



TECHNICAL COMMITTEE ON
CUSTOMS VALUATION

VT1147E1a
(+ annex)

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47th Session
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O. Eng.

Brussels, 9 July 2018.

SPECIFIC TECHNICAL QUESTIONS

ROYALTIES AND LICENCE FEES UNDER ARTICLE 8.1 (c) OF THE AGREEMENT

REQUEST BY URUGUAY

(Item V (d) on the Agenda)

Reference documents :

VT1128E1a (TCCV/46)
VT1137E1a (TCCV/46 – Draft Report)

I. BACKGROUND

1. At the 46th Session, the Technical Committee agreed to discuss a question submitted by Uruguay on “royalties and licence fees under Article 8.1 (c) of the Agreement”. The question was reproduced in Doc. VT1128E1a.
2. The question refers to the payment of royalties and licence fees, calculated by reference to the sale price of products manufactured in the country of importation from imported inputs, and their relevance to the Customs value of the imported inputs necessary for the manufacture of the finished products.
3. During the discussions at the 46th Session, some delegates requested more information to confirm whether or not the locally sourced ingredients are patented and whether the manufacturing process involved the use of patented processes.
4. During the intersession after the 45th Session, Chile submitted written comments which were distributed as a non-paper during the 46th Session, and are reproduced in Annex II to this document. In their comments, they requested for clarification on the “import costs of imported concentrate”.

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

II. SECRETARIAT COMMENTS

5. During the intersession, the Secretariat and Uruguay worked together to modify the draft Advisory Opinion taking into account comments made by Members. Additional information was added to reflect that the locally sourced ingredients are unpatented and the final product was not manufactured using patented processes. Clarification on “import cost on imported concentrate” in paragraphs 3 and 9 of the draft Advisory Opinion are also made. The revised draft Advisory Opinion is reproduced in Annex I to this document. The changes proposed are in **bold**.
6. The Secretariat notes that there are no instruments currently about the calculation of the apportionment of royalties paid.

III. CONCLUSION

7. Members are invited to examine the question and submit their suggestions and comments in electronic form to the Secretariat (e-mail address: valuation@wcoomd.org) not later than **9 September 2018**. Comments received in response to this document will be published and circulated to Members of the Technical Committee for consideration at the 47th Session. Members may also contribute their views and discuss the case via the WCO's CLiKC! platform.

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Draft Advisory Opinion X.X

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

1. ICO manufactures soft drinks to sell to retailers in the country of import I. ICO imports the patented concentrate from licensor, XCO in country of export X or from companies that are authorised by XCO in order to manufacture the patented concentrate. The imported concentrate is mixed with other ingredients sourced in the country of importation during the manufacturing process, in order to produce the final goods. **The locally sourced ingredients are unpatented and are not protected by any intellectual property rights.** There is no relationship, within the meaning of Article 15.4, between ICO, XCO and the authorised companies.
2. ICO has a licence agreement with XCO under which ICO is granted the right to incorporate or use the patented concentrate in products intended for resale and for the right to use the trademark on the final product. **The final product is manufactured not using a patented process as it only involves the mixing of all the ingredients to form the final product.**
3. ICO pays XCO 10 c.u for each 0.10 litre of concentrate imported. In consideration for the licence granted, ICO pays to XCO a licence fee calculated as 15% of the sales price of the finished soft drinks. The soft drinks are subsequently sold to retailers in the country of importation at 100 c.u. per litre in the country of importation. The production costs per litre of soft drinks are as follows based on generally accepted accounting principles in the country of importation:

a.	Cost of imported concentrate (price actually paid or payable per 0.10 litre):	10 c.u
b.	Import cost of imported concentrate (e.g. customs duties, inland transport, warehousing costs etc. per 0.10 litre):	2 c.u.
c.	Cost of other inputs:	13 c.u.
d.	Labour costs:	5 c.u.
e.	Other production costs:	20 c.u.
	Total cost of production per litre for product F:	50 c.u.
4. The issue is whether the royalties or licence fees paid on sales of final products under the licence agreement are to be added to the price actually paid or payable under Article 8.1 (c) of the Agreement for the imported inputs, and, if so, in what amount or quantity.

The Technical Committee on Customs Valuation expressed the following view:
5. In the determination of the Customs value under the provisions of Article 1 of the Agreement, 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, as provided in Article 8.1 (c) of the Agreement.
6. In this case, the imported goods (concentrate) being valued are supplied by XCO or authorised companies and are indispensable for the manufacturing of the products. These inputs which must be used are patented, or are manufactured under a patented process, for

which a subsequent payment of royalties or licence fees is made. The importer would not be able to import the imported goods for the manufacture of the finished products if payment of royalties or licence fees is not made to the licensor.

7. Thus, the payment of royalties or licence fees is related to the imported goods and are paid as a condition of sale for the import of the imported goods and as such should be added to the price actually paid or payable for the imported goods under the provisions of Article 8.1 (c).

8. The amount of the royalty or licence fee to be added to the price actually paid or payable for the imported input will result from the percentage share that this input has contributed towards generating the final amount of the royalty or licence fee to be paid on the processed product. Accordingly, the proportion or aliquot part of the price actually paid or payable for the imported input out of the total cost of the processed product should be determined, in line with generally accepted accounting principles in the country of importation. Once that proportion or aliquot part has been determined, it must be applied to the total royalty or licence fee on the processed product to obtain the amount of the royalty or licence fee to be added to the price actually paid or payable for the input being valued.

9. According to the information provided which could be considered as objective and quantifiable data, the proportion of the imported concentrate that is used to manufacture the soft drinks as compared to the production costs per litre based on generally accepted accounting principles is as follows:

a.	Cost of imported concentrate (price actually paid or payable per 0.10 litre):	10 c.u.
b.	Import cost of imported concentrate (e.g. Customs duties, inland transport, warehousing costs etc. per 0.10 litre):	2 c.u.
c.	Cost of other inputs:	13 c.u.
d.	Labour costs:	5 c.u.
e.	Other production costs:	20 c.u.
	Total cost of production per litre for product F:	50 c.u.

10. Percentage share **of the price actually paid or payable** for the imported concentrate in the total cost of production **per litre** of soft drinks:

$$10 \text{ c.u.} / 50 \text{ c.u.} = 20\%$$

11. Sales price of drinks per litre with imported concentrate: 100 c.u.

12. Licence fee to be paid by ICO to XCO under licence agreement (15% of sales price per litre): 15 c.u.

13. Adjustment to be made for the royalty or licence fee (Article 8.1 (c)) for imported concentrate:

$$20\% \text{ of } 15 \text{ c.u.} = 3 \text{ c.u.}$$

14. Customs value of imported concentrate (per 0.10 litre) = price paid or payable + adjustment under Article 8.1 (c), i.e.

$$\text{Customs value of imported concentrate (per 0.10 litre)} = 10 \text{ c.u.} + 3 \text{ c.u.} = 13 \text{ c.u.}$$

COMMENTS BY CHILE

1. The Customs Administration of Chile would like to thank the Secretariat and the Customs Administration of Uruguay for submitting this draft Advisory Opinion.
2. In this connection, our Administration has studied the Annex to Doc. VT1128S1a concerning the draft on royalties and licence fees under Article 8.1 (c) of the Agreement, and based on the analysis, we must make the following comments and suggestions to better understand the issue raised:
 - In view of the statements in paragraph 1 of the draft, concerning the good imported by ICO, i.e. “patented concentrate”, our Administration would suggest inserting in letters a) and b) respectively of paragraphs 3 and 9, and in paragraphs 10 and 11, the word “patented” between the words “imported concentrate”.
 - As regards the determination of the percentage share of patented concentrate in the total cost of production of soft drinks, found in paragraphs 10 et seq. of the draft, our Administration would welcome clarification of the items covered in that share, since the view of our Administration is to include “import cost of imported concentrate”, which in this example has a value equivalent to 2 c.u., as we consider that this amount would form part of the total cost of the imported patented concentrate.
3. Finally, our Administration would encourage the Customs Administration of Uruguay to continue examining the issue raised in this draft Advisory Opinion, as we consider it a useful instrument of technical support for future similar cases.

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