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TECHNICAL COMMITTEE
ON CUSTOMS VALUATION
-
42nd Session
-

VT1051E1b (revised)

O. Eng.

Brussels, 22 April 2016.

DRAFT REPORT TO THE CUSTOMS CO-OPERATION COUNCIL ON THE 42ND SESSION OF THE TECHNICAL COMMITTEE ON CUSTOMS VALUATION

Opening remarks

1. The Technical Committee on Customs Valuation ("Technical Committee") held its 42nd Session at the Headquarters of the World Customs Organization ("WCO"), in Brussels from 18 to 22 April 2016. The Session was chaired by Ms. Y. GULIS (United States) who extended a warm welcome to all delegates, especially those attending the Technical Committee for the first time.

2. Mr. Ping LIU also welcomed the delegates and observers present, in his new capacity as Director of the Tariff and Trade Affairs Directorate.

3. The Director shared briefly his career path before taking his new position at the WCO. He has worked for Customs for more than 30 years mainly in the areas of tariff and trade affairs and trade facilitation at various positions and has represented China's Mission

to different organisations including WTO and EU. His service to the Technical Committee has been for nine years as Senior Technical Officer at the WCO Tariff and Trade Affairs Directorate and four years as a delegate and he is honoured to continue to serve the Technical Committee in his new capacity.

4. He assured the Committee that Customs Valuation will remain one of the main pillars regarding revenue collection and the Secretariat is committed to continuing to support the work of Technical Committee within its mandate, which is to ensure uniform interpretation and application of the WTO Agreement on Customs Valuation.

Agenda Item I : ADOPTION OF AGENDA

(a) Draft Agenda

Doc. VT1021E1d

5. The Chairperson summarized the provisional Agenda contained in Doc. VT1021E1d and invited the Technical Committee to comment. She asked whether any Members wished to raise additional items under Agenda Item VII, Other business.

Discussion

6. One delegate wished to elaborate on his country's Customs - Tax co-operation under item IV (b) - Progress Report on Members' Application of the WTO Valuation Agreement. Upon a proposal of the Chairperson, the Delegate agreed to make his presentation under Item VII (c) of the Agenda which is dedicated to Customs - Tax co-operation.

Conclusion

7. The Agenda was adopted as proposed in Doc. VT1021E1d.

(b) Suggested programme

Doc. VT1022E1a

8. The Chairperson referred to Doc. VT1022E1a, which set out the suggested programme of work for the 42nd Session, and observed that no new technical question during the intersession had been received by the Secretariat.

9. The Delegate of Uruguay suggested to switch item V (g) - question submitted by Ecuador - with Item V(c) – question submitted by Japan in the suggested programme. He proposed that the question submitted by Ecuador be examined on Tuesday afternoon.

10. The Chairperson explained that moving the question of Ecuador on Tuesday afternoon might result in limited time being available to discuss the question as Agenda Item V(a) could take a substantial amount of time.

11. The Delegate of Japan did not agree to switch Japan's question with Ecuador's question and asked to keep the suggested programme unchanged. The Delegate of Uruguay agreed to leave the suggested programme unchanged.

Conclusion

12. The Technical Committee agreed to maintain the suggested programme as set out in Doc. VT1022E1a.

Agenda Item II : **ADOPTION OF THE TECHNICAL COMMITTEE'S 41st SESSION REPORT**

Doc. VT1011E1b

13. The Chairperson drew attention to the written proposals submitted by Argentina, China, European Union, India, Japan and Uruguay in response to the draft Report issued in Doc. VT1011E1a. These proposals had been included in Doc. VT1011E1b and summarized in Annex D of that document. Proposals regarding minor editorial points had been incorporated directly into Doc. VT1011E1b.

Discussion

14. The Chairperson invited comments on Members' proposals of substance as highlighted in bold in Annex D to Doc. VT1011E1b. All the proposals were agreed to, except for paragraphs 78 and 86 of the draft Report. In paragraph 78, there were two proposals ; one from Argentina and the other from Uruguay. After discussion, the Technical Committee accepted the proposal of Uruguay. With respect to paragraph 86, Japan proposed to delete the third sentence to keep a neutral position for future work on this matter. China stated that the sentence reflected the discussion and should be maintained. Japan agreed with the proposal of China, and the Technical Committee accepted to maintain the third sentence in the report.

Conclusion

15. The Technical Committee agreed to the amendments proposed by Members, taking into consideration the proposal submitted by Uruguay in paragraph 78 and Japan's agreement to keep the third sentence as proposed by China in paragraph 86 of the Report. The Report of the 41st Session was therefore adopted by the Technical Committee and will be reproduced in Doc. VT1011E1c.

Agenda Item III : REPORTS ON INTERSESSIONAL DEVELOPMENTS

(a) Director's Report

Doc. VT1023E1a

16. The Chairperson invited the Director to present the Director's Report, contained in Doc. VT1023E1a. He summarized and expanded on the key intersessional activities detailed in the document.

17. The Director updated the Technical Committee, summarizing the developments included in the working document, in particular those arising from the Policy Commission held in Punta Cana, Dominican Republic in December 2015 as well as other topical issues. The Policy Commission items included the WTO Trade Facilitation Agreement, Security, the Revenue Package, the WCO Strategic Plan 2016-2018, Digital Customs and Performance Measurement. The Revenue Package would be reported under Agenda Item IV(c) and Performance Measurement under Agenda Item VII (a).

18. Referring to the WCO's theme for this year – "Digital Customs - Progressive Engagement" – the Director underscored the relevance of Digital Customs to the work of the Technical Committee. Technological development including 3-D printing technology is reshaping the landscape within which Customs used to work and has implications for Customs valuation, Rules of Origin, IPR etc., as well as the potential need to redefine goods in the future for Customs purposes. The Permanent Technical Committee of the WCO had taken note of the 3-D printing topic and its impact on Customs and agreed to revisit its implication in light of any relevant future developments.

19. The attention of the Technical Committee was drawn to the decision of the WTO Ministerial Conference held in Nairobi in December 2015 to extend the moratorium on imposing Customs duties on electronic transmissions until its next Session in 2017.

20. The first draft of the information document, prepared by the Secretariat on Customs Valuation and Global Value Chains, was published, and further guidance would be required from the Technical Committee to continue work.

21. It was noted that the cooperation between Customs and Tax Administrations has a new impetus which is being reinforced by the regional trend of establishing Revenue Authorities, the merging of Customs and Tax agencies, as well as the work done in the area of Base Erosion and Profit Shifting by OECD and G20. With respect to Performance Measurement, it had been decided to work on the refinement of the first tier indicators. These two topics are covered under separate Agenda items.

22. The Director informed the Technical Committee of the publication of two books (Customs Valuation – Law and Practice by Sumit Dutt Majumder, Sixth edition 2016, and WTO – Trade in Goods by Rüdiger Wolfrum, Peter-Tobias Stoll and Holger P. Hestermeyer) on Customs Valuation by Customs officials. The Director encouraged initiatives of this nature which would supplement the existing publications on Customs valuation with the Customs viewpoint.

23. Delegates were also encouraged to ensure the valuation Contact Point lists were up to date and to advise the Secretariat accordingly of any updates.

Discussion

24. In response, a delegate thanked the Director for his report and for updating the Technical Committee on the topics being discussed at the Policy Commission.

25. One delegate questioned the procedure for dealing with the information document on Global Value Chains, based on the specific technical question submitted by Uruguay, which had been placed in Part III of the Conspectus at the last Session.

26. The Chairperson reminded the Technical Committee that this information paper was not an instrument of the Technical Committee and it was important to consider what to do with it and where to capture it. It is being dealt with under Item III (a) of the Agenda as this is the first time that the Secretariat was asked by the Technical Committee to prepare such a paper. The Secretariat requires further guidance in order to further develop this paper. The Chairperson suggested including this topic under Item VII of the Agenda.

27. One delegate suggested that the information paper should give a general description of the phenomenon to make people aware of its existence and all diagrams and charts provided by Uruguay could be inserted in the paper.

28. Another delegate asked whether an information paper would be prepared each time no consensus could be reached and what effect this would have. She suggested that for future cases where no consensus could be achieved further details were to be provided in Part III of the Conspectus.

29. One delegate highlighted the existence of Part III of the Conspectus which contains the questions examined by the Technical Committee and which had not resulted in the issuance of an instrument. All discussions are captured in the related documents referred to in the Conspectus.

30. One observer suggested that where it was not possible to finalize an instrument, the Technical Committee discussions on questions relating to growing business trends, (for example, GVCs and Japan’s case on unlocking fees), could be recorded in some other format.

31. The Technical Committee was asked to consider under what Agenda item this Information Paper could be discussed at a future Session. The Secretariat suggested

creating a Part IV of the Conspectus for housing Information Documents in cases where the Technical Committee was unable to achieve consensus and where it wished to capture discussions more comprehensively, in an accessible way.

32. A delegate was supportive of continuing discussion at a future session under Item VII – Other Business and no objection was raised to continue examination under Item VII.

Conclusion

33. The Technical Committee took note of the Director's Report and ensuing discussions. It was also agreed to put the information paper on Global Value Chains under Agenda Item VII – Other Business at the next Session. Members would be requested to submit their comments during the intersession after which the document would be updated. The Technical Committee will examine the document at the next Session and will decide how to proceed with it.

(b) WTO Committee on Customs Valuation Report

34. There was no report on the activities of the Committee on Customs Valuation (CCV) since no meeting of the CCV took place since the last meeting of the Technical Committee.

35. However, the report on the previous Sessions of the CCV to the Council for Trade in Goods was distributed to the delegates for their information.

36. The Director reminded the delegates of the development at the WTO at the Ministerial Conference held in Nairobi in December 2015. The WTO adopted the Ministerial decision on E- Commerce and extended the moratorium on imposing duties on electronic transmissions until its next session in 2017.

37. The next meeting of the CCV was scheduled for 25 April 2016 to enable delegates attending the Technical Committee to also attend the CCV.

Agenda Item IV : TECHNICAL ASSISTANCE, CAPACITY BUILDING AND CURRENT ISSUES

(a) Report on the technical assistance/capacity building activities undertaken by the Secretariat and Members

Docs. VT1024E1a and VT1039E1a

Background

38. In accordance with the Technical Committee's decision, the Secretariat had monitored and communicated the technical assistance/capacity building activities scheduled and/or delivered by Members in order to provide useful information to all Members for planning purposes and to prevent duplication of effort.

39. Since the last session, the Customs Administrations of Canada, the United States and Japan had provided information about their technical assistance activities. That information, together with information on the technical assistance/capacity building activities undertaken by the Secretariat, was set out in Annexes I and II respectively to Doc. VT1039E1a.

Summary of discussion

40. The Secretariat provided the Technical Committee with information on its technical assistance and capacity building activities scheduled for the period from May to September 2016, as follows-:

- from 16 to 21 May 2016, the Secretariat would hold a Customs Valuation Training Seminar in Lomé for experts and trainers from the Customs and Indirect Taxes Commissariat (CDDI) of the Togo Revenue Authority (OTR). This action formed part of the implementation of the Secretariat's recommendations following the diagnostic mission relating to the OTR's valuation control system, conducted in November 2015.

- from 23 to 27 May 2016, the Secretariat would lead a Train-The-Trainer Seminar on Customs Valuation for the Customs Administrations of Ghana and Nigeria;

- from 6 to 14 June 2016, two Secretariat experts would conduct a diagnostic mission relating to the Customs valuation control system used by the Cameroon Customs Administration; and,

- from 19 to 23 September 2016, a joint WCO-OECD Workshop on Customs Valuation and Transfer Pricing would be held in Ankara (Turkey) for Members of the WCO's North of Africa, Near and Middle East, Europe and Asia/Pacific regions.

41. The Delegate of Togo thanked the Secretariat for the technical assistance given to the OTR's CDDI, stating that the three-phase technical assistance programme requested by his Commissariat and accepted by the WCO Secretariat was found to be highly beneficial. The CDDI was preparing to host the second phase of this WCO technical assistance, scheduled from 17 to 21 May 2016, which would entail instructing 30 experts and trainers from the CDDI in Customs valuation control.

Conclusion

42. The Technical Committee took note of the reports on technical assistance activities as well as of the other information supplied by the Secretariat.

(b) Progress report on Members' application of the WTO Valuation Agreement

Doc. VT1025E1a

Background

43. In pursuance of a decision taken by the Technical Committee, the Secretariat had monitored progress with the application of the WTO Valuation Agreement by various Members and had published status reports on the subject.

44. In advance of the session, the Secretariat had issued Doc. VT1025E1a asking Customs administrations to provide information on the progress made in their countries with regard to the application of the WTO Valuation Agreement.

45. No Members had sent written comments in response to Doc. VT1025E1a during the intersession.

46. Vietnam offered to give a presentation on : “Customs valuation in Vietnam and experience in determining royalty fees”.

Presentation by Vietnam

47. After giving an overview of the General Directorate of Vietnam Customs, its vision and mission, major trading partners and organization system, the delegate’s presentation focused on Customs practices with respect to royalties and licence fees applied in her country.

48. She told the meeting that since 2007, her Customs Administration had been fully implementing the WTO Valuation Agreement as well as Decisions 3.1, 4.1 and 6.1 of the WTO Committee on Customs Valuation. However, the issue of the interpretation and implementing provisions of Article 8.1 (c) concerning royalties and licence fees had given rise to differences of opinion between Customs and the private sector prior to 2013.

49. In 2013, Vietnam had supplemented its legislative and regulatory basis for Customs valuation through Circular 29/2013/TT-BTC, which clearly ascertained whether a royalty or licence fee related to the imported goods being valued and whether a licence fee was paid as a condition of sale of the imported goods being valued.

50. This Circular had been developed following consultation between Customs and the private sector. It had made it possible to reconcile their points of view, especially on the issue of incorporating royalties and licence fees in the Customs value. The delegate stated that the Circular referred to royalties and licence fees paid not only for the use of rights related to the manufacture of imported goods (particularly patents and manufacturing know-how) but also to the use of trademarks affixed to goods sold in Vietnam.

51. The delegate continued her presentation by giving an example of Vietnam’s approach to certain royalty cases. In her presentation, the Delegate of Vietnam made a comparison on the approach applied by her Administration before and after 2013 with respect to royalty and licence fees.

51A. Before 2013, there was no policy paper issued by the Administration to explain when it considered royalty payments to be related to the imported goods and be dutiable.

Many importers were not certain when these should be added to the price actually paid or payable.

51B. In 2013, the Administration, after consulting the importers, issued a circular explaining clearly when it considered a royalty payment to be related to the imported goods and thus be dutiable. This was illustrated by an example of imported products which undergo further processing before being put on the local market. The policy has been well understood by the importers and since its issue no dispute has been recorded.

51C. Many delegates asked additional information about the method of allocating royalty payments to the imported product.

Enhancing co-operation between the WCO and Regional Economic Communities.

52. The Director of Tariff and Trade Affairs presented a brief report on the preliminary work undertaken by the Secretariat to enhance co-operation between the WCO and Regional Economic Communities (RECs).

53. This report represented the Secretariat's vision in response to new trends in regional economic integration throughout the world, prompting studies into the best ways forward for implementing effective and productive co-operation between the WCO and RECs. The Director told the Technical Committee that the Secretariat was developing a list of the work already carried out in order to pinpoint existing areas of co-operation to be enhanced or future areas to be explored.

54. The Secretariat wished to receive Members' comments on how to improve this type of co-operation between the WCO and their RECs.

55. One such area of co-operation had been identified, namely WCO technical assistance in response to requests by some RECs to transpose the 2017 version of the Harmonized System (HS) into Members' national tariffs. The Secretariat planned to organize joint WCO-REC workshops. To that end, it was seeking Members' collaboration in identifying other domains in which this co-operation could be enhanced and in determining its feasibility and usefulness.

56. Following on from the HS, the Secretariat was adopting the same approach to identifying possible avenues of co-operation with RECs in the area of Customs valuation control.

Summary of discussion

57. The Delegate of the Dominican Republic reported that her country, along with other countries in the region, had taken part in a Post-Clearance Audit Seminar organized in Guatemala by two international organizations, one of which was the CAFTA-DR[1].

58. She hoped to see the WCO play a more active role in these capacity-building efforts aimed at Customs officers in the region experiencing difficulties with Customs valuation control in general, and PCA in particular.

Conclusion

59. The Technical Committee took note of the progress made with regard to the application of the WTO Valuation Agreement and of the useful information provided in the presentation given by Vietnam as well as of the ongoing work within the Secretariat to enhance co-operation between the WCO and RECs.

(c) Revenue Package

Doc. VT1026E1a

60. The Chairperson invited the Secretariat to provide an update on the work undertaken in respect of the Revenue Package programme.

61. The Secretariat reminded the Technical Committee of the successful conclusion of Phase II in 2015, which led to the issuance of a wide range of new tools, as reported at the 41st Session. Members were encouraged to access and utilize the tools as appropriate, which are available via the Members' website and in CD form.

[1] The Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) constitutes the first free trade agreement between the United States and a small group of developing countries (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic).

62. Information was provided on the proposals for Phase III which will be presented to the Council in July 2016. A draft proposal had been presented to the Working Group on Revenue Compliance and Fraud at its second meeting in 2015. The proposal was in two parts; the first part was entitled 'Assisting Members in effective use of Revenue Package tools developed under Phases I and II', for example, the new diagnostic tools. The second part – '*New materials and initiatives'* - listed additional topics to be addressed in Phase III including, inter alia, Customs and tax cooperation (to be discussed under Agenda Item VII (c)), post-clearance audit (PCA), measuring the revenue gap, informal trade and Origin matters.

63. The Secretariat also gave a presentation on its activities in the field of post-clearance audit, as featured in the Revenue Package. The WCO Guidelines on Post-Clearance Audit, Volumes 1 and 2, were developed under Phase I. A diagnostic tool for PCA was developed in Phase II. Information was provided on new Implementation Guidance designed to improve the efficiency of audits; this had been endorsed by the Enforcement Committee in March 2016. A further tool is due to be prepared entitled *"'How to audit' typology".* Additional information was provided on planned technical assistance on PCA at the Regional level and PCA accreditation programmes. The presentation will be made available on the Members' website.

Discussion

64. Delegates congratulated the Secretariat on the work conducted to date. The Delegate of China commented that her administration had arranged Chinese translations of the Revenue Package tools and advised that a reform programme is to be launched in relation to duty collection procedures and that the Revenue Package tools will be very useful in this regard.

65. In response to a question from a delegate, the Secretariat explained that two global PCA accreditation events had been conducted and that regional events would be held subject to demand and funding; one such event has already been planned for Asia Pacific Region.

Conclusion

66. The Technical Committee took note of the presentations and discussion. The issue will be placed on the agenda of the next Session.

Agenda Item V : SPECIFIC TECHNICAL QUESTIONS

(a) Related party transactions under the Agreement and Transfer Pricing – case based on transactional net margin method

Documents : VT1027E1a and VT1040E1a

Background

67. The Chairperson introduced this item and made reference to the recent working document VT1040E1a, which contains written comments from Canada, China, Korea and Uruguay, as well as the draft text of the case study. She noted that the Technical Committee had already reached consensus on the conclusion of the document and drew delegates' attention to a further draft of the case study, which had been circulated as a non-paper. This draft contained proposals made jointly by Canada, China, Korea, United States and Uruguay addressing key areas of the text which had not yet been finalized, in particular paragraphs 1, 14, and 20, and via the Club de la Réforme. The Chairperson proposed that the Technical Committee examine this version of the text, restricting discussions to the unfinalized text.

Discussion

68. The Technical Committee examined the outstanding text, paragraph by paragraph, and various proposals were made to improve the text. The discussions focused on drafting issues rather than issues of substance.

69. The Technical Committee reached consensus on the outstanding text and, after language alignments in the three languages, the instrument - Case Study 14.1 – was adopted.

70. Following adoption of the document, one delegate commented that this was a significant step and that the Technical Committee should be ready to take up further related issues on the important topic of transfer pricing.

71. The Chairperson thanked the Observer of the OECD for her valuable contributions to the discussions.

Conclusion

72. The Technical Committee approved the new instrument, Case Study 14.1, which is annexed to this draft Report (Annex C) and will be presented to the WCO Council for approval in July 2016.

(b) Related party transactions under the Agreement and Transfer Pricing – case based on resale price method – request by China

Documents : VT1028E1a and VT1041E1a

Background

73. The Chairperson introduced the case which had been submitted by China and is designed to provide guidance in cases where Customs are examining a related party transaction and has been provided with information derived from a transfer pricing study based on the resale price method. The latest draft of the case is reproduced in the Annex to Doc. VT1041E1a. Written comments from China, Korea and United States are reproduced in Annexes I to III of this document. The Chairperson pointed out the proposal made by the United States, namely that the case study should not examine which valuation method should apply (paragraphs 18 – 20 of the draft case), after concluding the question of whether or not the price has been influenced by the relationship.

Discussion

74. The Delegate of Korea explained the background to its written comments and summarized the main points.

75. One delegate commented that it would be preferable, in the development of further case studies relating to transfer pricing issues, that such cases described scenarios demonstrating that the price was not influenced by the relationship, rather than the opposite which is the case here. He also supported the United States proposal to limit the current case to the analysis of whether or the price had been influenced by the relationship.

76. Another delegate said that the greater margin in this case could be due to different factors, adding that the crucial point in this case was the absence of a transfer pricing adjustment. He also agreed to limit the case to the examination of Article 1, as proposed by the United States.

77. The Delegate of China responded to Members' comments. Concerning the proposal to limit the case to the examination of Article 1, she acknowledged that although it would be easier to reach consensus, the examination of the application of alternative methods was equally important and would provide a useful solution to the problem raised. She drew attention to Customs' responsibility of examining the application of valuation methods and collecting duty legally due where the import price has been deemed to be influenced by the relationship between the buyer and the seller. She was therefore in favour of maintaining paragraphs 18 to 20.

78. One delegate proposed that the Technical Committee did not need to decide whether or not to accept the United States suggestion at this stage; the Technical Committee could concentrate on the first part of the case study, examining the circumstances surrounding the sale and then decide whether or not to consider the question of applying alternative methods in a sequential manner. The Technical Committee agreed to this proposal.

79. The Delegate of China agreed to delete the reference to the popularity of the bags as suggested by Korea. She explained that this expression had been added to the draft case study in order to help the delegates understand the situation where the actual sales income far exceeded the estimated income as indicated in this case, and she agreed that this expression could be deleted if the facts of the case had been understood by the Technical Committee.

79A The Chairperson raised the question of what the reason was for the rejection of transaction value. It would appear to be due to the fact that no adjustments were made, as highlighted by one delegate.

80. The Observer of OECD gave information relating to the transfer pricing considerations which arose in this case. She noted that in this case the Gross Margin of ICO was higher than that of an independent importer/ distributor of bags and explained that the Gross Margin is equal to (Sales minus Cost of Goods sold)/Sales).

81. In response to the question : 'Is the Cost of Goods Sold (COGS) too low relative to Sales ?' she noted that sales is calculated from sales price(s) and sales volumes and gave the following explanation-:

- If ICO imports all its stock from XCO, it would be expected that its COGS would be comprised largely of the import (transfer) price.
  - Although there can be flexibility in terms of what is included in COGS for accounting purposes, at its simplest, it is calculated as Opening inventory + Purchases – Closing inventory + direct costs (e.g. clearance costs, freight, Customs duties).
  - These other elements (e.g. inventory valuation, freight) may have reduced the COGS amount, but are unlikely to be the cause of a significant increase in the gross margin.

- As can be seen from this explanation, COGS thus normally consists almost entirely of costs which vary with sales. Therefore, if the unit sales price is constant (e.g. there are no significant differences between expected and actual sales prices), the ratio of COGS to total sales should also be fairly constant. Thus, if the ratio of COGS relative to Sales is too low, it is necessary to examine the (average) sales price achieved.

- From a transfer pricing perspective, a Tax administration would ask why (average) sales prices were higher than expected (e.g. because discounts given were less than anticipated to be required.) That is, where does this additional value come from ?

Hypothesis 1

The higher sales price is due to the international brand, as owned and developed by the parent company (or another entity or entities within the group), and this other entity assumes the risks associated with the exploitation of the brand.

- If this is the case, it is likely that the import (transfer) price paid by ICO to XCO was indeed too low and an adjustment for transfer pricing purposes should be made. (If XCO was not the entity responsible for the brand development and does not assume the related risks, there may also need to be a transfer pricing adjustment to ensure that taxable profits are aligned with where the value is created.)

Hypothesis 2

The higher sales price is due to ICO's activities; for example, ICO undertakes more advertising / marketing / sales activities than its competitors.

- In this case, note ICO's net margin may be similar to the net margins of the independent distributors.
- This scenario would raise the question of whether ICO is a "routine" distributor and whether the eight independent distributors are in fact comparable to ICO. For transfer pricing purposes, it is difficult to be too precise about such matters and a Tax administration would typically accept as comparable, independent distributors with a range of functional "intensity" (i.e. ratios of functions such as advertising / marketing to sales), particularly when the transfer price is tested based on the operating margin.

Hypothesis 3

The higher sales price is due to ICO's activities; for example, while ICO does not perform more activities, it performs its activities more successfully than its competitors.

- As with Hypothesis 2, for transfer pricing purposes, a Tax administration would generally allow a certain tolerance here as well, since it may be difficult to identify with precision when this hypothesis is valid. However, if ICO's activities are so successful that they are considered to have developed a local marketing intangible (or significantly enhanced the foreign-owned brand), this would need to be taken into account in the transfer pricing analysis
- Here, the facts of the case state that ICO is a "routine" distributor which has no significant local intangibles. This assumption would need to be tested for transfer pricing purposes, but if true, Hypothesis 3 can be eliminated.

Hypothesis 4

The higher sales price is due to local market conditions, such as so-called "market rents". That is, market conditions are such that consumers are willing to pay high prices for the goods, despite the fact that ICO does not perform additional activities, and is no better at performing its activities than its competitors.

- In this case, if the independent distributors operate in the same market, they will also enjoy the benefits of the market rents. It would therefore be expected that they would have similarly high gross margins. Hypothesis 4 could therefore be eliminated.
- Note that market rents are typically short-lived since (absent barriers to entry into the market) the entities which benefit from them cannot exclude other participants from competing against them on price.

82. The Delegate of China, in response to questions and comments raised, gave the following information in order to elaborate the evidence of price influence-: the resale gross margin derived from unrelated party transactions could be much higher than expected, however the transaction value could not be rejected accordingly since it was a 'one time deal' as all the benefits and risks have been transferred from the seller to the buyer. But for related party transactions, if no extra efforts have been made by the importer, the higher gross margin and the extra profits earned in the resale of the imported goods could probably be attributed (or partly attributed) to its parent company, especially in case of branded products. It was noted that ICO was a simple distributor and there was no evidence of ICO giving added value to the transaction.

83. The Delegate of China stated that the Transfer Pricing study is to find out whether comparable companies with similar functions, assets and risks make comparable profits. If yes, the price is an arm-length price which is acceptable. China's proposed conclusion was not based solely on the low import price and the high gross margin earned; as illustrated in the working document, ICO's high gross margin did not match its functions, assets and risks and the import price was not settled in a manner consistent with the normal pricing practices of the industry. Additionally, no transfer pricing adjustment had been made.

84. One delegate repeated his concern that they could not accept the case given that the facts state that ICO did not intend to make any transfer pricing adjustment. The Observers of the OECD and ICC agreed that such an adjustment would generally occur in actual cases. The Delegate of China reiterated that the absence of an adjustment should

be recorded in the facts of this case but it was agreed to amend the text in paragraph 16 to remove the phrase ' … and did not intend to make …' in relation to adjustments. The Delegate of China added that the absence of an adjustment was consistent with the factual case from which this draft case study had derived, and this situation was not uncommon in China's practice. Another delegate also reminded the Technical Committee that the facts were based on a real case.

85. The Delegate of China also suggested that the conduct and not just the transfer pricing documentation of the related parties be examined so as to ensure that the transfer pricing policy is implemented.

86. The Chairperson reminded the Technical Committee that there had been a previous suggestion to have different examples in the case study, one with and one without transfer pricing adjustments, but this had not been agreed.

87. The Delegate of China made some further drafting suggestions, including a proposal to move the text suggested by the United States in paragraph 5 to the analysis section (paragraph 15). A proposal was made to amend paragraph 4 regarding the reasons for Customs to examine this case; namely the existence of doubts. This text could be aligned to the wording used in the recently concluded Case Study 14.1. The Delegate of China agreed with the proposal from Korea to amend paragraph 18 in relation to the application of Article 5.

Conclusion

88. The Technical Committee agreed that the Secretariat would work with China to further develop the text of this case, taking into account discussions during the Session. Informal discussions can also take place on the Club de la Réforme.

(c) Treatment of the fees for unlocking a function of imported goods after importation (application of Articles 1, 8.1 (c) and 8.1 (d) of the Agreement)-: request by Japan

Documents : VT1029E1a and VT1042E1a

Background

20.

89. The Chairperson summarized the background to this question submitted by Japan which examines whether or not fees paid for accessing locked software on imported photocopiers, paid after importation, should be part of the Customs value. It had become clear at recent Sessions that there was no consensus on this case although the majority of delegates who expressed a view considered that the fees concerned should not be included. A proposal was made at the last Session to place the case in Part III of the Conspectus of Technical Questions; however, Japan preferred to work during the intersession to consider ways of amending the document and strive to reach consensus.

90. Japan provided an updated version of the text which was circulated in the Annex to VT1029E1a. In response, written comments were received from Chile, China, and Uruguay which were circulated in the Annexes to Doc. VT1042E1a.

Discussion

91. The Chairperson gave the floor to Japan who clarified the recent changes to the text. In response to two questions raised by China-: 1) Why does the manufacturer have to embed the software into the copier before importation, instead of the customers having to download it and, 2) Why should the password fees be paid to the licensor instead of the seller, Japan answered as follows : for question 1, Japan referred to the ICC's comment that it is a large burden to download the software so customers prefer to have it pre-installed. Regarding question 2, the purpose of the fee is to enable the customer to access the software which is different from the situation pertaining to the royalty fee which is fully reflected in the price paid or payable. Regarding the suggestion by China that there should be a definition of application software, Japan considered it would not be necessary to do this. Furthermore, Japan considered that the proposed instrument would not create a loophole as raised by China and that the text referring to Customs' rights to conduct enquiries covered this point.

92. The Delegate of China further explained China's comments and concerns about this case, as detailed in its written comments. She added that based on research with local companies, it appeared unlikely that cases such as this would be in line with commercial practice. She asked the Technical Committee to consider whether it was appropriate to adopt an instrument on this basis.

93. The Chairperson noted that there was still clearly no consensus on this case and sought delegates' views on the way forward.

94. Noting the absence of consensus, the Delegate of Japan agreed that the case could be placed in Part III of the Conspectus and proposed that an information document be prepared to record the discussions and opinions given, as suggested by the Secretariat in Doc. VT1042E1a.

95. One delegate suggested that, in order to provide certainty on application, the information document present two options on the valuation treatment of the fee for Members to choose. Another delegate expressed his concern that, should that happen, the Technical Committee would be going against its own raison d'être since, under Annex II to the Agreement, it was created "with a view to ensuring, at the technical level, uniformity in interpretation and application…" of its rules. In addition, he wondered why use was not made of the voting mechanism procedure provided for in that Annex.

96. The Chairperson commented that, while the Technical Committee had been working on the basis of consensus as other WTO Committees, the Secretariat could be asked to conduct a study on the issue of voting with input from the WTO.

Conclusion

97. The Technical Committee agreed to put the question into Part III of the Conspectus. A summary of the key points of this case and Members' opinions will be prepared by the Secretariat and annexed to the Report of the 42nd Session (Annex D). The Secretariat will also prepare a study on the issue of voting for discussion at the next session.

(d) Treatment of advertising and promotion costs: submitted by Uruguay

Docs. VT1030E1a and VT1043E1a

Background

98. The Chairperson summarized the background to this question submitted by Uruguay which concerns whether or not payments for advertising and promotion costs should be

part of the Customs value. At the 41st Session, the Technical Committee invited Uruguay to prepare a new document either in the form of an Advisory Opinion or Case Study - which would not be based on Commentary 20.1 - containing precise examples and be formulated on the basis of the example questions that the Technical Committee would need to answer.

99. In response, Uruguay proposed a draft Advisory Opinion with five examples during the intersession. This draft Advisory Opinion, annexed to Doc. VT1030E1a, was published and Members were invited to submit their written comments.

100. Written comments received from Chile, China and the United States were reproduced in the Annexes to Doc. VT1043E1a.

Discussion

101. The Delegate of Uruguay thanked those delegates who had submitted written comments and explained that the purpose of this question is to assist Customs officers who face the situations as provided in the examples to ensure the uniform application and interpretation of the Agreement. According to the delegate, the Agreement is not clear on this topic. He stated that under the Brussels Definition of Value it did not matter who imposed the advertising expenses: if the advertising payment were made by the buyer (on the buyer's own account or on another's account), it was understood that it was always to the benefit of the seller, thus influencing the price agreed between the parties, and consequently it was included in the Customs Value.

102. Based on the written comments received, the Delegate of Uruguay noted that there was consensus on examples 1 and 3. The Delegate of China agreed with the conclusion of examples 1, 2, 3 and 5 and wished to focus on example 4. The Delegate of the United States reiterated the position provided in its written comments.

103. One delegate suggested that the Technical Committee should look at each example in turn, as they are different and separate examples. Another delegate concurred with the above proposal on the way forward and with the position of the United States of not agreeing on the conclusion reached by Uruguay in examples 2, 4 and 5, as well as with Chile's written comments. He stated that his Administration took a policy decision in line with the Interpretative Note to Article 1 (b), with respect to advertising expenses and explained that promotion and advertising activities are marketing activities that are referred to in the Interpretative Note to Article 1 (b) of the WTO Customs Valuation Agreement.

104. The Observer of the ICC provided the Technical Committee with his understanding of the meaning of the phrase ‘on the buyer’s own account’ used under common law in certain countries. He explained that this does not mean what the buyer has done on his own initiative; it is rather a reference to who is bearing the financial risk or financial obligation. ‘Buyer’s own account’ means that the buyer is responsible for the payment and it is not a payment being made on behalf of another party such as the seller.

105. The Technical Committee proceeded by examining the question example by example. There was consensus on Example 1. The Delegate of Uruguay clarified the confusion arising from the last paragraph in which the words “as a condition of sale” are mentioned in Example 2. He explained that in the licence agreement, there is no mention of the obligation to carry out advertising and promotion activities but in the sales contract, the seller decided to undertake advertising and promotion activities on his own account. In such case there could be three hypotheses-:

(i) The seller decides to undertake advertising activities and the related costs are included in the price;
(ii) In the sales contract details corresponding to goods and advertising are shown separately
(iii) The seller decided to undertake and contract out advertising activities to a third party and asked the buyer to pay the third party.

106. Delegates who took the floor were divided on whether the payment was to be included in the Customs value. One delegate stated that the Technical Committee should analyse what the payments were for and why they were made.

107. The underlying theme of discussion for Example 3 was about the meaning of the phrase ‘on the buyer’s own account’, whether it means at the initiative of the buyer or “who is bearing the financial responsibility for the advertising and promotion costs”. Consensus was reached on the outcome proposed by Uruguay in this Example.

108. There was no consensus on Example 4. One delegate wished to examine this Example more closely and shared her Administration’s experience in a similar case. In their case, it was examined under the condition of dealing with sale aspect (condition of sale) as well as under the provisions of Article 1.1 (b) – that the sale or price is not subject

to some condition or consideration for which a value cannot be determined with respect to the goods being valued.

109. The Delegate of Uruguay shared information on the method of payment which was contained in the license Agreement. In response the above comment, he explained that, in this example, and in his Administration, there had been cases where, even in the license Agreement, the buyer recognised, via an explicit clause, the price for the imported goods would be reduced by the seller/brand owner so that a specific annual budget, based on a percentage of the net resale price, could be allocated, for the buyer to later contract and pay for advertising in the country of importation, said advertising being directed and overseen by the buyer from abroad.

110. With respect to Example 5, one delegate stated that it was important to know what the payment was for and why they are paid. If it was not for the imported goods only, there was a need to examine whether an adjustment under the provisions of Article 8 could be made.

111. Since there was no consensus on the question, the Delegate of Uruguay suggested putting the question in Part III of the Conspectus. One delegate proposed that since there was consensus on Examples 1 and 3 of the question the Technical Committee can move forward with these examples. The Technical Committee had two different positions on Examples 2, 4 and 5 and was divided about whether it would be productive to continue with the examination of the question.

Conclusion

112. The Technical Committee agreed to put the question in Part III of the Conspectus.

(e) Condition of sales, objective and quantifiable data-: Request submitted by Mexico

Docs. VT1031E1a, VT1038E1a and VT1044E1a

Background

113. The Chairperson introduced the question submitted by Mexico prior to the 40th Session. The question concerns the valuation of goods (inputs) imported under a franchise agreement. The imported goods are one of the inputs used in the manufacture by the Franchisee of a product in the country of importation. This input material is purchased only from the Franchisor or from any other person authorised by the Franchisor.

114. The issue is whether the royalties that are paid under the Franchise Agreement between the parties have to be added to the price actually paid or payable under Article 8.1(c). If it is determined that the royalties are to be added to the price actually paid or payable under Article 8.1 (c), then the Committee would be invited to examine whether objective and quantifiable data are available to make the addition. Royalties are calculated on the importer's gross sales of the finished product that are paid to the franchisor.

115. The question was reproduced in the Annex to Doc. VT1006E1a. During the intersession, a new working document, VT1031E1a was produced and the original Spanish version of the Development and Franchise Contract provided by Mexico was published.

116. The Secretariat continued to work with Mexico and other Members during the intersession to identify the provisions in the contract which were relevant to the issue in question. A new working document, VT1038E1a was published containing the relevant clauses of the contract. Annexes II and III to this document contained the list of imported inputs for the elaboration of the "Products" and the flow diagram of the manufacturing process respectively.

117. Written comments received from China and Uruguay were reproduced in Annexes I and II of Doc. VT1044E1a.

Discussion

118. One delegate thanked Mexico for submitting this very relevant question to the Technical Committee, noting that there is presently no instrument that covers this subject.

119. One delegate asked for the reasons why the royalty is paid. He wondered whether the fee is paid for the right to sell or to manufacture the goods or as a franchise fee to operate a shop bearing the franchisor's brand name.

120. The Observer of the ICC pointed out that the answer to this question could be found in Annex I to Doc. VT1038E1a at clauses 5.2 and 5.3. The Development Fee and Initial Franchise Fee are paid for the access to the Brands or the System as defined at Clauses 1.41 and 1.61. He also referred the Technical Committee to the Note to Article 8.1 (c) Paragraph 3, which is not applicable in the question being examined as these royalty payments are not related to the imported inputs.

121. The Delegate of Mexico clarified that, while the payment of the fee is for the use of the brands, it is based on the gross sale of the final products and is linked to the products. The inputs must meet the Franchisor's technical specifications and could be considered as special inputs. The inputs used were both imported and locally sourced. The imported inputs were purchased from the Franchisor directly and the Contract allows the Franchisee to source its inputs from other suppliers in case the Franchisor run out of stock. Additionally, he said that the imported goods could be more clearly listed in order to show which imported input gives the essential character to the final product.

122. Several delegates agreed that it would be necessary to examine whether the imported input was necessary and essential in the production of the final product to determine whether there was a link between the input and the final product. One delegate also suggested to look at whether the imported input materials are ordinary materials or special branded ones. However, another delegate wondered how it would be possible to determine whether an input was essential in the production of the final product.

123. Several delegates who took the floor referred to patent and know-how in their analysis and questioned whether there existed any such related contracts. In the case of raw materials, one delegate questioned whether the royalty could be considered to be related to the imported goods.

Conclusion

124. The Technical Committee will continue the examination of the question at the next Session and Mexico agreed to work with the Secretariat during the intersession to improve the document, taking into account the provisions of the Development and Franchise Contract and the comments of delegates.

(f) Meaning of the expression “sold for export to the country of importation”

Docs. VT1032E1a and VT1045E1a

Background

125. At its previous Session, the Technical Committee agreed that it would continue to examine this question submitted by Uruguay based on the current fact pattern with an improved text specifying that the parties were unrelated and that there was one sale between the buyer and the seller.

126. Uruguay worked with the Secretariat during the intersession and submitted a revised text taking into consideration the comments from Members together with a revised draft Advisory Opinion. The Comments and draft Advisory Opinion were published in Doc. VT1032E1 and Members were invited to examine the question and submit their suggestions and comments.

127. Written comments received from Canada, Chile and China were reproduced in Annexes I, II and III respectively to Doc. VT1045E1a.

128. The Chairperson reminded the Technical Committee that the question referred to a split shipment and the issue was whether Article 1 of the WTO Valuation Agreement would be applicable in this case. At the last Session, delegates who took the floor opined that the vehicles should be valued under Article 1 of the WTO Customs Valuation Agreement in country A and in country B, reflecting Commentary 6.1.

Discussion

129. The Delegate of Uruguay explained that in this question there is a discount of 10 % which is applicable provided the buyer purchased more than 3000 vehicles and noted that the price paid or payable was conditional upon a quantity threshold below which the discount would not be applicable. The consignment of 1000 vehicles imported into Country B did not meet this quantity threshold condition and he argued that Article 1 was not applicable and referred to paragraph 13 of Commentary 6.1 which concluded that Article 1 was applicable for split shipment, provided all the requirements of Article 1 are met.

130. Delegates were divided as to whether paragraph 12 of Commentary 6.1 was applicable to this question.

131. Several delegates expressed the opinion that Commentary 6.1 applied to this case. One delegate stated that the situation in this case was already covered by paragraph 12 of Commentary 6.1 and did not agree that discounts are covered under Article 1.1 (b). He also mentioned that none of the three instruments of the Technical Committee related to discounts, nor did the examples given in the Notes to Article 1.1 (b) allude to a discount as a condition of sale. Another delegate observed that the Customs territories to which the goods were exported did not have to be the same in order for Article 1 to apply in this case.

132. The Observer of the ICC emphasized that in this question there was only a single sale and a single transaction based on a single invoice. He noted that Advisory Opinion 15.1 deals with quantity discounts and specifies that Article 1.1 (b) does not apply.

133. Other delegates, however, supported Uruguay's position. One delegate indicated that the fact that the 10 % discount had been agreed for the 10000 vehicles purchased showed very clearly that the discount did not relate to the 1000 vehicles imported into country B, but to other goods, a situation allowing one to construe that the circumstances in Article 1.1 (b) of the Agreement were present here and that, consequently, that price could not be taken as the Customs value of such vehicles.

134. Noting that the Technical Committee had two opposing school of thoughts on this question, the Delegate of Uruguay suggested putting the question into Part III of the Conspectus.

Conclusion

135. The Technical Committee agreed to the proposal of Uruguay to put the question into Part III of the Conspectus of Technical Valuation Questions.

(g) Examining the circumstances surrounding the sale under the provisions of Article 1.2 (a) – goods produced in different countries : Submitted by Ecuador

Docs. VT1033E1a and VT1046E1a

Background

136. The Chairperson reminded the Technical Committee that this question was submitted by Ecuador at the 41st Session under the item "Questions Raised during the Intersession". During the intersession, Ecuador submitted a draft case study concerning the examination of the circumstances surrounding the sale in a related party transaction under Article 1.2 (a) of the Agreement and its Interpretative Note. The draft was made available in Annex I to Doc. VT1033E1a, with comments received on it from Uruguay.

137. Under the facts of this particular case, in order to demonstrate that the relationship had not influenced the price, the importer provided Customs with a transfer pricing study based on the comparable uncontrolled price method (CUP), a transfer pricing methodology described in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines).

138. For tax purposes, the only comparable uncontrolled transaction available to the importer involved goods that were neither produced in the same country of exportation nor imported into the same country as the goods being valued.

139. The three issues to be examined by the Technical Committee in determining whether the relationship has influenced the price under Article 1.2 (a) were-:

(i) whether goods originating from a country other than that of the goods under review are applicable;

(ii) whether prices of identical or similar goods sold for export to a country other than the country of importation can be used; and

(iii) whether appropriate adjustments can be made in a reliable manner.

Discussion

140. One delegate suggested ways to address transfer pricing issues in view of the difficulties experienced in the examination of cases based on TNMM and Resale Price Method. With regard to Commentary 23.1 and the use of a transfer pricing study in the

context of examining Customs valuation, priority should be given to application of the WTO Agreement. He added that to help the Technical Committee in its examination of specific cases it was important that as much information as possible was provided. It was also suggested that the OECD could help the Technical Committee to better understand the usage and principles of the Comparable Uncontrolled Price (CUP) methodology.

141. One delegate observed that it was uncommon for a transfer pricing study to be based on only one comparable transaction.

142. The Observer from the ICC explained that the CUP method was only used for commodities which required high similarity and it was possible to have only one transaction for comparison. He also noted that it was not mentioned in the facts of the case whether the TP study was accepted by the Customs administration in the country of importation.

143. According to one delegate, using goods that were neither produced in the same country of exportation nor imported into the same country as the goods being valued as a comparable would be against the underlying principles of the WTO Agreement, which are set out in Articles 1, 7 and 15, among others. It was also suggested, for the benefit of Members and the private sector, that the Technical Committee work to identify some situations when a transfer pricing study may not be useful to Customs as stated in Commentary 23.1.

144. One delegate suggested examining the case from a broader perspective and highlighted the limitation of looking at information from transactions between parties established in third countries other than those of the actual transactions. The Chairperson pointed out that the Technical Committee is looking at the circumstances surrounding the sale under Article 1.2 (a) and the case of Ecuador is not identical to the example in paragraph 2.18 of Chapter 2 of the OECD Guidelines, as stated in paragraph 6 of the case study.

145. The Delegate of Ecuador provided additional information regarding the reasons why Customs had doubts but considered it was not necessary to include this in the case.

146. The lack of precision in the questions as detailed in paragraph 2 of Doc. VT1033E1a could lead to ambiguity, according to one delegate. Thus, it was not clear whether the question was asking if goods originating from a country other than that of the goods under

review were applicable for test values also. The delegate commented that the Technical Committee needed to be cautious when examining this case since a positive answer to the first two questions of paragraph 2 of the draft case study could imply an acceptance of test values not specified in Article 1.2(b).

147. A few drafting proposals were made with respect to paragraph 2 of Doc. VT1033E1a and paragraph 9 of the draft case study. It was also suggested the title of the draft case study should make reference to the circumstances surrounding the sale test (reflecting the title as shown on the Agenda).

Conclusion

148. The Technical Committee decided to continue to examine the draft case study at its next Session. Ecuador agreed to work with the Secretariat to revise the issues, taking into consideration comments and suggestions from delegates, and update the document accordingly.

(h) International Marketing Fee : submitted by Colombia

Docs. VT1034E1a and VT1047E1a

Background

149. The Chairperson introduced the issue under consideration concerning an International Marketing Fee by reminding delegates that the Technical Committee had agreed to examine the topic as a specific technical question during its 41st Session. She referred to the initial working document (VT1034E1a) and to the second working document (VT1047E1a) which contained the improved version of the text submitted by Colombia for the Committee's consideration, along with written comments by Uruguay.

150. The Delegate of Colombia went back over the question raised by her Customs Administration, reminding delegates that under the terms of a royalties and licence fee contract signed between a parent company, which was the intellectual property rights holder (licensor) and an importing company situated in the country of importation (licensee), the licensee had to pay royalties of 6 % of the net product sales to the licensor for the products covered by the licence. The licensee also had to pay an amount equal to 4 % of

net sales as an international marketing fee which it paid to the licensor as remuneration for the marketing benefits arising from the advertising and promotional strategy for the trademark globally, implemented by the licensor. Non-payment of this fee would give rise to termination of the contract.

150A The activities performed by the licensor included managing contracts, signing event sponsorship contracts, and generating concepts for advertising campaigns. These activities were at the discretion of the licensor, and the latter was not obliged to provide details on actual or planned expenditure for performing these activities.

150B For its part, the licensee had to carry out the activities required by the licensor in terms of sports advertising and marketing, for which it would have to agree to spend an annual amount based on net sales. In this context, the licensee would have to comply with the licensor's guidelines on use of ~~a~~ the marketing budget and the appointment of a local advertising agency in line with the terms and conditions of the contract. As to what was indicated in Doc. VT1034E1a, to the effect that this last cost incurred in the country of importation, while it was an obligation imposed by the licensor, was not a condition of sale and had no effect on the price actually paid or payable for the imported product and was not an activity undertaken by the licensee on its own account but, rather, carried out at the requirement of the licensor. [, this view was not shared by various delegations, since the same case was involved as Example 4 of the previous technical question on advertising and promotion submitted by Uruguay.] (Uruguay)

151. The delegate reminded the Technical Committee that the treatment of royalties and licence fees did not pose any problems in terms of Customs valuation as this topic was already the subject of a number of Technical Committee instruments. She, consequently, invited the Technical Committee to decide : (1) whether or not the international marketing fee of 4 % of the net sales in the country of importation, which the licensee paid to the licensor in return for the profit made from the international marketing activities undertaken as part of the contract, should be included in the Customs value; (2) if yes, whether an adjustment should be made in line with Article 8.1 (d); and (3) whether or not the Technical Committee needed to draft a new instrument on this particular issue.

152. Colombia had submitted its opinion to the Secretariat in a document which had been distributed to Members during the session as a non-paper. Colombia considered that the International Marketing Fee paid to the licensor was part of the profit made by the licensor

from the resale of the imported goods and should, therefore, be included in the Customs value pursuant to Article 8.1 (d).

Summary of discussion

153. Once the issue at hand had been summed up, some delegates thanked the Delegate of Colombia and asked for clarification on certain points, which she was able to provide.

154. In answer to the question as to whether or not the sale had taken place between related parties and whether or not a sales contract for the goods had been signed between the parent company (licensor) and the importing company situated in the country of importation (licensee), the delegate informed the Technical Committee that the licensor was related to the licensee to which it sold goods directly or through one of its trading subsidiaries. There was no sales contract but rather a single licence contract referring both to the payment made to cover royalties and licence fees and to that made for the marketing of the products covered by the licence; the contract gave the licensee the right to sell, distribute and produce the products covered by the licence. If the licensee did not make the payments on time the licensor could terminate the contract, in which case the licensee had to forego its right to use the brands and know-how covered by the licence and could no longer sell the licensed products in the country of importation.

155. In answer to a question about which products were subject to the payment of 4 % of the net sales in the country of importation that the licensee had to make to the licensor by way of an International Marketing Fee, the delegate indicated that all the products covered by the licence were concerned. Some were products which were used in the country of importation to make items which would carry the brand name while others were finished products imported directly from the licensor or one of the group's subsidiaries. All the products covered by the licence that were sold in the country of importation benefitted from the results of the marketing activities for the brand undertaken at international level by the licensor.

156. One delegate raised the issue of the steps that should be followed when examining a related party transaction pursuant to Article 15.4 of the Agreement. She suggested that the Committee first decide whether or not the relationship between the seller and the buyer had influenced the price within the meaning of Article 1 before looking at the issue in

question on the basis of Article 8 of the Agreement. She pointed out that if it was proved that the relationship had influenced the price then the transaction value method could not be applied to the imported goods. An alternative method would therefore have to be used in order to determine the Customs value of the imported goods. In response, the Delegate of Colombia informed the Committee that a post-clearance audit carried out at the time on the licensee's company had allowed the Colombian Customs Administration to conclude that the relationship between the two parties had not influenced the price.

157. Some delegates suggested that the Technical Committee continue looking into this interesting and topical question during the following session on the basis of a new working document. It was suggested that the new document should state that the relationship had not influenced the price and include other relevant clauses from the contract where possible, as well as some of the analysis set out in Annex I to the working document (VT1034E1a).

Conclusion

158. At the suggestion of the Chairperson, the Technical Committee agreed to continue examining this issue at its 43rd Session on the basis of an improved working document. Colombia was invited to collaborate with the Secretariat in order to prepare a new working document taking into account the comments and suggestions made by Members.

Agenda Item VI : QUESTIONS RAISED DURING THE INTERSESSION

Secretariat comment : No questions were raised during the intersession.

Agenda Item VII : OTHER BUSINESS

(a) Performance measurement

Docs. VT1035E1a and VT1048E1a

Background

159. The Chairperson provided the background on this item which was first introduced to the Technical Committee at its 40th Session. At the 41st Session the Secretariat provided an update on the topic and the related framework developed and endorsed by the Policy Commission and the Council in 2015.

160. The Performance Measurement Framework was reproduced in Annex II of Doc. VT1008E1a. Twenty high level indicators for the first layer of the four primary areas of work contained in the WCO Strategic Plan were identified.

161. Second layer indicators for Valuation were developed by the WCO Secretariat and produced in Annex III to Doc. VT1008E1a inviting comments and inputs from Members of the Technical Committee. Written comments were received from Chile, Columbia and the European Union.

162. The Secretariat updated the first version taking into account the preliminary as well as the written comments from Members. The updated version was not published as the Policy Commission decided at its December 2015 Session to focus on the first layer for the time being.

163. In order to support objective self-assessment by Members, the Secretariat has developed draft technical guidance for the WTO Valuation Agreement and Advance Rulings for the first layer indicators. The draft technical guidance was produced in Annex II of Doc. VT1048E1a to enable Members to provide comments and suggestions.

Presentation by Secretariat

164. The Secretariat elaborated on the draft technical guidance. Three possible answers were available when answering the first layer questions related to the WTO Agreement on Customs Valuation and Advance Rulings for Customs Valuation. These are : (a) Implemented, (b) Under development, and (c) Other. The technical guidance lists the criteria to be applied when deciding under which category an administration would fall.

Discussion

165. One delegate remarked that reference was made only to Annex I of the WTO Agreement (rather than the whole Agreement), and another queried the inclusion of export

transactions in the definition of Advance Rulings on Customs valuation. It was clarified that this technical guidance was to assist Customs administrations when completing the first level of the Achieving Excellence in Customs Framework. The Technical Guidelines on Advance Rulings for Classification, Origin and Valuation, developed under the Revenue Package programme, contain materials which will assist in developing a system for the provision of advance rulings on Customs Valuation.

Conclusion

166. The Technical Committee approved the proposed text, subject to the Draft Technical Guidance being amended to take into consideration the comments from delegates.

(b) Improving the efficiency of the Technical Committee

Doc. VT1036E1a, VT1049E1a.

Background

167. The Chairperson gave the floor to the Secretariat who referred to the updated Working Procedures text, contained in Annex I of Doc. VT1049E1a. A non-paper containing a revised reporting procedure was prepared by the Secretariat and circulated to delegates. The key proposed changes were highlighted, including the following :

- A revised template for requesting advice has been introduced (reproduced in Annex II of Doc. VT1049E1a) which is aligned to the version used by the Nomenclature Sub-Directorate. Members are encouraged to use this template when submitting technical questions either to the Technical Committee or the Secretariat.
- It is proposed that all Technical Committee documents are made available to the public, following publication to Members and after necessary editing or censoring of confidential information.
- Revised procedures for preparing, issuing and commenting on the Session Report were proposed so that a final version can be produced during the intersession without the need for examination at the following Session, other than in exceptional cases.
- The Technical Committee may consider alternative outputs in cases where consensus cannot be reached on a specific technical question, for instance preparation of an information document, summarizing the discussions on a particular case.

Discussion

168. Some delegates commented on the proposal to hold Theme Meetings and suggested that the Technical Committee arrange such a meeting for the Spring 2017 Session on topical issues. In response, the Secretariat pointed out that in order to achieve this, it would be necessary to discuss the content and structure of the meeting at the next Session, to allow sufficient time for planning the Theme Meeting.

169. Regarding the public availability of working documents, one delegate queried whether this would include documents containing Members' comments. In the context of this discussion, the delegate also commented that all Technical Committee instruments should be made available to all, free of charge. The Director confirmed that it was the intention to release all working documents, including those containing Members' comments, adding that Members' names would be taken out. With regards to the free availability of finalized instruments, the Director reminded the Technical Committee that this was for consideration by the Finance Committee as it was a budgetary issue and said that further enquiries could be made in this regard.

170. Regarding the proposed new reporting procedure, delegates in general agreed that these arrangements could be trialled. The Deputy Director gave the example of the Harmonized System Review Sub-Committee, where this procedure had been successfully introduced.

171. Regarding the suggestion to develop information documents in situations where the Technical Committee cannot reach consensus, one delegate noted that it was preferable to strive towards finalizing technical questions, rather than develop such papers, which would be more to the benefit of Members. Other delegates considered the proposal to be a good idea.

172. Delegates had no objection to the introduction of the revised template for the submission of technical questions.

Conclusion

173. The Technical Committee agreed with the Secretariat's proposal to amend the Working Procedures document. A final version, reflecting the changes proposed by delegates and further drafting edits by the Secretariat, will be made available as an Annex to the Report of the Session (Annex E). The revised reporting procedure will be introduced for the Report of the 42nd Session. The topic of Theme Meetings will be included in the Agenda for the 43rd Session, with a view to arranging a Theme meeting to be held during the 44th Session.

(c) Customs - Tax Cooperation

Doc. VT1050E1a

Presentation

174. The Chairperson welcomed the Representative of the Organisation for Economic Co-operation and Development (OECD) and invited her to make the presentation on Base Erosion and Profit Shifting (BEPS) under the Agenda Item Customs- Tax Cooperation for the benefit of the Technical Committee.

175. The Technical Committee was updated with the BEPS project which started out about three years ago with a diagnosis and the development of an action plan and concluded with the delivery of a number of reports to the G20 in 2015.

176. The action plan came into being because of the concern that multinationals were not paying an appropriate amount of tax in countries following the financial crisis in 2008. The action plan included 15 action items under three main headings of coherence, substance and transparency and with two horizontal items, one on digital economy and the other on multilateral instruments.

177. The representative explained briefly the different action points and highlighted that action items 8 to 10 were relevant to transfer pricing. She elaborated on the use of the comparable uncontrolled price methodology (CUP), which she stated to be the most direct of the transfer pricing methodologies described in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines).

178. Under this methodology the price was compared directly, rather than a profit margin or split of profit of the transaction between related parties, with a comparable transaction between uncontrolled or unrelated parties. The CUP methodology could be used in a number of ways and the situation described in the case study of Ecuador is, in the opinion of the Representative of the OECD, similar to the example described in the OECD Guidelines.

179. When applying the CUP, both the product and the circumstances by which the product was sold should be examined. This methodology would not be commonly used because of the difficulty of the related parties obtaining information about the conditions agreed and price paid by the unrelated parties. It is used in commodity transactions that are particularly traded on mercantile exchange and not for branded products.

180. The Secretariat updated the Technical Committee on work conducted in relation to Customs –Tax cooperation.

181. Work on this topic started in 2013 at the 70th Session of the Policy Commission. Members had indicated to the Secretariat the increasing need for cooperation between Customs and Tax authorities, particularly to increase understanding of the type of cooperation and working arrangements established, taking into consideration the type of organisational structure in place at national level.

182. After the Policy Commission in 2013, the Working Group on Revenue Compliance and Fraud (WGRCF) addressed the issue in 2014 and further discussed the matter. A practical approach was adopted to gain an insight into what was being done at the national level in terms of Customs and Tax cooperation.

183. A survey was conducted by the Secretariat to gather information from WCO Members on their working arrangements related to cooperation and exchange of information with their respective tax authorities and to identify potential areas for enhanced collaborative work by the establishment of more formal cooperation mechanisms.

184. It was noted that the cooperation between Customs and tax was often influenced by various political factors and the organisational structure in place. The survey indicated a growing traction among Members towards bi-directional exchange of information and 93 %

of Members who responded stated that they do exchange certain information through various mechanisms, including Memoranda of Understanding.

185. Benefits identified from such cooperation included efficient collection of legally due duties and taxes, comprehensive risk management, enhanced post clearance audit and curbing of cross border tax fraud /evasion.

186. Of interest to the Technical Committee was the fact that eight countries stated that they had contact between Customs and tax on the topic of transfer pricing.

187. It was observed that the information exchange process was not uniform; some were made on a request basis while others were on an automatic basis. The type of information exchanged included import/export data, travellers' currency declarations tax returns (sales /purchases, base erosion and profit shifting cases).

188. The challenges to the exchange of information included interoperability of IT systems, national legislations and resource constraint. Lack of reciprocity was also identified as another challenge by 14 % of the Members who responded. The outcome of the survey was published in Annex I to Doc. VT1050E1a.

189. Following the recommendation of the December 2015 Policy Commission draft Guidelines for strengthening cooperation and exchange of information between Customs and Tax authorities at the national level were developed by the Secretariat and presented to the WGRCF. The purpose of the Guidelines, reproduced in Annex II to Doc. VT1050E1a, was to provide Customs administrations with guidance in developing a cooperation framework and/or strengthening existing cooperation.

190. Delegates were invited to liaise with their colleagues in their home administration and contribute to the improvement of the guidelines by submitting their comments and sharing their working experiences and best practices by 29 April. The final draft will be presented to the Policy Commission in July 2016.

191. The Delegate of Chile informed the Technical Committee of a resolution taken by the Ministry of Finance of Chile. This resolution relates to a procedure for resolving requests for advance agreements of transfer prices, in the case of imports of goods.

192. According to the resolution, the Internal Revenue Service and the National Customs Service should establish the instances of coordination, the procedures and deadlines for resolving claims about advance agreements of prices that are presented by the taxpayers.

193. The delegate stated that the collaboration between the Internal Revenue Service and the National Customs Service of Chile was a step forward in the implementation of the WTO Agreement on Customs Valuation on the issue of transfer pricing and specifically with regard to the advance agreements on prices for imported goods.

Comments

194. Some delegates took the floor to share their national Customs –Tax cooperation experience. The update on this topic was appreciated and commented to be relevant to the work of the Technical Committee.

Conclusion

195. The Technical Committee took note of the information presented and ensuing discussions. Written comments and working experiences/best practices received by 29 April will be considered for inclusion in the working document to be presented to the Policy Commission in July 2016.

Agenda Item VIII : ELECTIONS

196. The Chairperson gave the floor to the Director who explained the new election procedure introduced for all WCO committees. The Secretariat would no longer preside over any elections except where a Committee has been newly set up and/or has no sitting Chairperson or Vice-Chairperson. Additionally, a Chairperson or a Vice-Chairperson should not chair an election in which he or she is a candidate.

197. One of the Vice-Chairpersons of the Technical Committee, Mr J. BIRKHOFF, chaired the election for Chairperson. The Vice-Chairperson invited nominations for the position of Chair. The Delegate of Argentina nominated Ms Y.GULIS (United States) to be re-elected as Chairperson, noting the extremely efficient way she has chaired the Technical Committee. The delegates of Nigeria, Mexico, China and Egypt seconded the nomination.

Ms. GULIS was re-elected by acclamation as Chairperson of the Technical Committee for a period of one year. Ms. GULIS thanked the delegates for the nomination and their vote of confidence and accepted the appointment.

198. The newly elected Chairperson conducted the election of the two Vice-Chairpersons of the Technical Committee.

199. The Delegate of Uruguay nominated Mr. J. BIRKHOFF (Netherlands) as Vice-Chairperson. The nomination was seconded by the Delegate of China. Mr. BIRKHOFF was elected by acclamation as Vice-Chairperson of the Technical Committee for a period of one year.

200. The Delegate of Canada nominated Mr. J. NGOY KATSHELEWA (Democratic Republic of Congo) as Vice-Chairperson. The nomination was seconded by the Delegate of Sri Lanka. Mr. NGOY KATSHELEWA was elected by acclamation as Vice-Chairperson of the Technical Committee for a period of one year.

201. The Chairperson thanked the outgoing Vice-Chairperson, Mr G.VILLARROEL (Chile), for his contribution to the Technical Committee.

Agenda Item IX : PROGRAMME OF FUTURE WORK

202. The Deputy Director stated that the following items would be included in the Agenda for the 43rd Session :

- **Adoption of Agenda/Suggested programme**

- **Adoption of the Technical Committee's 42nd Session Report**

- **Reports on intersessional developments**
  - Director's Report
  - WTO Committee on Customs Valuation oral report

- **Technical assistance, capacity building and current issues**
  - Report on technical assistance/capacity building activities undertaken by the Secretariat and Members

- Progress reports from developing country Members' on practical application of the WTO Valuation Agreement
- Revenue Package

- **Specific technical questions**
  - Related Party transactions under the Agreement and Transfer Pricing – case based on resale price method example-: submitted by China
  - Sales condition, objective and quantifiable data-: submitted by Mexico
  - Examining the circumstances surrounding the sales under the provisions of Article 1.2 (a) – goods produced in different countries-: submitted by Ecuador
  - International Marketing Fee-: submitted by Colombia

- **Questions raised during the intersession** *(as appropriate)*
- **Other business**
  - Information document on Global Value Chains
  - Discussion on future Theme Meeting

- **Programme of future work**
- **Dates of next meeting**

Agenda Item X : **DATES OF NEXT MEETING**

203. The Director announced that the 43rd Session of the Technical Committee on Customs Valuation had been scheduled for 17 to 21 October 2016.

Concluding Remarks

204. The Chairperson and Director thanked delegates, the Secretariat and support staff for their efforts during the week, before the Chairperson formally declared the 42nd Session closed.

Y. GULIS,
Chairperson.

* * *

Annex A to Doc. VT1051E1b (revised)
(VT/42/Apr. 2016)

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* * *

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CASE STUDY 14.1

USE OF TRANSFER PRICING DOCUMENTATION WHEN EXAMINING RELATED PARTY TRANSACTIONS UNDER ARTICLE 1.2 (a) OF THE AGREEMENT

Introduction

1. This document describes a case where Customs took into account information provided in a company's transfer pricing study based on the Transactional Net Margin Method (TNMM) when examining whether or not the price of imported goods had been influenced by the relationship between buyer and seller in accordance with Article 1.2 (a).

This case study does not indicate, imply, or establish any obligation on Customs authorities to utilize the OECD Guidelines and the documentation resulting from the application of the OECD Guidelines in interpreting and applying the WTO Valuation Agreement.

Facts of Transaction

2. XCO, a manufacturer in country X sells relays to its wholly-owned subsidiary, ICO, a distributor of country I. ICO imports the relays and does not purchase any products from unrelated sellers. XCO does not sell relays or goods of the same class or kind to unrelated buyers.

3. In 2012, ICO entered its goods using the transaction value, based on the price stated on the commercial invoice, which was submitted to Customs of country I. There is no indication that special circumstances exist as set out in subparagraphs (a) to (c) of Article 1 of the Agreement that would prevent the use of transaction value.

4. After importation, Customs in country I decided to review the circumstances surrounding the sale of goods between ICO and XCO, pursuant to Article 1.2 (a) of the Agreement, because it had doubts about the acceptability of the price.

5. The importer did not provide test values in accordance with Article 1.2 (b) and (c), as a means of demonstrating that the relationship did not influence the price.

6. In response to Customs request for additional information, ICO presented a transfer pricing study for the period 2011, prepared by an independent firm on behalf of ICO.

7. The transfer pricing study used the Transactional Net Margin Method ("TNMM") that, in this case, compared ICO's operating margin with the operating margins of functionally comparable distributors of goods of the same class or kind, also located in Country I, that conducted comparable uncontrolled transactions in the same period of time. The transfer pricing study was prepared in order to comply with the requirements of Country I tax regulations and applied principles contained in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations of the Organisation for Economic Cooperation and Development ("OECD Transfer Pricing Guidelines"). The transfer pricing study covered all relays purchased by ICO from XCO.

8. Relevant data for ICO, taken from the company's financial records-:

- Sales	100.0
- Cost of Goods Sold (COGS)	82.0
- Gross profit	18.0
- Operating expenses	15.5
- Operating profit	2.5
- Operating profit margin (benchmarked)	2.5 % of sales

9. The transfer pricing study, using data taken from ICO's company records, indicated that ICO's operating profit margin on the sale of relays purchased from XCO was 2.5 percent in 2011.

10. The study concludes that it is possible to find reliable comparables for ICO and, accordingly, ICO was selected as the tested party in the transfer pricing study.

11. ICO's transfer pricing study had been reviewed by the Tax authorities of countries I and X in the context of negotiating a bilateral Advance Pricing Agreement (APA). An APA was subsequently agreed between ICO, XCO and the Tax authorities of countries I and X with respect to all transactions between ICO and XCO. While in review by the Tax authorities of countries I and X, ICO provided information showing that the profit margins it earns on the sale of its relays are generally the same as those made by independent distributors in the electrical apparatus and electronic parts industries.

12. In the transfer pricing study, eight distributors, unrelated to their suppliers, were selected based on the substantial similarity of their functions, assets and risks, compared to ICO.

13. Information concerning these eight distributors was taken for fiscal year 2011 for purposes of the comparison. The range of operating profit margins earned by these unrelated distributors was 0.64 to 2.79 percent, with a median of 1.93 percent. In the context of the APA negotiations, this range was accepted by the Tax authorities as an arm's length range of operating profit margins for transactions comparable to ICO's transactions with XCO. This arm's length range was established using the operating profit margins of the eight comparable companies, using the financial records of these companies available in public databases. ICO's operating profit margin was 2.50 percent, thus falling within the range. The 2.50 percent margin achieved by the importer in the country of importation was a function of : a) the price actually paid or payable by ICO to XCO, b) ICO's own sales revenue, and c) ICO's own costs.

14. It was determined that no adjustments prescribed by Article 8 of the Agreement were required to be made to the price actually paid or payable. Additionally, ICO did not make compensating adjustments for tax purposes for the year 2011.

15. ICO sets its selling prices in order to allow the company to earn an operating profit that meets the target arm's length (interquartile) range as set out in the transfer pricing study. The price paid or payable to XCO has not undergone significant changes over the year.

Issues for Determination

16. Does the transfer pricing study supplied in this case, prepared on the basis of the OECD Transfer Pricing Guidelines and used as the basis of a bilateral APA, provide information which enables Customs to conclude whether or not the price actually paid or payable for the imported goods is influenced by the relationship of the parties under Article 1 of the Agreement ?

Analysis

17. Under Article 1 of the Agreement, a transaction value is acceptable as the Customs value when the buyer and the seller are not related, or if related, the relationship does not influence the price. Where the buyer and seller are related, Article 1.2 of the Agreement provides two ways of establishing the acceptability of the transaction value when Customs have doubts concerning the price : (1) the circumstances surrounding the sale shall be examined to determine whether the relationship influenced the price (Article 1.2 (a)); or (2) the importer demonstrates that the value closely approximates one of three test values (Article 1.2 (b)). In this case, as indicated in paragraph 5, the importer did not provide test values therefore Customs examined the circumstances surrounding the sale.

18. The Interpretative Note to paragraph 2(a) of Article 1 of the Agreement provides that in examining the circumstances surrounding the sale, “the customs administrations should be prepared to examine relevant aspects of the transaction, including the way in which the buyer and the seller organize their commercial relations and the way in which the price in question was arrived at, in order to determine whether the relationship influenced the price.”

19. Based on the information obtained from ICO, XCO does not sell the merchandise to unrelated buyers. Therefore, ICO is unable to demonstrate that the price was settled in the same manner as in sales to unrelated parties, specified in Note to paragraph 2(a) of Article 1 of the Agreement.

20. During its review of the circumstances surrounding the sale, Customs took into account the examination of information discussed in the transfer pricing study when determining whether the price had been settled in a manner consistent with the normal industry pricing practices under the Note to paragraph 2(a) of Article 1. In this regard, the term “industry” includes the industry or industry sector that contains goods of the same class or kind (including identical or similar goods) as the imported goods.

21. Based on the information provided in Paragraph 8 :

- The Sales figure can be accepted since ICO is selling only to unrelated parties (and it is assumed ICO is rationally seeking to maximize its profits in its dealings with unrelated parties)

- The Operating expenses amount has been examined and accepted as reliable since it is determined that these expenses are paid by ICO to unrelated parties, with ICO seeking to minimize its costs and these expenses have not been paid for the benefit of the seller

- The transfer pricing study confirms that ICO's operating profit margin is within the arm's length range (i.e. based on a study of comparable, but independent (unrelated) distributors)

- The Cost of Goods Sold of ICO reflects the price paid or payable to XCO and represents the transaction between ICO and its related party, XCO. This is the transfer price in question.

By working back from the arm's length range of operating profit margins and the other accepted information set out above, it could be deduced that the transfer price is an arm's length amount. This demonstrates that information relating to the transaction between ICO and unrelated distributors can be helpful and relevant to Customs when examining the circumstances surrounding the sale between XCO and ICO.

22. The functional analysis showed that there were no significant differences in functions, risks, and assets between ICO and the eight unrelated distributors. In addition, an adequate level of product comparability was observed. The comparable companies were chosen from the electrical apparatus, and electronic parts industries (companies that sell goods of the same class or kind as the imported goods). Thus, the operating profit margin on the resale of the imported goods was shown to be generally the same as in the electrical apparatus and electronic parts industries.[2] Specifically, the transfer pricing study found that the arm's length range of the comparable companies' operating profit margins was 0.64 percent to 2.79 percent. As previously noted, ICO's operating profit margin was 2.50 %. Accordingly, since all the comparable companies sell goods of the same class or

[2] In this case, Customs accepted the operating profit margin as a more accurate measure of ICO's real profitability because it revealed what ICO actually earned on its sales once all associated expenses have been paid. Nevertheless, in certain circumstances, gross profit may be considered by Customs to illustrate the appropriately deducted associated expenses and the establishment of the accurate transfer price.

kind, the transfer pricing study supports a finding that the price between ICO and XCO was settled in a manner consistent with the normal pricing practices of the industry.

Conclusion

23. After examination of the circumstances surrounding the sale in respect of related party transactions between ICO and XCO, Customs concluded, including by analysis of a transfer pricing study based on the TNMM and additional information concerning operating expenses as deemed necessary, that under the provisions of Article 1.2 (a) of the Agreement, the relationship between the parties did not influence the price.

24. As indicated in Commentary 23.1, the use of a transfer pricing study for examining the circumstances surrounding the sale must be considered on a case-by-case basis.

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Annex D to Doc. VT1051E1b (revised)
(VT/42/Apr. 2016)

TECHNICAL COMMITTEE ON CUSTOMS VALUATION

INFORMATION DOCUMENT ON A QUESTION SUBMITTED BY JAPAN

"Treatment of the fees for unlocking a function of imported goods after importation (application of Articles 1, 8.1 (c) and 8.1 (d) of the Agreement)"

1) Introduction

At the 36th Session, Japan submitted a technical question to the Technical Committee on Customs Valuation entitled : *Treatment Of Fees For Unlocking a Function Of Imported Goods After Importation (Application Of Articles 1, 8.1 (c) and 8.1 (d) of The Agreement).* Over the following Sessions the Technical Committee examined this question and considered various draft texts. At the 42nd Session, no consensus had been reached on the conclusion to this case so the Technical Committee agreed to place the question in Part III of the Conspectus of Technical Questions. In addition, it was agreed to prepare an information document in order to capture the discussions and opinions of Members.

2) Background to the case

The facts of the case, as presented in the final version of the text at the 42nd Session in Doc. VT1029E1a, were as follows :

TREATMENT OF THE OPTIONAL PAYMENT BY CUSTOMERS FOR UNLOCKING A FUNCTION OF IMPORTED GOODS AFTER IMPORTATION

1. Importer B in country of importation I purchases and imports copiers from exporter (manufacturer) S in country of exportation X. S and B are not related under the terms of the Agreement.

The copiers incorporate application software[3] which prevents the leakage of document data. This security function, which is an optional component for individual customers in

[3] Normally, software is defined in two categories: (1) internal operating system software that is linked to a specific hardware device and is necessary for that specific hardware to function; and (2) application software that is purchases at the customer's discretion and is not required for the hardware to function. This case specifically applies to the application software that is embedded but locked on the imported copier, with a key needed to access this software.

country I, is embedded on the imported copiers for customers' convenience. However, this application software is locked at the time of importation and will not function without entering a password. The fee for unlocking the password is not known at the time of importation, and the imported copiers perform their basic function without the security function being activated.

The application software for the security function was developed by licensor L in country X who is not related to B nor S. L owns the copyright of the application software. S is given the license to incorporate the application software into the copiers in a locked/inactivated condition. The license fees for the locked security function paid by S to L are fully reflected in the price actually paid or payable for the imported goods.

The sales agreement for copiers with the locked security function between S and B does not include any provisions concerning the payments for passwords.

After the importation of the copiers, B sells all the imported goods to customers C in country I. Then C decides whether or not it will obtain the password which activates the application software preventing the leakage of document data. When C chooses to access the optional security function, C makes a contract for the purchase of the password with L and needs to pay the fee to obtain the password for the activation either directly from L through the internet (Route 1), or via B and S from L (Route 2).

If C chooses to acquire the optional security function, the payment made for the password and the amount which accrues to L is the same in each payment method.

All the provisions of Article 1.1 (a) to (d) are satisfied and, therefore, the Customs value is to be determined under the transaction value method.

A diagram of the transaction is provided at Annex I.

The International Chamber of Commerce (ICC) provided the Secretariat with background information on software licensing models. Some examples were given of products which are similar to the Japan case. The ICC commented that in some circumstances 'locked' application software features may be pre-installed on the goods in question whereas in other cases it may be downloaded and then installed on the product; they pointed out that from a business perspective the method of accessing the software is not relevant to either the buyer or seller. The ICC comments are reproduced in Annex II to this document.

3) Question for consideration by the Technical Committee

The question to be answered was posed as follows-:

Where a payment is made to obtain the password which activates the application software preventing the leakage of document data, does such payment constitute part of the price actually paid or payable for the imported goods, or should the payment be added to the price actually paid or payable for the imported goods under Article 8.1(c) or (d)?

4) Technical Committee discussions

In response to the question, two main schools of thought evolved during the course of the discussions. These opinions can be summarized as follows :

Opinion 1 – the fees should not form part of the Customs value of the imported goods.

Article 1 provides that the Customs value of imported goods shall be the price actually paid or payable for the goods adjusted in accordance with the provisions of Article 8. Paragraph 7 of Annex III further explains that the price actually paid or payable includes all payments actually made or to be made as a condition of sale of the imported goods, by the buyer to the seller, or by the buyer to a third party to satisfy an obligation of the seller. The sales agreement between importer B and exporter S does not include any provisions concerning the payment for the passwords. B can purchase the imported goods from S without any obligation to pay for the passwords. As the activation of the application software is an optional component for customers C, the decision whether or not to obtain the passwords is decided by C after the importation and Customs clearance of the copiers, regardless of the payment route. The payment for the passwords is incurred by C and the same amount accrues to licensor L in each payment route. The payment for the passwords, based on the contract between C and L, is not related to the license fee payment made by S to L as each fee is covered in a separate contract and the parties of each contract are different. Therefore, the payment for the passwords which is derived from the transaction between C and L in any payment route is not a condition of sale of the imported goods and should not constitute part of the price actually paid or payable for the imported goods under Article 1.

Article 8.1(c) provides that royalty and license 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. The payment for the passwords is not a condition of sale of the imported goods for the same reasons as stated above. In addition, the payment for the passwords is not related to the imported goods but made to obtain the passwords. Therefore, the payment for the passwords should not be added to the price actually paid or payable for the imported goods under Article 8.1(c).

Article 8.1(d) provides that the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller as an element to be added to the price actually paid or payable for the imported goods. The payment for the passwords accrues not to S but to L because the payment for the passwords is derived from a separate transaction between C and L and not from any subsequent resale, disposal or use of the imported goods. Therefore, the payment for the passwords should not be added to the price actually paid or payable for the imported goods under Article 8.1(d).

Thus, where a payment is made for the passwords to activate the application software to prevent leakage of document data, such payment should not form part of the Customs value of the imported goods.

As a matter of course, Article 17 and paragraph 6 of ANNEX III recognize that in applying the Agreement, Customs administrations may need to make enquiries concerning the truth or accuracy of any statement, document or declaration presented to them for customs valuation purposes. Each situation must be analyzed based on all the facts surrounding the sale and importation of the goods, such as the sales agreement and the royalty or licence agreement, in order to determine whether or not the payment of the password fee is a condition of sale of the imported copiers.

Opinion 2 – the fees should form part of the Customs value of the imported goods.

Article 1 provides that the Customs value of imported goods shall be the price actually paid or payable for the goods adjusted in accordance with the provisions of Article 8. Paragraph 7 of Annex III further explains that the price actually paid or payable includes all payments actually made or to be made as a condition of sale of the imported goods, by the buyer to the seller, or by the buyer to a third party to satisfy an obligation of the seller.

In this case, the nature of the imported products has changed once the password has been purchased, they become the copiers with additional security function. For these copiers, two payments are made as conditions of sale, one is the payment for the original copiers made at the time of importation, and the other is the payment for password fees made after importation. The copiers with the security function enabled would not be made available to customers C without the payment of password fees, which indicates it is a condition of sale for the imported goods.

Given that customers C would not have known about the arrangements for the payments of password fees without the information (publicity/promotional material etc.) provided by the seller, it could be deduced that the obligation of payments for the password fees derives from the seller even if it has not been indicated in the sales contract. Therefore, even if the password fees are paid to the licensor, they are actually paid to a third party to satisfy an obligation of the seller.

Where the password fees are paid by customers C via B and S (Route 2), there are payments of password fees between B and S, which indicates the payments are made by the buyer to the seller. Where the password fees are paid by customers C directly to L (Route 1), the obligation of payments for the password fees derives from the seller via the buyer, thus it could be deemed as an indirect payment by B.

In conclusion, the payments for the password fees could be considered as payments actually made or to be made as a condition of sale of the imported copiers with additional security function, by the buyer to the seller, or by the buyer to a third party to satisfy an obligation of the seller. Thus, these payments should be included in the price actually paid or payable for the imported goods under Article 1.

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The Technical Committee discussed the above two opinions at successive Sessions. The majority of delegates expressed support for Opinion 1.

Japan supported Opinion 1 and provided the following comments :

Customers C is not a “buyer” of the sale for export to the country of importation for the imported goods. Based on the provision of Article 1 and paragraph 7 of Annex III, the payment for the password would not be part of the price actually paid or payable unless the payment for the password is an obligation for Company B who is a “buyer” of the sale for export to the country of importation for the imported goods.

Then, does Buyer B have an obligation to pay for the password-?

What is agreed between Buyer B and Seller S is the sale for export of copiers with the locked security function, not copiers in an activated condition. Seller S meets his obligations under the sales agreement when he sells and delivers copiers with the locked security function to Buyer B.

Whether to activate the security function of copiers is decided by customers C after Buyer B imported copiers and resold to customers C. Customers C who decided to activate the security function make a contract with Licensor L to obtain the password for the activation and then have an obligation to pay for the password to Licensor L under the contract. Neither Buyer B nor Seller S is a party of the contract for the password fee and has an obligation to pay for the password.

One of the two payment routes which customers C can choose for his convenience is that Buyer B receives the payment for the password from customers C, then passes the money to Seller S, and Seller S transfers the money to Licensor L (Route 2). Exactly the same amount incurred by customers C accrues to Licensor L via Buyer B and Seller S. It is not appropriate in this case to judge that both Buyer B and Seller S have an obligation to pay for the password who are not parties of the contract to obtain the password by only the fact that the Buyer B and Seller S are involved in money transfer. In another payment route (Route 1), neither Buyer B nor Seller S is involved in any part of the payment for the password.

Considering all these facts, Japan expressed the view that neither Buyer B nor Seller S has an obligation to pay for the password.

Regarding the sentence “customers C would not have known about the arrangements for the payments of password fees without the information (publicity/promotional material etc.) provided by the seller” stated in paragraph 3 of Opinion 2, Japan pointed out that customers C and Seller S have no direct contact for copiers and customers C are not in a position to

recognize who supplies copiers to Buyer B. Customers C gets to know how to activate the security function and how to pay for the password from information provided by Buyer B from who customers C purchased the copiers.

Japan clarified the following two points in response to Members who supported Opinion 2 :

1. Opinion 2 says that the payment for the password is a condition of sale for the imported goods, therefore the payment should be included in the price actually paid or payable for the imported goods under Article 1.

However, the imported goods in this sale are copiers with the locked security function, not copiers in an activated condition. The payment for the password by Customers C is based on the transaction between Customers C and Licensor L, that is to say, this payment is different from the sale for export to the country of importation for the imported goods.

Japan therefore considered that the payment of password fee has no influence on the importation of copiers with the locked security function and doesn't become a condition of sale for imported goods.

2. In the third paragraph of Opinion 2, it is said that "Given that Customers C would not have known about the arrangements for the payments of password fees without the information (publicity/promotional material etc.) provided by the seller, it could be deduced that the obligation of payments for the password fees derives from the seller even if it has not been indicated in the sales contract.". Do you consider whether Customers C know the arrangements for the payment for password fees or do not have influence on the price actually paid or payable for the imported goods under Article 1? Even if the Customers C deduce that the obligation of this payment for the password is derived from the Seller, Japan considers that the nature of the payment by Customers C does not change. Actually, the obligation of Customers C doesn't derive from the Seller, and Buyer B has no obligation to pay password as previously described. So this obligation of payment essentially derives from Licensor L.

Views of other countries supporting Opinion 1

One country expressed the following view-:

- The security function is an optional component for individual customers in Country I. Also, the copiers perform their basic functions without the security functions being activated. Subsequent purchasers in Country I may choose not to activate the security function in the copiers after the purchase. For these reasons it considered that the payment from C to L for software activation constitutes a separate transaction from the contract for the sale of goods between S and B, and therefore does not constitute part of the price actually paid or payable for the copiers.

One country noted the following-:

- The procedure for obtaining the password is totally independent of the importation of the goods and is related to the option granted by licensor L to customers C in the country of importation, once those customers have purchased the copiers from the importer in country I. The amount of 10 c.u. for the use of the password is not included in the price actually paid or payable for the copiers and is a sum received by licensor L when customer C voluntarily chooses to purchase the password.
- The imported copiers are not two different types of good but only one type of good which, following importation, may be used with its security functions locked or unlocked, subject to payment of 10 c.u.
- Payment of the 10 c.u. by customer C in country of importation I to activate the password constitutes a different agreement to the contract for sale of the goods which has been concluded between seller/exporter S and buyer/importer B. Consequently, there is no condition of sale of the imported goods; nor does the payment constitute the proceeds of any resale, disposal or use of the imported goods. This means that payment of the amount corresponding to the password does not fall under Article 8.1 (c) or Article 8.1 (d) of the Agreement.
- This reinforces the view that the sales agreement between seller/exporter S and buyer/importer B does not contain any provisions concerning the payment for the password and, consequently, activation of the password is a matter for a separate agreement. Accordingly, there is no condition of sale of the imported copiers, nor does payment involve the proceeds of any resale, disposal or use of the imported copiers.

Countries also noted the considerable practical control challenges which Customs would face if the fees were considered to be dutiable. Considering that it would be a decision of the final customer whether or not to access the additional functions, Customs are unlikely to be aware where this is the case, given that it is not the original importer who is paying this fee.

Views of countries supporting Opinion 2

The imported copiers could be regarded as two different kinds of goods based on the customers' different choices; one is the copiers with the basic functions and the other is the copiers with additional security functions, although they are in the same state at the time of importation due to the security functions being locked at that time. In other words, it can be considered that where the fee is paid and the security functions are unlocked, the copier is no longer the original imported product.

There was concern that if an instrument was issued based on Opinion 1 it could be used by some unscrupulous traders who may split the import price into two parts for duty evasion purposes by manipulating the arrangements among licensor, seller, buyer and customers, which would be a great challenge for Customs.

In response to supporters of Opinion 1, attention was drawn to Explanatory Note 1.1 which states that "Neither in this Article nor in the corresponding Interpretative Notes is there any reference to a time standard external to the actual transaction, which would need to be taken into consideration when deciding whether the price actually paid or payable is a valid basis for the calculation of the Customs value." Thus, the time element does not need to be considered when the transaction value method is used.

As mentioned in the document, software is defined in two categories, internal operating system software and application software application software is not required for the hardware to function. So it could be deduced that application software is independent of the hardware and doesn't need to be incorporated in the hardware in advance, and customers can download the application software via the internet at any time when they have the hardware in hand. Just like the case with smartphones when some application software is downloaded from the "App" store.

Another question is how to define application software ? Is there a clear boundary between internal operating system software and application software ? This is extremely important for Customs, since different categories of software may be subject to different valuation treatment. However, it appears that there is currently no globally accepted standard for the identification of software in terms of category.

Even if the security software in this case was taken as the application software, according to the information provided by ICC : *"Application software may be licensed at any time, and is typically made available immediately to the customer upon payment of the license fee"* ; but in this case, the licensee (seller S) is only given the license to incorporate the software into the copiers in a locked condition, and has not been granted the right to use the software upon the payment for the license fees; only upon the payment of password fees, the security function could be made available to the customers C. This may imply that the license fees have not been paid in total, and the transaction value may not reflect the total cost of the imported goods. Therefore when the rest of the license fees have been paid after importation in the form of password fees, they should be included in the price paid or payable for the imported goods**.**

[Alternative texts for "Views of countries supporting Opinion 2"

Regarding the nature of the imported goods:

The imported copiers could be regarded as two different kinds of goods based on the customers' different choices; one is the copiers with the basic functions and the other is the copiers with additional security functions, although they are in the same state at the time of importation due to the security functions being locked at that time. In other words, it can be considered that where the fee is paid and the security functions are unlocked, the copier is no longer the original imported product.

For these copiers, two payments are made as conditions of sale, one is the payment for the original copiers made at the time of importation, and the other is the payment for password fees made after importation. The copiers with the security function enabled would not be made available to customers C without the payment of password fees, which indicates it is a condition of sale for the imported goods.

Regarding the concerns expressed by the delegates in favor of Opinion 1 that the password fees are paid after importation of the imported goods, therefore they are not condition of sale for the imported goods and the payments are not to be included in the price actually paid or payable, attention was drawn to Explanatory Note 1.1 which states that "Neither in this Article

nor in the corresponding Interpretative Notes is there any reference to a time standard external to the actual transaction, which would need to be taken into consideration when deciding whether the price actually paid or payable is a valid basis for the calculation of the Customs value." Thus, the time element does not need to be considered when the transaction value method is used.

Analysis of the facts:

According the facts of case, L owns the copyright of the software, S is given the license to incorporate the software into the copiers and pay the license fees to L, and the license fee are fully reflected in the price actually paid or payable for the imported goods. It would cause misunderstanding that S has paid for the license fees in total. If S has done so, it would be able to use the security function, but the fact says the security function can only be available when the password fees have been paid. Besides, if S has made the total payment of the license fees and possesses the right to use it, it would require the customer C to pay the password fees to itself rather than to L. So the facts here are questionable. The possible situation could be like this: the license fees paid by S are not a total payment of license fees, the password fees together with the license fees paid by S constitute the total payment of license fees; the fact that all payments including license fees and password fees go to L supports above analysis. Therefore it could be deduced that the obligation of payments for the password fees derives from the seller S, S passes the obligation to C via B.

In the light of Opinion 1 of the draft, "The payment for the passwords is not related to the license fee payment made by S to L as each fee is covered in a separate contract and the parties of each contract are different", which indicates the obligation of payment for password comes from a contract, does it mean L signs a contract with C to reach an agreement on the payment of password fees? But customer C remains uncertain until the copiers have sold in the country of importation. So how and when could this contract be signed between L and C? More reliable situation could be: L defines and imposes the obligation of payment for password, requires S to pass this information to C via B, which means L and S have reached an agreement on the payment of password fees. The Delegate of Japan confirmed in 39th session that the customer would be aware of the existence of the security functions by reading publicity/promotional

material etc, which indicates C would also be aware of information concerning the payment of password fees by reading publicity/promotional material. As we know, promotional materials of products normally contain information in relation to the functions and manual instructions of the products, they are normally provided by the manufacturers of the sellers, which supports the analysis above that the information concerning the payments of password fees comes from S. Again it could be deduced that the obligation of payments for the password fees derives from the seller S, S passes the obligation to C via B.

Analyses above may lead to the conclusion in Opinion 2 which is: even if the password fees are paid to the licensor, they are actually paid to a third party to satisfy an obligation of the seller; the payments for password could be deemed as payments made by B directly or indirectly. Thus, these payments should be included in the price actually paid or payable for the imported goods under Article 1.

Examples of discrepancy and inconsistency with the commercial practice:

It should be noted that this case is a theoretical case which is not based on factual commercial situations, and the facts of the case have been modified for several times in order to address the concerns raised, however, there are still some elements of discrepancy and vagueness which would probably cause confusions. Some of scenarios do not make sense and are far from the commercial practices in the industry.

For example, 1) If the security software in this case is application software which is not required for the hardware to function, why does the manufacturer have to embed the software into the imported goods before importation, instead of requiring the customer C to download the complete version of that software via internet by themselves? 2) If the royalties for the software are fully reflected in the price paid or payable for the imported goods, why should the password fees be paid to the licensor instead of to the seller? As another example, it’s unreasonable and illogical that those customers who do not use the security software are still subject to the royalties (fully reflected in the price) for the locked software, because the incorporation of software will increase the cost of the product and decrease its price competitiveness.

Based on research with local copier companies conducted recently, it appeared unlikely that cases such as this would be in line with commercial practice.

Regarding software categories:

As mentioned in the document, software is defined in two categories, internal operating system software and application software application software is not required for the hardware to function. So it could be deduced that application software is independent of the hardware and doesn't need to be incorporated in the hardware in advance, and customers can download the application software via the internet at any time when they have the hardware in hand. Just like the case with smart phones when some application software is downloaded from the "App" store.

Another question is how to define application software? Is there a clear boundary between internal operating system software and application software? This is extremely important for Customs, since different categories of software may be subject to different valuation treatment. However, it appears that there is currently no globally accepted standard for the identification of software in terms of category.

Even if the security software in this case was taken as the application software, according to the information provided by ICC : *"Application software may be licensed at any time, and is typically made available immediately to the customer upon payment of the license fee"*; but in this case, the licensee (seller S) is only given the license to incorporate the software into the copiers in a locked condition, and has not been granted the right to use the software upon the payment for the license fees; only upon the payment of password fees, the security function could be made available to the customers C. This may imply that the license fees have not been paid in total, and the transaction value may not reflect the total cost of the imported goods. Therefore when the rest of the license fees have been paid after importation in the form of password fees, they should be included in the price paid or payable for the imported goods**.**

Examples in the WCO Valuation Training Module:

It should be noted that there is a similar case in VALUATION TRAINING MODULE

(INTERMEDIATE ADVANCED) published by WCO. In that case, the imported goods are telephone switchboards with additional software contained within them which enable the switchboards to be upgraded to Model B or Model C after importation, extra payments are required for the upgrades. There are two alternate ways provided in the training module(see ANNEX 1). Although there are differences between this case and the case in question, it could still serve as an inspiration when dealing with similar case.

Risk consideration:

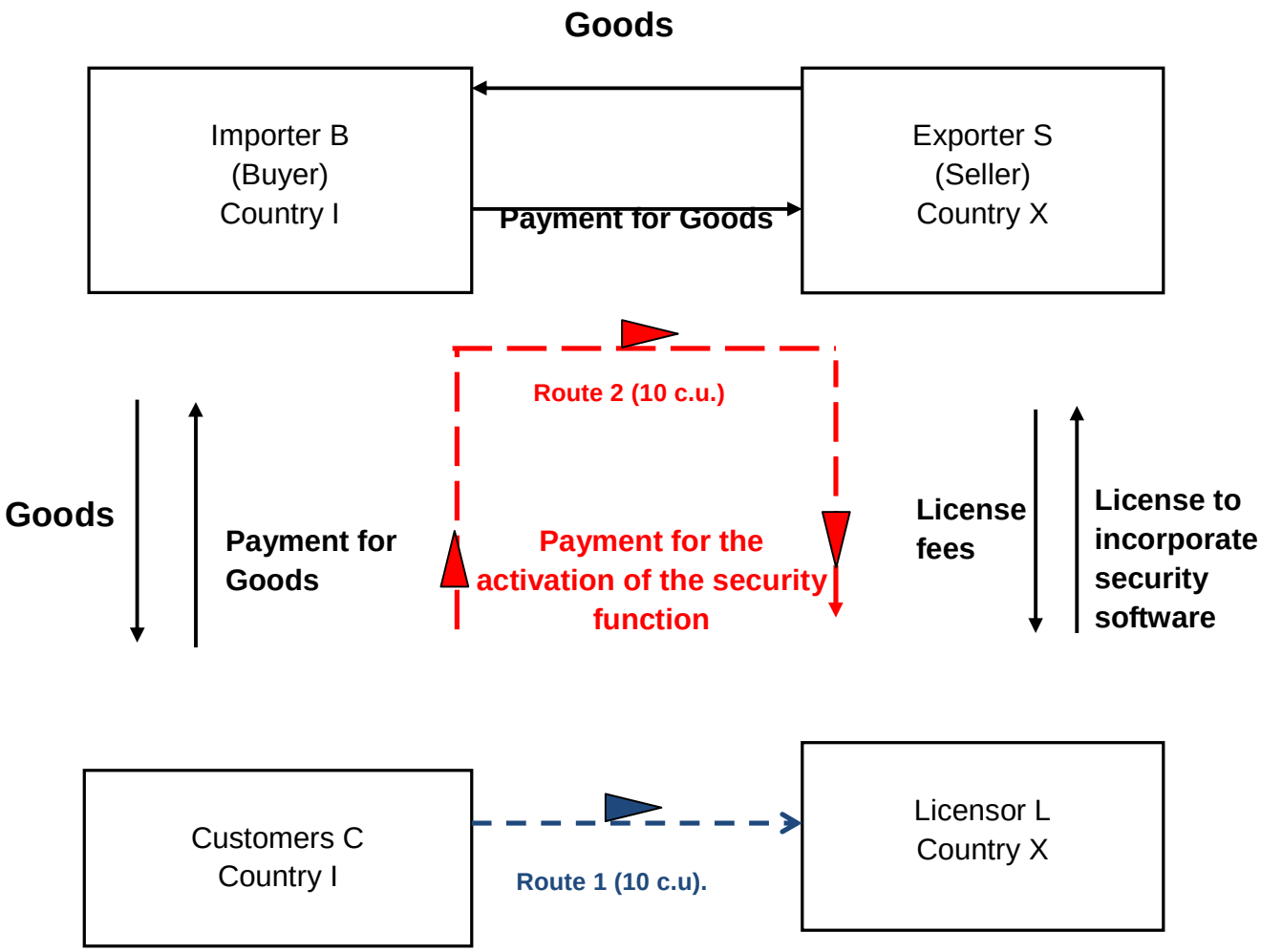
There was concern that if an instrument was issued based on Opinion 1 it could be used by some unscrupulous traders who may split the import price into two parts for duty evasion purposes by manipulating the arrangements among licensor, seller, buyer and customers, which would be a great challenge for Customs.](China)

5. *Conclusion*

The above information and opinions may be taken into account by Members when considering cases involving 'locked software', noting that each case may have different characteristics and that different conclusions may be possible.

Annex I

Transaction Chart



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Annex D to Doc. VT1051E1b (revised)
(VT/42/Apr. 2016)

Annex II

Software Licensing Models

Discussion document provided by International Chamber of Commerce

1. Software license fees paid with respect to imported hardware can be an addition to transaction value under Article 8.1(c) of the Agreement. To conduct the analysis, information on the type of software licensed and the licensing arrangement is needed.

Categories of software

2. Broadly speaking, software is defined in two categories :

Internal operating system software (IOS)

3. IOS is linked to a specific hardware device and is necessary for that specific hardware to function. IOS has no value to the customer other than to make the specific hardware upon which it is embedded operate. IOS is generally present on the hardware at the time of import. If it was not present, the hardware would not function, and the operation to install it would be more complex than a simple download from the internet. IOS is not portable among devices.

Application software

4. Application software is purchased at the customer's discretion; it is not required for the hardware to function. Application software may be licensed at any time, and is typically made available immediately to the customer upon payment of the license fee. Application software may be utilized on previously purchased compatible hardware. When hardware is later purchased by the customer who holds a license for the application software, the customer may use the application software on newly acquired hardware without further fee. Application software is usually made available to the customer by download. In some cases, for convenience, a hardware provider may include application software already under license embedded on the subsequently purchased hardware. Typically, when this occurs, a key is provided to the customer to access the application.

Annex II

Licensing models

Application software licensed after product importation

5. As application software is optional, a hardware owner may choose to license application software after importation. Typically the software is downloaded from the internet. There is no addition to value under Article 8 in this circumstance.

Separate license fee for IOS

6. IOS is licensed with every hardware device. For some transactions, there is one price for the hardware inclusive of the IOS license. In others, the IOS license fee is a separately stated single fee. When separately stated, the license for IOS is an addition to value under Article 8.

Prepaid application software license

7. Under this business model, a customer enters into a prepaid license agreement that enables a right to access and download specific application software, or a suite of application software. A single license fee is pre-paid for a term of years. Renewal terms may also be identified. The customer has immediate access to the application software licensed by download. The customer may also use this software on subsequently purchased hardware, which may be purchased from the licensor or a third party. The license fee paid for the application software is not tied to any specific importation, and is not a condition of sale of any hardware. It is not an addition to value under Article 8.

Purchase of hardware with application software license loaded

8. In some instances a customer will purchase hardware and simultaneously license application software. For customer convenience, the application software is loaded on the hardware by the exporter, and the hardware is imported with the software on it. While the application software is, by definition, optional, the customer has effectively exercised the option at the time of the sale for export of the hardware. Unless the importer is able to offer evidence of the separate nature of the hardware purchase and software license, the license fee payable for the application software would be considered part of the transaction value, either as a part of

the price paid or payable if software is licensed by the seller, or as an addition to value under Article 8.1(c) if paid to another party.

Renewal payments

9. In some instances application software is licensed simultaneously with the hardware purchase, but the application software license is for a specified period, for example, one year. Term license agreements often include an option to renew. Renewal payments for application software are not part of the consideration related to the imported product, and do not need to made as a condition of sale of the imported product. Renewal license fees are not part of the transaction value of the imported hardware.

Further comments

10. Using the framework provided above, the Japan case is an example of application software licensed after importation. In the Japan case, the application software is resident, but locked on the device, and a key is needed to access the software (as opposed to the application software being downloaded via the internet). There are a variety of reasons that companies use keys to access pre-loaded software instead of having customers access the software via the internet. Sometimes this is based on the complexity of the installation process; for example, depending on the strength of the internet connection, updates can take a long time and sometimes there are interruptions that cause multiple tries. Other times it is for customer convenience or at customer request. In situations in which application software is licensed for multiple users, it is very common for the software to be made available via the internet so that it can be loaded on existing hardware, and for the customer to require that it be loaded on subsequently purchased hardware, with the access key provided. A critical point to make is that from a business standpoint, the method of access is irrelevant—it does not matter to either the buyer or the seller if the software is present on the hardware and requires a key, or is downloaded.

11. There are a number of product examples that are like the Japan case-: networking or telecommunications equipment, like routers or switches, which offer a variety of features (often called “advance features”); security or encryption enhancement options on wide ranging devices; even automobiles that have software for satellite radios, GPS, or connection services.

Annex II

Reference documents :

VT0911E1a (TCCV/37)
VT0918E1a (TCCV/37)
VT0920E1c (TCCV/37 – Report)
VT0931E1a (TCCV/38)
VT0937E1a (TCCV/38)
VT0941E1b (TCCV38 – Report)
VT0964E1a (TCCV/39)
VT0967E1a (TCCV/39 – Report)
VT0978E1a (TCCV/40)
VT0988E1a (TCCV/40)
VT0994E1a (TCCV/40) - Report)
VT1004E1a (TCCV/41)
VT1015E1a (TCCV/41)
VT1011E1a (TCCV/41 –Report)
VT1029E1a (TCCV/42)
VT1042E1a (TCCV/42)

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Annex E to Doc. VT1051E1b (revised)
(VT/42/Apr. 2016)

Working procedures for the Technical Committee on Customs Valuation

General Provisions

1. In order to ensure the Technical Committee is meeting its mandate set out in Annex II of the WTO Valuation Agreement, the Technical Committee has agreed the following working procedures.

2. A priority of the Technical Committee shall be directed to the discussion of technical questions in order to continuously improve the achievement of its key deliverables.

Communication and Working groups

3. Ensure the efficient working of the Technical Committee, by, inter alia:

- Promoting and encouraging pertinent and concise interventions by Members during the Sessions, noting the provisions of paragraph 17 of Annex II : "*The Chairman may also call a speaker to order if the speaker's remarks are not relevant";*

- Encouraging the participation of Members by the use of new technology tools during intersessions, such as the Club de la Réforme or other suitable platforms;

- Creating informal "virtual" discussion groups to further deliberations with respect to specific technical questions;

- Considering the use of "ad hoc" sessions and working groups to improve drafting and to have strategic planning to achieve goals;

- Holding theme meetings on specific topics, when the need arises.

Administrative documents and procedures

4. In order to simplify and expedite the process for dealing with administrative items, the Committee will:

- Follow the procedures outlined below in order to finalise the Report of the Session in an expeditious way;

- Refer to the update of the following administrative issues in the Director's Report:
  - Contact points on valuation matters
  - Contact points on exchange of customs valuation information
  - Index of Reference Materials

- ~~o~~ Discuss the above administrative items only if requested by Members or the Secretariat

Submission of specific technical questions

5. To ensure consistency, a template has been developed for the use of Members when submitting a technical question. The template, which is available via the Members' website, contains an option whereby Members can choose whether to submit a question for consideration by the Technical Committee or by the Secretariat.

Reasonable time limit

6. Taking into account the requirement in paragraph 3 of Annex II of the WTO Valuation Agreement to conclude its work "in a reasonably short period of time", the Technical Committee may consider the use of time targets to conclude work on a technical question.

7. Depending on the consideration of time targets and on the analysis of the Committee a technical question on the Technical Committee´s programme of work might be moved to Part III "Questions raised, pending future work" of the Conspectus of Technical Valuation Questions, while waiting for further progress on the discussions.

Procedure for the publication of working documents and the submission of Members' comments

Agenda

8. The provisional agenda should be published on the WCO Members' website within eight weeks of the last Session in all official languages.

9. The provisional agenda on the WCO Members' website should be updated as appropriate.

Working documents/ Members' written comments

10. Working documents that invite Members' written comments should, to the greatest extent possible, be published on the WCO Members' website within eight weeks of the last Session in all official languages.

11. Members' written comments should be forwarded to the Secretariat no later than six weeks prior to the next Session in electronic form, via e-mail whenever possible. (E-mail : Valuation@wcoomd.org)

12. Members' written comments received by the Secretariat before the above deadline should be published in a working document on the WCO Members' website approximately three weeks prior to the next Session in all official languages.

13. Members' comments received by the Secretariat after the above deadline will not be published as a document of the Technical Committee. Such comments will be circulated to delegates during the Session as a "non-paper" in the language(s) received. However, a "non-paper" concerning an ongoing issue will be republished as a document of the Technical Committee in all official languages for the next Session.

Reporting Procedure

14. At the end of each Session, the Technical Committee will approve completed work necessary for presentation to the Council and the Committee on Customs Valuation (CCV), such as new or revised instruments, studies or questions to be referred to the CCV.

15. The first draft of the Technical Committee Report ('a' version) will be prepared by the Secretariat within three weeks after the end of the Session and circulated by email to the Chairperson and delegates for written comments;

16. Members' written comments should be submitted within three weeks of circulation of the "a" version.

17. After this deadline, the Secretariat will prepare the 'b' version of the draft Report containing all Members' written comments and additional edits by the Secretariat. All changes will be highlighted in the text. The "b" version will be published on the WCO Members' Web site three weeks after the deadline for written comments;

18. From the date of the publication of the "b" version on the WCO Members Web site, delegates would have a period of two weeks for submitting comments on or objections to the comments included in this version to the Secretariat;

19. If the Secretariat did not receive any comment or objection within the two-week period, the Draft Technical Report (body and relevant annexes) would be deemed to be approved and the Secretariat would publish a "clean" version "c", being the "final Report", on the WCO Members' Web site;

20. If, however, a comment or objection is received regarding the "b" version in the two-week period, then the Technical Committee Chairperson will raise the point in question for discussion at the subsequent Session.

21. The Secretariat will prepare an Executive Summary of the Session which will be made available one week after the end of the Session, via the Members' website.

Public availability of documents

22. All working documents of the Technical Committee will be made available via the WCO Public website at the time of publication on the Members' website, subject to the exclusion of information provided on a confidential basis and the names of Members.

Outputs of the Technical Committee

23. As stated in Annex II of the WTO Valuation Agreement, in response to specific technical questions posed by Members, the Technical Committee may give advisory opinions on appropriate solutions in the form of instruments (Commentaries,

Explanatory Notes etc.). Where it is not possible to reach consensus, the Technical Committee may decide to produce alternative outputs such as a detailed minute of a specific technical discussion, or a summary document in order to provide a record of relevant opinions or background information on a particular topic.