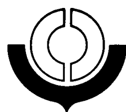

WORLD CUSTOMS ORGANIZATION
ORGANISATION MONDIALE DES DOUANES
ORGANIZACIÓN MUNDIAL DE ADUANAS

TECHNICAL COMMITTEE ON CUSTOMS VALUATION

VT1158E1a
+ (Annexes)

-
47th Session
-

O. Eng.

Brussels, 3 October 2018.

SPECIFIC TECHNICAL QUESTIONS

ROYALTIES AND LICENCE FEES UNDER ARTICLE 8.1 (c) OF THE AGREEMENT (ROYALTY-INCOME TAX)

Request by China

(Item V (e) on the Agenda)

Reference documents :

VT1135E1a (TCCV/46)
VT1137E1a (TCCV/46 – Draft Report)
VT1148E1a (TCCV/47)

I. BACKGROUND

1. At the 46th Session, the Technical Committee agreed that the question submitted by China on “royalties and licence fees under Article 8.1 (c) of the Agreement” should be examined at its 47th Session as a Specific Technical Question.

2. Following the 46th Session, the Secretariat worked with China to adjust the text reflecting the third opinion as suggested by one delegate. The new text is reproduced in Annex I to Doc VT1148E1a.

3. Members were invited to examine the document and submit their written replies to the Secretariat.

II. MEMBERS’ COMMENTS

4. Written comments were received from Canada, China, the United States and Uruguay. These comments have been reproduced in Annexes I to IV to this document.

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5. In particular, in its comments, Canada proposes amending the text to properly frame and distinguish the nuances between the three opinions, Uruguay also proposes amendments to the text to reflect that the importer is required by the tax rules in his country to declare a gross royalty of 5.5% on the net resale price in order to ultimately secure a net royalty (after the tax in question) of 5% of the net resale price in order to comply with the signed contract. The Secretariat has incorporated both proposals in the text in Annex V of this document. The proposed amendments are shown in **bold**.

III. CONCLUSION

6. The Technical Committee is invited to examine the question, taking into account the written comments by Canada, China, the United States and Uruguay and also the proposed amendments to the text in Annex V of this document.

* * *

COMMENTS BY CANADA

1. Canada would like to thank the Chinese Customs Administration and the Secretariat for having adjusted the text to include a third option for the question under review. Canada wishes to provide the following comments.

2. Canada believes the emphasis of the solution proposed in Advisory Opinion 4.16 was on the necessity to capture the entire royalty amount that was required to be paid by the importer, regardless of whether the payment was divided with a portion being remitted to the tax authority in the country of importation and the remaining portion being remitted back to the licensor.

3. For instance, paragraph 11 states *"At no point does the Agreement refer to tailoring this adjustment to the royalties that the licensor will receive. Indeed, Article 8.1 (c) provides that, to the extent that the requirements therein are met, the royalties payable by the buyer are part of the Customs value, and does not specify that they are the royalties that the licensor will ultimately receive…in this case, the amount of money which the importer pays, not that which the licensor ultimately receives, should be added to the Customs value of the goods."*

4. Likewise, paragraph 12 states that *"the solution proposed does not involve including in the Customs value of the goods the amount of a tax…but the amount of a royalty <u>agreed</u> between the licensor and the licensee."*

5. Ultimately, in Advisory Opinion 4.16, the royalty which the buyer is required to pay for the commercial use of the trademark is 100 currency units, and it is this amount that must finally be added to the price actually paid or payable.

6. Based on the facts of Document VT1148E1a, the royalty <u>agreed</u> between Buyer B and Licensor S is calculated by applying a rate of 5% of the net sale price of the patented goods in the country of importation. In addition to this, a further income tax derived from the royalty income is due by the licensor but ultimately paid by the importer on their behalf.

7. To properly frame and distinguish the nuances between the three opinions, Canada would therefore like these references to be represented in the third option and the third paragraph of this option should be amended accordingly; that is to say that the license fee of 100 currency units represents the agreed amount for the commercial use of the patent licensed in the agreement, and the income tax of 10 currency units represents a tax of the country of importation which must be excluded from the Customs value of the imported goods.

8. Canada suggests that the 3rd paragraph of Opinion 3 be replaced with:

> "Therefore, the importer makes two payments: a payment of 100 currency units for the commercial use of the patent calculated by applying the fixed rate set out in the license agreement; and another payment of 10 currency units for withholding tax paid by the licensee to the Tax authority in the country of importation for the benefit of the licensor (to satisfy an obligation of the licensor)."

9. Likewise, the 4th paragraph of Opinion 3 should be amended to read:

> "However, in accordance with paragraph 3 (c) of the Interpretative Note to Article 1, the income tax is viewed as a tax of the country of importation. Hence, the 10 currency units must be excluded from the Customs value of the imported goods."

10. By making these amendments the discussions could focus on the salient and distinguishing arguments of the three options in order to examine the nature of the payment, i.e., whether this payment is an indirect payment of royalty under Article 8.1 (c), an indirect payment in respect of the imported goods within the meaning of Article 1, or a tax of the country of importation within the meaning of paragraph 3 (c) of the Interpretative Note to Article 1.

11. Canada anticipates to make additional comments on this question at the 47th Session of the Technical Committee on Customs Valuation.

* * *

COMMENTS BY CHINA

China Customs Administration would like to thank the Secretariat for its help in drafting the current version, and Chilean Customs for the comments. We wish to make the following comments:

1. It should be noted that there are only two opinions in the original version submitted by China. At 46th session, one delegate suggested adding a third opinion – the income tax should not be included in the Customs value of imported goods. During the intersession, the draft text was amended to reflect the third opinion with the Secretariat's help. Actually when drafting the original text before its submission, we did considered the third option – not to include the tax payment, however we didn't see any strong reason to exclude the tax payment in the Customs value.

2. Chilean Customs mentioned in the comments that income tax is an indirect payment in line with the example given in paragraph 1 of the Interpretative Note of the Agreement, since the buyer is settling a debt owed by the seller, which is in accordance with opinion 2 in this case.

3. We would like to remind the Committee that the payment of the ten (10) currency units paid by the buyer/licensee is not based on sales contract, but based on the license agreement. The payment was an obligation between licensee and licensor rather than buyer and seller. In order to obtain the patent from the licensor, the licensee needs to meet two conditions, which are the payment of royalty and income tax. In this case, the taxpayer is licensor, whose obligation was transferred to licensee.

4. According to Advisory Opinion 4.16, the "duties and taxes of the country of importation" which shall be excluded from the Customs value as prescribed in Paragraph 3 (c) of the Interpretative Note to Article 1 relate to domestic taxes which may be levied on the import of goods rather than taxes which may apply to royalty income. This statement was quoted in the analysis of all three opinions. However, for opinion 1 and 2, it leaded to the conclusion that the ten (10) currency units should not be excluded from customs value; while the newly added opinion 3 concluded that it should be regarded as a tax of the country of importation and not for the imported goods, which should not be included in the price actually paid or payable.

5. Advisory Opinion 4.16 is the first guidance indicating treatment of income tax in relation to royalty payment, which will have a great influence on Customs valuation practice. We recommend the Committee to further specify this issue to ensure uniform interpretation and application of WTO Valuation Agreement.

* * *

COMMENTS BY THE UNITED STATES

1. The United States would like to thank China for submitting this question for the Technical Committee's consideration, and to thank the Secretariat for its work on the case. The United States has the following comments.

2. In this case, importer/buyer/licensee B, in country of importation, I, enters into a license agreement with supplier/seller/licensor S, in country of exportation X, for use of a patent in the production of the imported goods. B pays S a five percent (5%) royalty fee calculated based on the net sale price of the patented goods in the country of importation. S and B also have a purchase contract in place. The facts section of China's submission refers to all of the requirements provided for in Article 8.1(c) of the Agreement being met. In addition to the royalty payment, under the terms of the license agreement, S requires B to pay an income tax on behalf of S in the country of importation.

3. Under Article 1 of the Agreement, "the customs value of the imported goods shall be the transaction value, that is the price actually paid or payable for the goods when sold for exportation to the country of importation adjusted in accordance with the provisions of Article 8. . ." Interpretative Note 1.1 to Article 1 defines the price actually paid or payable as the total payment made or to be made by the buyer to or for the benefit of the seller for the imported goods. It is further stated that the payment may be made directly or indirectly, with an example of an indirect payment being the settlement by the buyer, whether in whole or part, of a debt owed by the seller. Further, paragraph 7 of Annex III states 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."

4. In this case, the United States would like to note that the royalty for the use of patents is paid by the buyer to the supplier/seller/licensor for the imported merchandise. Therefore, the Technical Committee might consider analyzing the royalty payment itself as being part of the price actually paid or payable under Article 1, not as an addition under Article 8.1(c) of the Agreement.

5. Further, supplier/seller/licensor S is obligated to pay the income tax on the royalty earned in accordance with the domestic tax rules of country of importation. However, pursuant to the contractual arrangement with importer/buyer/licensee B, it is B who actually makes the payment to satisfy this obligation of S. Therefore, the United States is of the view that the income tax paid by B on behalf of S pursuant to the contractual arrangement between the parties in the country of importation is part of the price actually paid or payable. Therefore, this payment should be included in the customs value of the imported goods.

6. The U.S. Administration anticipates that it may have additional comments to make in respect of this matter at the 47th Session of the Technical Committee on Customs Valuation.

* * *

COMMENTS BY URUGUAY

1. The Delegation of Uruguay would like to thank the Administration of China and the Secretariat for the work undertaken for the 47th Session on Doc. VT1148, “Royalties and licence fees under Article 8.1 (c) of the Agreement (royalty-income tax)”.

2. The Administration of Uruguay considers it crucial for our Customs officials and for the private sector in general to have a thorough analysis of this matter, since it will supplement Advisory Opinion 4.16.

3. The following facts are presented in Annex I to Doc. VT1148 :

   a. In addition to paying a price of one thousand (1,000) currency units for a product P, importer B, who is the licensee of a patent, subsequently has to pay the licensor S, who is in another country, a royalty of one hundred (100) currency units for use of that patent. The royalty meets the three requirements provided for in Article 8.1 (c) of the Agreement and should be adjusted in respect of the price actually paid or payable for product P in order to determine its Customs value.
   b. The amount of this royalty as agreed in the licence agreement results from a fixed payment of five per cent (5 %) of the net resale price of product P in the country of importation; in other words five per cent (5 %) of a net resale price of two thousand (2,000) currency units results in a royalty payment of one hundred (100) currency units.
   c. “In accordance with the domestic tax rules in force in country of importation I, the one hundred (100) currency units paid by way of a royalty […] are subject to income tax, the amount of which is determined by applying a nominal rate of ten per cent (10 %) to the total sum payable; the taxpayer should be licensor S, and importer B is the withholding agent who normally pays income tax on behalf of the licensor under a requirement to withhold tax at source”.
   d. "Based on a clause in the licence agreement, licensor S requires licensee B to pay the ten (10) currency units tax on behalf of the licensor, and the licensee must pay the total amount of the royalty due without any deduction".
   e. "Accordingly, B pays out a total of one thousand, one hundred and ten (1 110) currency units : one thousand (1,000) currency units corresponding to the price of product P, one hundred (100) currency units by way of royalty for use of the patent, and ten (10) currency units for payment of the income tax".
   f. The question raised is whether the sum of ten (10) currency units is part of the Customs value and, if so, in what capacity?

4. In view of the above facts, the first task is to analyse the characteristics of the tax payable to the domestic tax authority in the country of importation as a result of the royalty. Having heard the opinion of our tax experts, we have concluded that this tax is widely used by many countries and is referred to as “non-resident income tax” or similar, and has the following features :

   i. it must be levied by law in the country of importation,
   ii. it is a direct tax because it is levied on income received (here a royalty) and is a direct manifestation of the taxpayer’s economic capacity,
   iii. the income (in this case the royalty) is generated after importation, when the imported product is resold on the domestic market,
   iv. the taxpayer is the licensor S in another country who in this case is not resident in the country of importation,

v. the licensee B must therefore act as a withholding agent when remitting the income (royalty) abroad to the licensor,
vi. the income (royalty) is calculated at an established rate,
vii. and the tax base is the total royalty generated in the country of importation (without prior deduction of any tax or charge).

5. In other words, by reason of its definition and structure, this tax must be declared on the licensor's behalf by the licensee as withholding agent, based on the total royalty payable (or gross amount, or amount prior to deduction of the tax in question) and not on the fixed amount (or amount net of the tax in question) that the licensor abroad ultimately receives. In order to calculate the final sum payable, the tax rate should be applied to that total amount.

6. Accordingly, the initial statement of the facts presented above should be amended slightly. In order to maintain the same economic outcome for the parties, i.e. a final payment for licensor S of a net royalty of one hundred (100) currency units and a payment of ten (10) currency units in income tax on the royalty in the country of importation, it must be borne in mind that, in fact, in this case :

i. the total or gross royalty is one hundred and ten (110) currency units,
ii. the percentage of the gross royalty agreed between the parties is five point five zero per cent (5.50 %) of the net resale price (based on 110 for 2,000), and
iii. the "non-resident income tax" rate is nine point zero nine per cent (9.09 %), which is obtained by dividing the tax paid by the tax base, i.e. 10 over 110.

7. In other words, in order to comply with the signed contract, the importer is required under the tax rules in his country to declare a gross royalty of one hundred and ten (110) currency units, or five point five zero per cent (5.50 %) gross on the net resale price in order ultimately to secure a net royalty (after the tax in question) of five per cent (5 %) of the net resale price to remit to licensor B abroad. Therefore, the facts presented in Annex I to Doc. VT1148 should be amended as follows :

a. In addition to paying a price of one thousand (1,000) currency units for a product P, importer B, who is the licensee of a patent, subsequently has to pay the licensor S, who is in another country, a gross royalty of one hundred and ten (110) currency units for use of that patent. Since the royalty meets the three requirements provided for in Article 8.1 (c) of the Agreement, for the purposes of determining its Customs value it should be adjusted in respect of the price actually paid or payable for product P.
b. This royalty of one hundred and ten (110) currency units results from the fixed payment of a gross (i.e. pre-tax) royalty percentage of five point five per cent (5.50 %) of the net resale price of product P in the country of importation; equivalent to a net (or post-tax) royalty percentage of five per cent (5 %), as previously agreed in the licence agreement. In other words, five point five zero per cent (5.50 %) of a net resale price of two thousand (2,000) currency units equals one hundred and ten (110) currency units by way of gross or total royalty.
c. In accordance with the domestic tax rules in force in country of importation I, the one hundred and ten (110) currency units paid by way of gross royalty are subject to income tax, the amount of which is determined by applying a nominal rate of nine point zero nine per cent (9.09 %) to the total royalty payable; the taxpayer should be licensor S, and importer B is the withholding agent who normally pays income tax on behalf of the licensor under a requirement to withhold tax at source.
d. Based on a clause in the licence agreement, licensor S requires licensee B to pay the ten (10) currency units tax on behalf of the licensor, and the licensee must pay the total amount of the royalty due without any deduction. (In fact, the requirement for licensee B to make this payment and the rate for the sum payable arise under the law

of the country of importation, independently of whether such a clause is included in the licence agreement.)

e. Accordingly, B pays out a total of one thousand, one hundred and ten (1,110) currency units : one thousand (1,000) currency units corresponding to the price of product P, and one hundred and ten (110) currency units by way of total royalty for use of the patent; he must withhold ten (10) currency units of the total royalty for tax purposes.

f. The question raised was whether the sum of ten (10) currency units is part of the Customs value and, if so, in what capacity? The reply to this question is plain. Since the ten (10) currency units are part of the total royalty payable by the importer, they are also part of the Customs value. The total (gross) royalty is one hundred and ten (110) currency units : one hundred (100) currency units in respect of royalty net of tax which licensor S receives and ten (10) currency units to be withheld for income tax purposes. Therefore, the Customs value is one thousand, one hundred and ten (1,110) currency units : one thousand (1,000) currency units in respect of the price actually paid or payable and one hundred and ten (110) currency units by way of a royalty adjustment under Article 8.1 (c)

8. Furthermore, "Opinion 3", which is presented in Annex I to the document, has no basis in the Agreement. Paragraph 3 (c) of the Interpretative Note to Article 1 applies to duties and taxes that are distinguished from the price actually paid or payable, and not to taxes that are distinguished from the adjustments provided for under Article 8. Here, the price actually paid or payable is one thousand (1,000) currency units. The resale of the goods in the country of importation generates a total royalty of one hundred and ten (110) currency units from which ten (10) currency units must be withheld for payment of "non-resident income tax" when remitted to the licensor abroad. This income tax of ten (10) currency units is not part of and therefore cannot be distinguished from the one thousand (1,000) currency units of the price actually paid or payable because it is not related to that price. In fact, the tax of ten (10) currency units is related to an adjustment provided for under Article 8.1 (c). This paragraph of the Agreement applies to certain indirect taxes arising upon importation (for example Customs duties or importation VAT), and not to a direct tax arising as a result of a subsequent royalty upon resale where the licensor is the taxpayer.

9. The Administration of Uruguay would flag that it may make further comments, as it is keen to contribute to the analysis of this issue.

* * *

Issue for submission to the Technical Committee on Customs Valuation

TITLE : Royalties and licence fees under Article 8.1 (c) of the Agreement

SUBMITTED BY: China

THE ISSUE:

1. Importer/buyer/licensee B of country of importation I enters into a license agreement with supplier/seller/licensor S of country of exportation X for use of a patent. As part of this arrangement the parties also agree that the royalty payable by B to S for the commercial use of the patent licensed in the agreement will be calculated by applying a rate of five percent (5%) of the net sale price in the country of importation of the patented goods.

2. Subsequently, S and B enter into a contract for the international sale of product P at a price of one thousand (1000) currency units. Under the contract, the patent has been incorporated in the product P, such that the corresponding royalty may be considered to be related to the goods. In addition, the price does not include the royalty, which is paid as a condition of sale of the goods. Accordingly, all the requirements provided for in Article 8.1 (c) of the Agreement are met.

[In addition to paying a price of one thousand (1,000) currency units for a product P, importer B, who is the licensee of a patent, subsequently has to pay the licensor S, who is in another country, a gross royalty of one hundred and ten (110) currency units for use of that patent. Since the royalty meets the three requirements provided for in Article 8.1 (c) of the Agreement, for the purposes of determining its Customs value it should be adjusted in respect of the price actually paid or payable for product P.] (Uruguay)

3. Given that the net sale price of product P in country I is two thousand (2000) currency units, the license fee which B owes S for use of the patent is one hundred (100) currency units.

[This royalty of one hundred and ten (110) currency units results from the fixed payment of a gross (i.e. pre-tax) royalty percentage of five point five per cent (5.50 %) of the net resale price of product P in the country of importation; equivalent to a net (or post-tax) royalty percentage of five per cent (5 %), as previously agreed in the licence agreement. In other words, five point five zero per cent (5.50 %) of a net resale price of two thousand (2,000) currency units equals one hundred and ten (110) currency units by way of gross or total royalty.] (Uruguay)

4. In accordance with the domestic tax rules in force in country of importation I, the one hundred (100) currency units paid by way of royalty for use of the patent are subject to income tax, the amount of which is derived by applying a nominal rate of ten percent (10%) of the total sum payable; the taxpayer should be the licensor S, and the importer B is the withholding agent who normally pays income tax on behalf of licensor under a requirement to withhold tax at source.

[In accordance with the domestic tax rules in force in country of importation I, the one hundred and ten (110) currency units paid by way of gross royalty are subject to income tax, the amount of which is determined by applying a nominal rate of nine point zero nine per cent (9.09 %) to the total royalty payable; the taxpayer should be licensor S, and importer B is the withholding agent who normally pays income tax on behalf of the licensor under a requirement to withhold tax at source.] (Uruguay)

5. Based on a clause in license agreement, licensor S requires licensee B to pay the 10 currency units tax on behalf of licensor, and licensee must pay the total amount of the royalty due without any deduction.

[Based on a clause in the licence agreement, licensor S requires licensee B to pay the ten (10) currency units tax on behalf of the licensor, and the licensee must pay the total amount of the royalty due without any deduction. (In fact, the requirement for licensee B to make this payment and the rate for the sum payable arise under the law of the country of importation, independently of whether such a clause is included in the licence agreement.)] (Uruguay)

6. Accordingly, B pays out a total of one thousand one hundred and ten (1110) currency units: one thousand (1000) currency units corresponding to the price of product P, one hundred (100) currency units by way of royalty for use of the patent, and ten (10) currency units for payment of the income tax. However, S receives only one thousand and one hundred (1100) currency units, including one thousand (1000) currency units for product P, and one hundred (100) currency units for royalty and license fee.

[Accordingly, B pays out a total of one thousand, one hundred and ten (1,110) currency units : one thousand (1,000) currency units corresponding to the price of product P, and one hundred and ten (110) currency units by way of total royalty for use of the patent; he must withhold ten (10) currency units of the total royalty for tax purposes.] (Uruguay)

7. The issue brought before the Technical Committee is whether the ten (10) currency units income tax paid by Importer B is part of the Customs value for the imported goods.

[The question raised was whether the sum of ten (10) currency units is part of the Customs value and, if so, in what capacity?] (Uruguay)

REFERENCES:

Article 1, Article 8.1 (c), paragraph 3 (c) of the Interpretative Note to Article 1, Advisory Opinion 4.16

ANALYSIS:

8. Based on the facts of the case, there could be **three** different opinions.

9. Opinion 1:

Based on the facts, the payment of royalty - one hundred (100) currency units made by buyer/licensee under the license agreement is related to the imported goods, has been made as a condition of sale for the imported goods and has not been included in the Customs

value, thus the payment 100 currency units should be added to the Customs value under Article 8.1 (c) of the Agreement.

Besides, pursuant to the license agreement, the seller/licensor S requires the buyer/licensee B to pay 10 currency units tax on behalf of S to the tax authority of country of importation I. In accordance with the domestic tax rules in force in country of importation I, the taxpayer is the licensor, while the licensee is the withholding agent. So the buyer/licensee B pays 10 currency units to the Tax Authority together with one hundred (100) currency units to S.

Therefore, the buyer/licensee makes two payments for the commercial use of the patent, one is 100 currency units calculated by applying the fixed rate set out in the license agreement, the other one is 10 currency units for withholding tax. Both two payments are made for the right to use the patent. The ten (10) currency units are paid by the licensee to the tax authority for the benefit of the licensor (to satisfy an obligation of the licensor) and should be regarded as an indirect payment of royalty.

Article 8.1 (c) of the Agreement provides that, in determining the Customs value, there shall be added to the price actually paid or payable royalties and license fees “that the buyer must pay, either directly or indirectly […]”. Given that all the requirements provided for in Article 8.1 (c) of the Agreement are met in this case, thus the one hundred and ten (110) currency units of royalty should be added to the Customs value.

According to Advisory Opinion 4.16, the “duties and taxes of the country of importation” which shall be excluded from the Customs value as prescribed in Paragraph 3 (c) of the Interpretative Note to Article 1 relate to domestic taxes which may be levied on the import of goods rather than taxes which may apply to royalty income. Hence the ten (10) currency units tax should not constitute a reduction in the Customs value of imported goods.

10. Opinion 2:
Based on the facts, the payment of royalty - one hundred (100) currency units made by buyer/licensee under the license agreement is related to the imported goods, has been made as a condition of sale for the imported goods and has not been included in the Customs value, thus the payment 100 currency units should be added to the Customs value under Article 8.1 (c) of the Agreement.

Besides, pursuant to the license agreement, the seller/licensor S requires the buyer/licensee B to pay 10 currency units tax on behalf of S to the tax authority of country of importation I. In accordance with the domestic tax rules in force in country of importation I, the taxpayer is the licensor, while the licensee is the withholding agent. So the buyer/licensee B pays 10 currency units to the Tax Authority together with one hundred (100) currency units to S.

In this case, the licensee is also the buyer and the licensor is also the seller. The payment of ten (10) currency units could be considered as a payment made by the buyer for the benefit of the seller (to satisfy an obligation of the seller). According to Article 1 and paragraph 1 of

the Interpretative Note to Article 1, this payment should be regarded as indirect payment, which should be included in the price actually paid or payable.

According to Advisory Opinion 4.16, the "duties and taxes of the country of importation" which shall be excluded from the Customs value as prescribed in Paragraph 3 (c) of the Interpretative Note to Article 1 relate to domestic taxes which may be levied on the import of goods rather than taxes which may apply to royalty income. Hence the ten (10) currency units tax should not constitute a reduction in the Customs value of imported goods.

11. Opinion 3:
Based on the facts, the payment of royalty - one hundred (100) currency units made by buyer/licensee under the license agreement is related to the imported goods, has been made as a condition of sale for the imported goods and has not been included in the Customs value, thus the payment 100 currency units should be added to the Customs value under Article 8.1 (c) of the Agreement.

Besides, pursuant to the license agreement, the seller/licensor S requires the buyer/licensee B to pay 10 currency units tax on behalf of S to the tax authority of country of importation I. In accordance with the domestic tax rules in force in country of importation I, the taxpayer is the licensor, while the licensee is the withholding agent. So the buyer/licensee B pays 10 currency units to the Tax Authority together with one hundred (100) currency units to S.

According to Advisory Opinion 4.16, the "duties and taxes of the country of importation" which shall be excluded from the Customs value as prescribed in Paragraph 3 (c) of the Interpretative Note to Article 1 relate to domestic taxes which may be levied on the import of goods rather than taxes which may apply to royalty income. However, in this case, the income tax is paid in addition to the royalty payment made by the buyer to the seller while in the case of Advisory Opinion 4.16, the income tax paid is deducted from the total royalty payment from the buyer to the seller.

[Therefore, the importer makes two payments: a payment of 100 currency units for the commercial use of the patent calculated by applying the fixed rate set out in the license agreement; and another payment of 10 currency units for withholding tax paid by the licensee to the Tax authority in the country of importation for the benefit of the licensor (to satisfy an obligation of the licensor).] (Canada)

Therefore, the income tax is viewed as a tax of the country of importation and it can be distinguished from the price paid or payable for the imported goods. Hence, the ten (10) currency units tax should not be included in the Customs value of imported goods.

[However, in accordance with paragraph 3 (c) of the Interpretative Note to Article 1, the income tax is viewed as a tax of the country of importation. Hence, the 10 currency units must be excluded from the Customs value of the imported goods.] (Canada)

PROPOSED OUTCOME - Member's View:

12. In summary, there might be **three** different views:

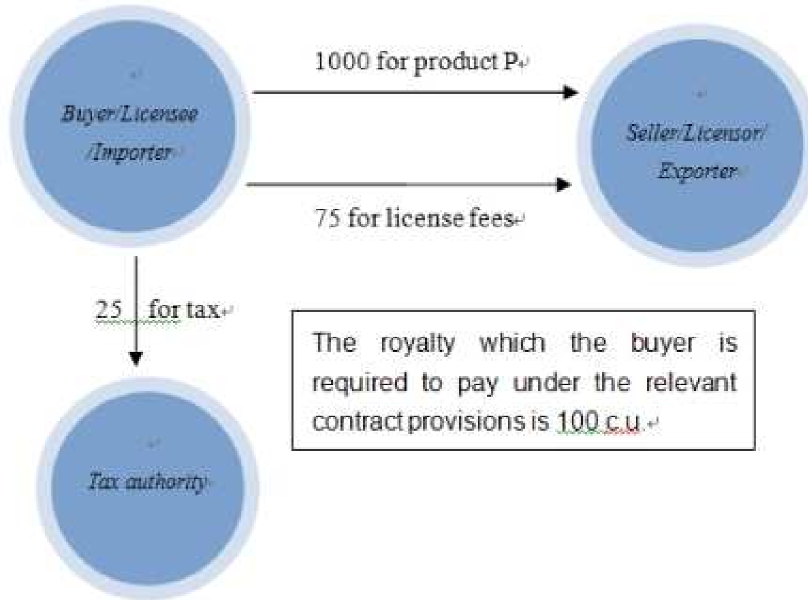
Opinion 1: According to Article 8.1 (c) of the Agreement, the ten (10) currency units paid by the buyer/licensee to the tax authority for the benefit of the licensor/seller should be regarded as an indirect payment of royalty, and thus the total payment of royalty - one hundred and ten (110) currency units should be added to the Customs value. Therefore the Customs value in this case is one thousand one hundred and ten (1110) currency units.

Opinion 2: According to Article 8.1 (c) of the Agreement, the one hundred (100) currency units of royalty should be included in the Customs value. According to Article 1 and paragraph 1 of the Interpretative Note to Article 1, the ten (10) currency units paid by the buyer/licensee to the tax authority for the benefit of the seller/licensor should be regarded as an indirect payment for the imported goods, which should be included in the price actually paid or payable. Therefore the Customs value in this case is one thousand one hundred and ten (1110) currency units.

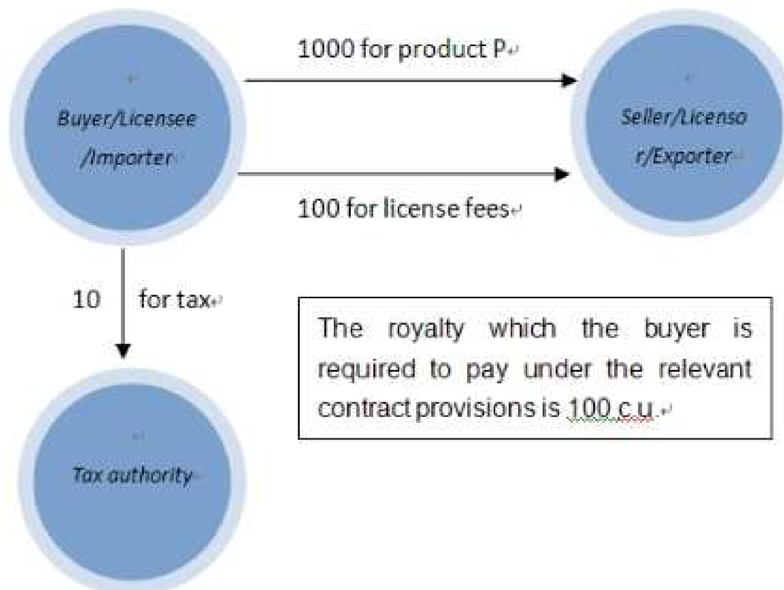
Opinion 3: According to Article 8.1 (c) of the Agreement, the one hundred (100) currency units of royalty should be included in the Customs value. According to paragraph 3(c) of the Interpretative Note to Article 1 of the Agreement, the ten (10) currency units paid by the buyer/licensee to the tax authority for the benefit of the seller/licensor should be regarded as a tax of the country of importation and not for the imported goods, which should not be included in the price actually paid or payable. Therefore the Customs value in this case is one thousand one hundred (1100) currency units.

Annex: Comparison between Advisory Opinion 4.16 and this case

AO 4.16



This case



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