problems arising in the day-to-day administration of the Customs valuation system of Members, providing advisory opinions on appropriate solutions based upon the facts presented, and furnishing such information and advice on any matters concerning the valuation of imported goods for customs purposes as may be requested by any Member or the Committee. Therefore, the Technical Committee would normally be in the position to consider the case submitted by Brazil. However, based on our review, we are of the opinion that the statement of facts of the transaction and the analysis of these facts, as presented in Doc. VT0723E1a, contain serious inconsistencies and omissions when compared to the provisions of the license agreement between IMP and OWNER. These inconsistencies and significant contradictions and omissions that exist between the working document and the underlying agreements, to be fully discussed at the 30th Session, go to the heart of the issue that the Technical Committee is being asked to consider.

3. Accordingly, we suggest that the Technical Committee is not in a position to render an opinion on this matter.

4. The United States recommends that this matter be moved to part III of the Conspectus.

5. The U.S. Administration anticipates that it may have additional comments to make in respect of this matter at the 30th Session.

WORLD CUSTOMS ORGANIZATION
ORGANISATION MONDIALE DES DOUANES
ORGANIZACIÓN MUNDIAL DE ADUANAS

TECHNICAL COMMITTEE ON CUSTOMS VALUATION

-

30th Session

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VT0724E1a
(+ Annexes I and II)

O. Eng.

Brussels, 7 January 2010.

STUDY ON ROYALTIES AND LICENCE FEES

CASE SUBMITTED BY COLOMBIA

(Item VI (a) on the Agenda)

Reference documents :

VT0433E1a (TCCV/20)
VT0440E1c (TCCV/20 – Report)
VT0467E1a (TCCV/21)
VT0470E1c (TCCV/21 – Report)
VT0482E1a (TCCV/22)
VT0492E1a (TCCV/22)
VT0499E1c (TCCV/22 – Report)
VT0515E1a (TCCV/23)
VT0534E1c (TCCV/23 – Report)
VT0546E1a (TCCV/24)
VT0564E1c (TCCV/24 – Report)
VT0578E1a (TCCV/25)
VT0598E1c (TCCV/25 – Report)
VT0611E1a (TCCV/26)
VT0626E1c (TCCV/26 – Report)
VT0642E1a (TCCV/27)
VT0658E1a (TCCV/27)
VT0663E1c (TCCV/27– Report)
VT0672E1a (TCCV/28)
VT0686E1c (TCCV/28– Report)
VT0701E1a (TCCV/29)
VT0715E1a (TCCV/29– Draft Report)

I. BACKGROUND

1. At its 28th Session, the Technical Committee decided to defer the examination of this case to the next session, as Colombia was not present at the meeting. The Technical Committee also requested that the Secretariat contact the Delegate of Colombia for further clarification during the intersession and agreed that this case might be placed in Part III of the Conspectus if no reply was received from Colombia.

2. During the intersession, the Secretariat prepared a new working document, which was set out in Doc. VT0701E1a, and contacted Colombia to invite them to clarify the points raised in Doc. VT0672E1a to facilitate further discussion at the 29th Session of the Technical Committee.

3. In response to this, Colombia submitted the information to the Secretariat during the 29th Session of the Technical Committee. That information is reproduced in Annex I to this document.

4. At its 29th Session, the Delegate of Colombia requested the Technical Committee to defer examination of this case to its 30th Session. Accordingly, the Technical Committee

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agreed to continue discussion of the case at its 30th Session and asked the Secretariat to prepare a new working document incorporating the additional information from Colombia.

II. SECRETARIAT COMMENTS

5. According to the facts presented by Colombia, this case deals with royalty/licence fee payment transactions in which various parties performing different functions in the production and sale of the goods are related.

6. Based on the information provided by Colombia, the facts of the transaction are briefly enumerated below (The transaction chart of this case prepared by the Secretariat is attached as Annex II to this document):

Facts of transaction

- The manufacturers of country P sold the trademarked goods to Exporter C of country P. Exporter C in turn supplied the goods to Importer E of country I through Intermediary D of country Q, who provided logistical support.
- Exporter C controlled the manufacturers and their production. Importer E had no direct relationship with the manufacturers.
- The sales contract was not available, as perhaps Importer E did not enter into any written contract/agreement with Exporter C.
- With respect to the imported goods, two different licence agreements had been concluded between Importer/Licensee E and Licensor B of country Y (Contract 1) as well as Licensor S of country X (Contract 2) respectively depending on the types of trademarks. Both the licence agreements granted Importer/Licensee E the rights to manufacture, import, distribute and sell the licensed goods using granted know how as well as technology given by the Licensors.
- In consideration of the licences granted under the licence agreements, Importer/Licensee E shall pay Licensor B as well as Licensor S royalties, and the amount of the said royalties was calculated based on the net sales of the licensed goods in Colombia.
- In connection with the production as well as the distribution of the licensed goods, both Licensor B and Licensor S provided the Importer/Licensee E with necessary know how and technology, such as, technical knowledge, specifications and marketing plans, respectively.
- Whereas the licence agreements granted Importer/Licensee E the right to conclude a sub contract with subcontracting manufacturers, it was not allowed to enter into a sub licence agreement.
- Exporter C, Intermediary D, Importer E, Licensor B and Licensor S belonged to the same economic group under the Parent Company M of country Z. Only the manufacturers were outside that economic group.
- The transaction value in question, however, had not been influenced by their relationship, as that price was adequate to ensure recovery of all costs plus profit, consistent with Paragraph 2 (a) of the Interpretative Notes under Article 1 of the Agreement, namely, that profit was representative of the firm's overall profit from the sale of goods of the same class or kind.

Issue for determination

7. In determining the Customs value of the imported goods, whether or not the royalties Importer E pays to Licensor B and Licensor S should be added to the price actually paid or payable pursuant to Article 8.1 (c) of the Agreement.

Analysis

8. The Secretariat would like to submit the following points for further consideration by the Technical Committee:

(1) Clarify the "seller"

9. At its 26th Session of the Technical Committee, the Delegate of Colombia explained that the "seller" of the imported goods in question was Exporter C of country P. In response to this explanation, the Delegate of the United State raised a question on as to how Exporter C was identified as the "seller" in this transaction, since the sales contract was not available.

10. In its written comments, which were set out in Doc. VT0658E1a, Japan suggested that the following facts be added to the facts of transaction, in order to move the case forward, as no sales agreement was available in this case:

- Trade terms (price, quantity, etc.) of the imported goods were negotiated and determined between Importer E and Exporter C
- Payment of the imported goods was made by Importer E to Exporter C (through Intermediary D)
- Purchase orders were sent by Importer E to Exporter C (through Intermediary D).

11. Colombia in its written comments (paragraphs 1 to 4 of Annex I to Doc.VT0672E1a) explained that the "seller" of the imported goods was "C", based in country P, who received payment for the goods and delivered them to Importer E via Intermediary D in country Q.

12. Accordingly, the Technical Committee should consider as to how the facts of this case could be further developed, keeping in mind, whether the facts of transaction could be reinforced by adding some new elements proposed by Japan.

13. In order to clarify the issue about the "seller", the Secretariat would like Colombia to clarify about the sub contract manufacturers, that is, whether Importer E concluded the sub contract for the imported goods with Exporter C or the manufacturers in country P.

(2) Examine "related to the goods being valued" under Article 8.1 (c) of the Agreement

14. There are various circumstances in which a royalty may be considered to relate to the goods being valued. The most common is when the imported goods incorporate the intellectual property and/or are manufactured using the intellectual property covered by the licence. For example, if the imported goods incorporate the trademark for which the royalty is paid, this would indicate that the royalty relates to the imported goods.

15. In this case, based on the facts presented and the terms of the licence agreement s , the royalty can be considered to relate to the goods being valued.

(3) Analyse a "condition of sale" under Article 8.1 (c) of the Agreement

16. As regards the issue of "condition of sale" under Article 8.1 (c) of the Agreement in this case, several questions had already been raised in the previous documents. In response to those questions, Colombia provided its clarifications, which were reproduced in Annex I to Doc. VT0672E1a and also in Annex I to this document. The key elements of two licence agreements, which were submitted by Colombia, were given in Annex to Doc. VT0578E1a.

17. As for the analysis on "condition of sale", Colombia explained (paragraphs 5 to 10 of Annex I to Doc. VT0672E1a) that a "condition of sale" under Article 8.1 (c) should be analysed from two angles, namely, "content of the licence agreements" and "relationship between the buyer and the licensor".

18. Concerning "content of the licence agreements" (paragraphs 5 to 8 of Annex I to Doc. VT0672E1a), Colombia explained that the licence agreements and the sales for export were closely related, as non payment of the royalty by the importer would terminate not only the licence agreements but also sale of the goods to the importer.

19. Regarding "relationship between the buyer and the licensor" (paragraph 9 of Annex I to Doc. VT0672E1a), Colombia stated that relationship amongst the members of the same economic group (Parent Company M, Licensor B, Licensor S, Importer/Licensee E, Intermediary D and Exporter C), made it possible for Importer E to purchase the licensed goods from Exporter C.

20. Consequently, Colombia was of the view that the royalties in question should be added to the price actually paid or payable, as a "condition of sale" under Article 8.1 (c) did exist in this transaction.

21. The Secretariat is of the view that the issue of whether the buyer must pay the royalty as a condition of sale of the imported goods would depend on the review of all the material facts surrounding the sale and importation of the goods, including the terms of the licence agreement as well as other pertinent facts and information. The critical question is as to whether or not the buyer/importer could purchase (or the seller/ exporter could sell) the imported goods without paying the royalty.

22. In this case, there is no explicit statement in the sale documentation that the royalty must be paid as a condition of the sale.

23. Accordingly, following key factors in the transaction should be taken into account for analysing the issue of "condition of sale" under Article 8.1 (c) of the Agreement :

- The royalty is paid by Importer/Licensee E to Licensor B and Licensor S who are related to the seller, in case Exporter C would be clarified as seller;
- The interrelationship between the licence agreement and the sale of the imported goods in this transaction, that is, whether or not the seller automatically could not sell the goods to Importer/Licensee E in case the licence agreement was terminated because of the failure of the royalty payments by Importer/Licensee E.

(4) Examine the nature of the royalty payments under the licence agreements

24. Following payments and rights were covered under the two licence agreements (Contract 1 and Contract 2) in the Annex to Doc. VT0578E1a:

25. Under Contract 1 of the licence agreement between Importer/Licensee E and Licensor B, the royalty payment (10% of net product sales) related to the rights to use the trademark (Mark 1, Mark 2, and Mark 3) and know how.

26. Under Contract 2 of another licence agreement between Importer/Licensee E and Licensor S, the royalty payment related to the use of R & D, which represented the value of the technology and the technical Materials generated by the licensor, as well as the use of trademarks, which represented the value of the marks and materials of marks.

27. The Secretariat is of the view that the nature of all the payments and rights in the said licence agreements required to be examined thoroughly, in order to determine which payments fall within the ambit of Article 8.1(c) of the Agreement. The Secretariat would like Colombia to clarify what kind or type of know how, R & D, technology, technical materials, etc are directly related to the goods or utilized in the production of the imported goods.

III. CONCLUSION

28. Members are invited to examine the case and submit their comments to the Secretariat not later than **26 February 2010**. Comments received in response to this document will be published and circulated to Members of the Technical Committee for consideration at the 30th Session.

29. For the efficient work of the Secretariat, Members are invited to send their comments in electronic format to the extent possible. (E-mail address : valuation@wcoomd.org).

* * *

INFORMATION FROM COLOMBIA

Study on royalties and licence fees – Case submitted by Colombia

In order to facilitate the smooth running of the 29th Session of the Technical Committee on Customs Valuation, which will take place from 23 to 29 October 2009, the Colombian Administration submits the following comments in reply to the questions raised by various members of the Technical Committee and by the Secretariat, as indicated in Doc. VT0672E1a.

1. Paragraph 16. Provision of production specifications to the manufacturers

In relation to the analysis of the "condition of sale" concept under Article 8.1 (c) of the Agreement, Japan raises the question of who provides the manufacturers with the production specifications.

The ASSIGNOR* or the LICENSOR provides the manufacturers with the production specifications. This can be deduced from the following clauses of the licence agreements:

CONTRACT 1
The Chapter on Quality Control stipulates that: The Assignor must provide the Concessionaire with the know-how that the Assignor considers reasonable in terms of being necessary for the manufacture of the products under licence. The products shall be manufactured in strict compliance with the know-how and/or any other specifications or instructions that the Assignor may specify or approve from time to time. For this purpose, the Assignor shall supply a sample of each licensed product. In particular, the Assignor's specifications regarding style, colours and materials must be complied with.

If the standards set are not adhered to, the Assignor may revoke the approval for any licensed product, with the result that manufacture of that product will have to cease.

CONTRACT 2
The Chapter on Rights Granted sets out the conditions to be fulfilled by the subcontractors, it being noted that these conditions must be consistent with those laid down by the Licensor.

The Chapter on Quality Control stipulates that: The Licensor shall provide the technical materials deemed necessary for the manufacture of the products. The Concessionaire shall manufacture the products in accordance with the Licensor's instructions, and shall seek his approval for the sale and distribution of the products. It is also specified that the Concessionaire, in accordance with the Licensor's instructions, must comply with the specifications relating to quality, brand image policies and marketing, and will be responsible for the mark, the products and the style and colours standards, in particular.

Another relevant provision is clause 2.6 of CONTRACT 1, which states that "The PRODUCTS may be supplied and invoiced to the Concessionaire through any SUBSIDIARY, manufacturer or other entity in any country, duly authorized for this purpose by the ASSIGNOR." (Extract from text)

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* Translator's Note : referred to as the "Transferor" in certain texts previously provided in English by the Colombian Administration

2. Paragraph 17. Clarifications regarding the apparent discrepancies between the two licence agreements

- In this connection it is important to note, as is indicated in the table setting out the Key Elements of the Contracts concerning Royalties and Licence Fees, that Contract 1 relates to the "Mark", which includes other registered trademarks, the patent and know-how.

- Chapter 2 c) of Contract 2 refers to the exclusive right and licence to import, sell and distribute the products. It must be borne in mind that the Licensor is the owner of the "Pepe" mark, and that payment of the royalties takes place through third parties.

3. Paragraphs 18 to 21. Analysis of the "condition of sale" concept

Where termination is concerned, the licence agreements provide as follows:

CONTRACT 1
Article 9: Duration – Termination. Paragraph 3 states : "...The ASSIGNOR shall have the right to terminate this CONTRACT, with immediate effect ... should one or more of the following events occur : If the CONCESSIONAIRE fails to honour his obligations with regard to payments or remittances under this CONTRACT when they fall due...". Also, paragraph 4 states that : "On expiry of this CONTRACT, all the rights conferred under the terms of the CONTRACT shall revert to the ASSIGNOR, and with effect from that date the CONCESSIONAIRE shall immediately cease to use the MARKS and the KNOW-HOW, as well as the ...".

CONTRACT 2
Article 9: Duration – Termination. Paragraph 3 states: "The LICENSOR shall have the right to terminate this CONTRACT with immediate effect ... should one or more of the following events occur: If the CONCESSIONAIRE fails to honour his obligations with regard to payments or remittances under this CONTRACT when they fall due ..."Also, paragraph 4 states that : "On expiry of this CONTRACT, all the rights guaranteed under the CONTRACT shall revert to the LICENSOR, and with effect from that date the CONCESSIONAIRE shall immediately cease to use the TECHNOLOGIES and the MARKS, and shall cease all activity in relation to the PRODUCTS....

As can be seen from the above, non-compliance is not confined to non-payment of the royalties. It is clear that non-compliance is a general issue that relates to all of the obligations arising out of the contract concerned, including non-payment of the royalties, and this is why no specific reference is made to the latter.

In this connection, account must be taken of certain significant aspects of the "condition of sale" concept, namely the relationship between seller and buyer, as well as the nature of the imported goods, which in this instance are specialist (unusual) products which can be manufactured only to the specifications of the ASSIGNOR or the LICENSOR.

4. Paragraph 22. How will the rights to use the intellectual property under the licence agreements be transmitted from Importer E to the manufacturers?

In this connection the Colombian Administration reiterates what it previously indicated in paragraph 13 of Annex I to Doc. VT0672E1a: "13. This being the case, the rights relating to the use of the intellectual property **are not transferred** from the importer to the manufacturer." (Extract from text)

5. Paragraph 22. With whom did importer E conclude the subcontract for the imported goods, i.e., with Exporter C or with the manufacturers?

As is stated in the Contracts, the subcontract is concluded between the importer and the subcontracting manufacturers. This can be deduced from clause 2.7 of CONTRACT 1 and clause 2.3 of CONTRACT 2 which indicate, respectively, the following:

CONTRACT 1
"The CONCESSIONAIRE can use subcontractors in the TERRITORY for the manufacture of PRODUCTS under LICENCE ..."

CONTRACT 2
"The CONCESSIONAIRE can, nevertheless, use subcontractors in the TERRITORY or in any other part of the world for the manufacture of the products ..."

6. Paragraph 26. The nature of the payments made under the licence agreement.

Under CONTRACT 1 : "As remuneration for the rights granted by this CONTRACT, the CONCESSIONAIRE shall pay the ASSIGNOR a COMPOUND CHARGE equal to ten per cent (10 %) of his NET SALES of the PRODUCTS and PRODUCTS UNDER LICENSE. This COMPOUND CHARGE relates to NET SALES for an amount of up to 200 million dollars in any contractual year. If the sum of the NET SALES during that contractual year exceeds 200 million dollars, a discount of one per cent (1 %) will be granted, meaning that the COMPOUND CHARGE applied to the NET SALES in excess of 200 million dollars will be nine per cent (9 %). If the sum of the NET SALES exceeds 500 million dollars during the same contractual year, an additional discount of one per cent (1 %) will be granted, meaning that the COMPOUND CHARGE applied to the NET SALES in excess of 500 million dollars will be eight per cent (8 %).

Under CONTRACT 2
The COMPOUND CHARGE consists of the following:

a) Commission for R&D (Research and Development) costs, representing the value of the TECHNOLOGY and TECHNICAL MATERIALS provided by the LICENSOR, equal to 8 % (eight per cent) of the amount of its NET SALES of PRODUCTS;

b) A royalty representing the value of the MARKS and the MATERIALS OF MARKS, equal to 6 % (six per cent) of its NET SALES OF PRODUCTS. If the net sales are less than 30.5 million EUROS (thirty point five million EUROS) in any one contractual year, the commission for R&D costs and the royalty shall each be reduced by 1 % (one per cent). »

7. Paragraph 27. "The Secretariat would also like Colombia to clarify the following issues in order to determine which payments fall within the ambit of Article 8.1(c) of the Agreement:

What types of Know-How (Contract1), Technology, Technical Materials and Materials of Marks (Contract 2) are provided to the manufacturers?"

"KNOW-HOW : Any technical knowledge, methods, secrets of manufacture, design, specifications, plans, marketing programmes, business plans, manual plans and similar materials that are the property, whether exclusive or acquired for the duration of the present

CONTRACT, of the ASSIGNOR or of another member of the GROUP .... and that the ASSIGNOR considers reasonable in terms of being necessary for the manufacture and distribution of PRODUCTS and PRODUCTS UNDER LICENCE."

"TECHNICAL MATERIALS: The elements of the technical Know-How and of the technical results and quality standards which the LICENSOR considers reasonable in terms of being necessary in order to manufacture the PRODUCTS satisfactorily."

"MATERIALS OF THE MARK: Any communication, mark identification table or commercial knowledge, methods, marketing, business and similar plans, owned or acquired by the LICENSOR and considered by him to be reasonable in terms of being necessary for the promotion and distribution of the PRODUCTS."

Who provides Know-How (Contract 1), Technology, Technical Materials and Materials of the Mark (Contract 2) to the manufacturers, that is does Importer E provide them to the manufactures directly or via Exporter C?"

CONTRACT 1
The Assignor grants the Concessionaire the non-exclusive right and the licence to use the Know-How to manufacture products under licence on the territory.

CONTRACT 2
The Assignor grants the Concessionnaire the intellectual property rights on the Technology, the Technical Materials and Materials of Marks.

"Regarding Know-How (Contract1), and Technology, Technical Materials and Materials of Marks (Contract 2), how are they related to the imported goods, namely, what is the nexus between them and the imported goods?"

CONTRACT 1
In the "Considering" part of the Contract it is stated that "the Concessionaire wishes to obtain a licence with a view to using the registered marks and other intellectual property rights belonging to the GROUP... for the manufacture, importation, distribution and sale of PRODUCTS and PRODUCTS UNDER LICENCE."

Moreover : "2.1 The ASSIGNOR grants the Concessionaire (a) the non-exclusive right and the licence to use the "KNOW-HOW" to manufacture PRODUCTS UNDER LICENCE on the TERRITORY", the TERRITORY being the country of importation, i.e., Colombia.

"b) The exclusive licence to sell and distribute the PRODUCTS UNDER LICENCE which are manufactured anywhere on the TERRITORY, using the MARKS."

CONTRACT 2
"a) The non-exclusive right and the licence to use the TECHNOLOGY in order to manufacture the PRODUCTS as defined in accordance with the COLLECTION or in order to have these PRODUCTS manufactured by subcontractors anywhere in the world, provided that manufacture takes place in APPROVED FACTORIES and in strict compliance with the TECHNICAL MATERIALS."

"b) The non-exclusive right and the licence to place the MARKS on the products as defined in accordance with the COLLECTION and the COLLATERAL MATERIALS, or to have them placed on the PRODUCTS by subcontractors anywhere in the world, provided that this is done in APPROVED FACTORIES and in strict compliance with the MATERIALS OF THE MARK."

"c) The exclusive right and the licence to import, sell and distribute the products as defined in accordance with the COLLECTION, solely on the TERRITORY...", that TERRITORY being the one where the importation, sale and distribution of the PRODUCTS take place, i.e., Colombia.

The Colombian Administration hopes that this information addresses the concerns expressed, and will be happy to respond to any further queries raised in the future.

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TECHNICAL COMMITTEE
ON CUSTOMS VALUATION
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30th Session
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VT0734E1a
(+ Annex)

O. Eng.

Brussels, 17 March 2010.

STUDY ON ROYALTIES AND LICENCE FEES

CASE SUBMITTED BY COLOMBIA

(Item VI (a) on the Agenda)

MEMBERS' COMMENTS

Reference documents :

VT0433E1a (TCCV/20)
VT0440E1c (TCCV/20 – Report)
VT0467E1a (TCCV/21)
VT0470E1c (TCCV/21 – Report)
VT0482E1a (TCCV/22)
VT0492E1a (TCCV/22)
VT0499E1c (TCCV/22 – Report)
VT0515E1a (TCCV/23)
VT0534E1c (TCCV/23 – Report)
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VT0626E1c (TCCV/26 – Report)
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VT0663E1c (TCCV/27 – Report)
VT0672E1a (TCCV/28)
VT0686E1c (TCCV/28 – Report)
VT0701E1a (TCCV/29)
VT0715E1b (TCCV/29 – Draft Report)
VT0724E1a (TCCV/30)

1. Following the decision of the Technical Committee at its 29th Session, the Secretariat prepared a working document on the Royalties and Licence Fees Case submitted by Colombia, which was set out in Doc. VT0724E1a along with the Secretariat's comments.

2. In response to this, comments have been received from the United States. These comments are reproduced in the Annex to this document.

3. The Technical Committee is invited to continue to examine the case submitted by Colombia taking into account these comments.

* * *

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COMMENTS BY THE UNITED STATES

1. The United States thanks the Secretariat and the Colombian Administration for providing further clarification regarding the facts of the case.

2. It is stated under the Facts of Transaction that Exporter C controlled the manufacturers and their production. Due to the fact that the manufacturers seem to be unrelated to Exporter C, Importer E, and to both licensors, the U.S. would like to clarify what is meant specifically by "control over the manufacturers and their production" in this instance.

3. The U.S. Administration would like Colombian Administration to clarify whether there are any contracts between Exporter C and the manufacturers for the production of the imported goods.

4. Additionally, the U.S. supports written comments submitted by Japan in Doc. VT0658E1a, suggesting the addition of certain facts to the facts of transaction and further identifying Exporter C as the "seller."

5. The U.S. Administration anticipates that it may have additional comments to make in respect of this matter at the 30th Session.