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TECHNICAL COMMITTEE
ON CUSTOMS VALUATION
-
43rd Session
-

VT1069E1a
(+ Annexes)

Brussels, 22 September 2016.

CONDITION OF SALES, OBJECTIVE AND QUANTIFIABLE DATA

REQUEST BY MEXICO

(Item V (b) on the Agenda)

Reference documents :

VT0993E1a (TCCV/40)
VT0994E1b (TCCV/40 - Report)
VT1006E1a (TCCV/41)
VT1044E1a
VT1059E1a
VT1011E1b (TCCV/41 – Report)
VT1031E1a
VT1038E1a
VT 1051E1a – Draft Report

I. BACKGROUND

1. During the intersession, the Secretariat published the response of Mexico to the comments made by the delegates at the 42nd Session of the Technical Committee in the Annex to Doc. VT1059E1a.

2. Members were invited to examine further the question in light of the response given by Mexico and provide their written comments to the Secretariat.

II. SECRETARIAT COMMENTS

3. Written comments have been received from China and the United States. These are reproduced in Annexes I and II respectively to this document.

III. CONCLUSION

4. The Technical Committee is invited to continue the examination of the question taking into consideration the written comments made by China and the United States.

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COMMENTS BY CHINA CUSTOMS ADMINISTRATION

Sales condition, objective and quantifiable data

1. China Customs Administration would like to thank the Secretariat and Mexico Customs Administration for preparing the updated document concerning the valuation of goods imported under the franchise agreement.

2. The key issue of this case is whether the royalties should be included in the customs value of the supplies. According to the provision of Article 8.1(c) of the Valuation Agreement, royalties and license fees should be added to the Customs value of imported goods only when the following two conditions are satisfied: (i) royalties and license fees are related to the imported goods being valued; and (ii) royalties and license fees are paid as a condition of the sale of the goods being valued.

3. According to Commentary 25.1, “Determining whether a royalty or licence fee is related to the goods being valued: The most common circumstances in which a royalty or licence fee may be considered to relate to the goods being valued is when the imported goods incorporate the intellectual property and/or are manufactured using the intellectual property covered by the licence. For example, if the imported goods incorporate the trademark for which the royalty or licence fee is paid, this would indicate that the fee relates to the imported goods. Therefore, it should be determined whether or not the supplies “incorporate the intellectual property and/or are manufactured using the intellectual property covered by the licence.” However, based on the facts provided so far, it could not yet be determined.

4. In the Annex of Doc.VT1059E1a, it seems to be kind of inconsistent between the response 3, 4 and the response 6 to some extent. It is mentioned in response 3 that “these supplies are used for products that are part of a franchise and therefore must meet very strict specifications”, in response 4 that “the franchisor requires the franchisee to buy them exclusively”; while in response 6, it is stated “Supplies are not patented and can be obtained from other suppliers.” If the franchisor requires the franchisee to buy them exclusively, is it because of the quality requirements consideration or because the supplies “incorporate the intellectual property and/or are manufactured using the intellectual property covered by the licence”? We are expecting clarifications from Mexico Customs.

5. In the light of response 2 in the Annex of Doc.VT1059E1a, “all are necessary and essential elements for making cakes and donuts, therefore they cannot be substituted”. There could be two interpretations on “cannot be substituted”. One is that the supplies “incorporate the intellectual property and/or are manufactured using the intellectual property covered by the licence”; the other is that the supplies used for the final products must meet some special specifications. The former situation may indicate the payment of royalties is related to the supplies – the imported goods, while the latter may not.

6. In the Annex of Doc.VT1059E1a, it is mentioned in the response 6 that “Supplies are not patented and can be obtained from other suppliers. However, there is a condition of sale from the moment the franchisee is obliged to acquire them from the franchisor or from a person he authorizes. ” Actually, this response does not indicate whether the royalty payment is a condition of sale of the supplies. According to Commentary 25.1 “A key consideration for determining whether the buyer must pay the royalty or licence fee as a condition of sale is whether the buyer is unable to purchase the imported goods without paying the royalty or licence fee.” However the response given could not address this question.

7. Based on the information and responses provided by Mexico Customs, it’s more likely that the royalties are paid for the right to use the brand, logo, system, etc. in respect of the final products in the importing country, rather than for the right to use the brand, logo, system, etc. in respect of the imported supplies. Therefore, the royalties paid under the franchise agreement are related to the final products, rather than the imported supplies.

8. China Customs would like to thank Mexico Customs and the Secretariat again for their hard work in preparing the relevant documents.

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COMMENTS BY THE UNITED STATES

Sales condition, objective and quantifiable data

1. The United States would like to thank Mexico for submitting the draft case study related to the valuation of goods imported under a franchise agreement for the Technical Committee's consideration. The United States has the following comments concerning the draft case study.

2. Under Article 8.1(c) of the Agreement, in determining the customs value under Article 1, there shall be added to the price actually paid or payable for the imported goods "royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable." Article 8.3 of the Agreement states that "additions to the price actually paid or payable shall be made under this Article only on the basis of objective and quantifiable data." Further, Paragraph 3 to the Note to Article 8 provides that "where objective and quantifiable data do not exist with regard to the additions required to be made under the provisions of Article 8, the transaction value cannot be determined under the provisions of Article 1. As an illustration of this, a royalty is paid on the basis of the price in a sale in the importing country of a litre of a particular product that was imported by the kilogram and made up into a solution after importation. If the royalty is based partially on the imported goods and partially on other factors which have nothing to do with the imported goods (such as when the imported goods are mixed with domestic ingredients and are no longer separately identifiable, or when the royalty cannot be distinguished from special financial arrangements between the buyer and the seller), it would be inappropriate to attempt to make an addition for the royalty. However, if the amount of this royalty is based only on the imported goods and can be readily quantified, an addition to the price actually paid or payable can be made."

3. The draft case study submitted by Mexico provides that under the Development and Franchise Contract between Company A and Company B, in order to compensate Company B for the use of its Brands and System, Company A will make royalty payments to Company B calculated as a percentage of company A's gross sales of each store it operates. In Paragraph 1.41 of the Development and Franchise Contract, "brands" is defined as "the registered brands or service marks and other commercial symbols in the operation of the Franchisor's Stores, including but not limited to the commercial brands and service marks of the "FRANCHISOR" and associated logos." In paragraph 1.61 of the contract, "system" is defined as "the formats, methods, procedures, advertisements, designs, layouts, equipment, mixtures, standards and commercial specifications currently or subsequently owned by the Franchisor and/or any of its Subsidiaries and Brands."

4. The United States disagrees with Mexico's conclusion that an addition should be made to the price actually paid or payable for the imported inputs under Article 8.1(c). Under Article 8.1(c) of the Agreement, a royalty payment must be 1) related to the goods

and 2) paid as a condition of sale. The United States believes that in this case, the royalty paid by Company A is not related to the imported inputs. Rather, the royalty is being paid by Company A for use of the Brands and the System in the operation of Company B's stores (franchise fee). In other words, royalties are paid for the rights related to the operation of the stores and not for intellectual property rights related to the inputs.

5. The U.S. Administration anticipates that it may have additional comments to make in respect of this matter at the 43rd Session of the Technical Committee on Customs Valuation.