Global Trade and Customs Journal
Every so often, a sale of goods is related to the transfer of certain intellectual property rights to the buyer by either the seller or a third party. In cases such as these, in addition to the price agreed for the goods, the buyer is required to pay an additional sum of money, called royalties, as compensation for the right to use that intellectual creation. For instance, the buyer of athletic footwear of certain very-well known brand names will usually have to pay not just the agreed price of the goods but also an additional sum of money for the right to market them under a registered trademark.

Where intellectual property rights, which are intangible, are related to imported goods, a problem arises of determining whether, for custom purposes, the royalties paid by the buyer should or should not be added to the goods’ price in order to calculate the customs value.

Article 8.1(c) of the Agreement on Implementation of Article VII of the GATT 1994 (hereinafter, the Agreement) provides that, in order to determine the customs value under the provisions of Article 1, there must be added to the price actually paid or payable for the imported goods the ‘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’.

The Agreement, which World Trade Organization (WTO) countries are required to follow, has been introduced in the exact same or similar terms into the domestic legislation of, or regional agreements signed by, those countries.¹

For the adjustment to apply, royalties must satisfy two essential requirements: first, they must relate to the imported goods; second, the buyer must pay the royalties directly or indirectly to satisfy a condition of the sale of the goods. This is as much as can be inferred from a reading of the Agreement, according to Sherman and Glashoff, because there is no other subject in this legal instrument which has been left to interpretation or implementation to an extent such as this one, or one in regard to which there is so little to be inferred via a literal interpretation of the language used in the Agreement. Some critics maintain that the matter was not sufficiently explored by the drafters of the Agreement, perhaps owing to the fact that it was belatedly addressed during the Geneva negotiations and the various governments were in substantial disagreement on the subject.²

Defining when the payment of royalties is a condition of sale and, in particular, who can and how they can impose the condition such that the requirement established in Article 8(1)(c) of the Valuation Agreement is satisfied are the main issues addressed by expert commentators and courts from different countries.

Following Sherman and Glashoff’s line of reasoning, some authors believe³ that the payment of royalties is a condition of sale when, absent such payment, the goods would not have been sold or, at the very least, would not have sold for the same price. The European Customs Code

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² Saul L. Sherman & Hinrich Glashoff, Customs Valuation, Commentary on the GATT Customs Valuation Code 123 (ICC Publishing Co. 1980).
³ Pablo González Bianchi, El valor en aduana. La valoración de las mercancías en el sistema GATT/WTO (Customs Value. Valuation of Goods under the GATT/WTO System) 291 (Montevideo 2003); Daniel Zolezzi, La valoración en aduana de la ley 23.311 (Customs Valuation under Act No. 23.311) 166 (Buenos Aires 1987).
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I. Sales Contracts and License Agreements Between the Same Parties

Where, in a contract of sale, the buyer undertakes the obligation not just to pay the price of the goods but also to pay royalties to the seller (direct payment) or to a third party (indirect payment), payment of such royalties is, in principle, a condition of sale that satisfies the requirement laid down in the above-discussed Article 8.1(c), which condition may be disproven if the buyer can demonstrate that the goods could be purchased at the same price billed by the seller without acquiring the license rights and, naturally, without paying royalties.

Most international courts and commentators find that the situation is the same when the same parties choose to enter into separate license and sales contracts. However, some contrary opinions also exist on the subject. The Canadian Federal Court, for instance, heard a case involving a contract of sale (purchase order) that did not make provision for the payment of royalties, and, on the other hand, a trademark license agreement that made no reference whatsoever to the contract of sale either. Both contracts had been signed by the same parties, which were related parties. The Canadian customs agency argued that, insofar as the seller and licensor were one and the same person, and even though no formal or written connection existed between the purchase order and the royalties contract, commercial reality makes it reasonable to assume that the seller would refuse to sell the goods without royalties, and payment thereof was, thus, a condition of sale. The Court rejected the economic reality argument. It accepted that, in the future, the seller might perhaps refuse to continue to sell under the circumstances presented by the customs authority, and it also found it likely that the buyer, if trying to make new purchases in the future, would be required to sign a sales contract where the seller would include the payment of royalties as a condition of sale, including even the obligation to pay royalties due on account of the prior contract. It did, however, conclude that the condition of sale referred to in the customs act is not a presumption that the seller might in the future refuse to sell other goods to a purchaser who fails to pay royalties, but a refusal to sell the goods sold under a pre-existing contract that predated the non-
payment. It further noted that, even if the parties to both contracts were the same, this did not necessarily mean that the obligations laid down in one would become obligations under the other, as this would depend on the language used in the contracts. The Court found that the royalties paid by the buyer to the seller of the goods under a license agreement signed between the same parties separately and unrelated to the sales contract are not added to the customs value of imported goods.9

We disagree on this approach, which certainly drew inspiration from an interpretation that prioritizes forms and appearances in contracts over economic reality and might be easily used to avoid custom duties through an abuse of forms. If the parties agree on the payment of royalties through a contract separate from the sales contract, then the payment of royalties is a condition of sale, as economic reality allows a founded assumption that the seller would be unwilling to provide the goods with the brand name under which they will be marketed in the country of importation, for instance, if the buyer had not signed the license agreement, thereby evidencing a willingness to pay for the right to use the trademark registered by that very same seller. In this case, the burden of proving otherwise, i.e., providing proof that the buyer could purchase the goods without acquiring the intellectual property rights, paying for them the same price as was agreed with the seller, would lie with the buyer. Such proof would operate as conclusive evidence that the payment of royalties is not a condition of the sale of the goods.

Along the same lines, the World Customs Organization’s Technical Committee made the following observation on the subject:

The mere fact that the parties decided to lay down their agreement for the payment of royalties or license fees in a separate contract does not affect the fundamental aspects of the commercial terms between the buyer and the seller regarding the imported goods. If the seller will not sell the goods for export to the buyer unless royalties or a license fee are paid, or if the buyer cannot purchase or import the goods that are the subject-matter of valuation, on a legal and definitive basis, unless royalties and license fees are paid, then the obligation to make payment is a condition of the sale of the goods in question.10

2 SEPARATE SALES CONTRACTS AND LICENSE AGREEMENTS BETWEEN RELATED PARTIES

This analysis takes a more complex turn when the licensor is a person different from the seller of the goods, and the question to be answered in such cases is whether the sale can be deemed to be conditional upon the payment of royalties, taking the fact that the seller is not a party to the license agreement into consideration. It is generally accepted that, where a relationship exists between the seller and the licensor in the sense of Article 15.4 of the Agreement, payment of the royalties and license fees would be an implied condition of the sale of the goods, even if not actually written into the contract.11

According to the Customs Code Committee, when the royalties are paid to a third party directly or indirectly exercising control over the manufacturer, which allows a presumption that they are related in the sense of Article 15.4 of the Agreement, payment of the royalties can be deemed to be a condition of the sale,12 and, in order to determine whether control is exercised by a person over another, the following situations must be looked for: (a) the licensor selects the manufacturer and specifies it for the buyer; (b) there is a direct contract of manufacture in place between the licensor and the seller; (c) the licensor exercises actual control either directly or indirectly over the manufacture (as regards centres of production and/or methods of production); (d) the licensor nominates/restricts who the producer can sell their goods to; (e) the licensor sets conditions relating to the price at which the manufacturer/seller should sell their goods or the price at which the importer/buyer should resell the goods; (f) the licensor has the right to examine the manufacturer’s or the buyer's accounting records; (g) the licensor designates the methods of production to be used/provides designs, etc.; (h) the licensor designates/restricts the sourcing of materials/components; (i) the licensor restricts the quantities that the manufacturer may produce; (j) the licensor does not allow the buyer to buy directly from the manufacturer, but, through the licensor who could as well act as the importer's buying agent; (k) the manufacturer is not allowed to produce competitive products (non-licensed) without the consent of the licensor; (l) the goods produced are specific to the licensor (i.e., in their conceptualization/design and with regard to the trade mark); (m) the characteristics of the goods and the technology employed are laid down by the licensor.

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11 The Contentious Division of the Madrid Supreme Court found the relationship between the parties to be sufficient evidence that payment of the royalties is a condition of the sale of the goods. In re Warner Music Spain, S.A., (formerly WEA Records S.A.), judgment of 17 Nov. 2006, said Court held: ‘In addition to the above, there is also the essential fact that both Record and Warner Music are affiliates (the former being a German affiliate and the latter a Spanish affiliate) of U.S.'s WEA International Inc., which is why sales by the former to the latter cannot be independent from the obligations between the parent company and the Spanish affiliate.’
According to the Committee, together, these factors, which go beyond mere quality controls by the licensor, are indicative of a relationship in the sense of Article 143(d)(1)(e) of the Regulation and, accordingly, the payment of royalties would be a condition of sale under the provisions of Article 160 of the Regulation. The Committee has also pointed out that other indicative factors may exist in certain specific cases, and not all such factors carry the same weight, as some are more evident indicators that the licensor exercises restraint or direction over the manufacturer or seller, which is why they may, on their own, be a condition of sale. The same conclusion is arrived at where any of the other relationship situations provided for in Article 15(4) exists.

2.1 Treatment in Argentina

More recently, Argentina’s Supreme Court of Justice heard a case involving an importer who, in turn, was a cars manufacturer, and acquired from a related seller certain spares parts, pieces and accessories that are necessary to manufacture the vehicles. Both parties to the sales contracts were, on the other hand, related to the licensor of the trademark and know-how for the cars’ manufacturing. In the Court’s opinion, the importer failed to disprove the customs agency’s claim that the payment of royalties under the license agreement is a condition of sale under Article 8.1(c) of the Agreement, since the manufacturing of a car under that brand name required the importation of parts and pieces that could only be provided by companies belonging or related to the same group, as the licensed product that led to the payment of royalties could not be otherwise obtained. The Court found that, without question, the imported goods are part of the production process leading to the end product based on which the license fee is calculated, at 2% of the net sales value of the products, and that such finding was supported by the fact that the importer had failed to prove that the end products, which were subject to the license, could be obtained by acquiring the parts and accessories from third-party providers independent of the licensor.

The Supreme Court’s ruling endorses the argument that, unless otherwise demonstrated, transactions with a licensor who is related to the seller are indicative of the fact that the sale of goods is implicitly conditional upon the payment of royalties, unless the buyer can actually prove that the goods could be obtained from independent providers. Much will depend on whether, under the license agreement, the buyer is allowed to use certain intellectual property rights, such as trademarks, for instance, both if the goods are purchased from a seller who is related to the licensor or from an independent third party.

3 Separate sales contracts and license agreements between unrelated parties

A different situation exists where the sale is agreed with a seller who is unrelated to the licensor and to whom no obligation exists to pay royalties. In any such case there is no assuming an implied condition of sale based on the economic reality that arises, as already discussed, from the involvement of one and the same person as seller and licensor in separate contracts, or the involvement of related parties. The Technical Committee reviewed some situations of this kind in various documents, where the common factor is the fact that a third party is paid royalties as a result of an agreement exclusively signed with the buyer, and the seller sets no condition at all regarding the payment of such royalties. The buyer acts independently and reaches an independent agreement with the licensor. The Technical Committee found that, in the cases under analysis by it, the royalties are not part of the customs value.

However, we should not outright rule out the possibility of a condition of sale being implied in any such cases, even where there is no relationship between the licensor of the intellectual property rights and the seller, provided, that there are sufficient convincing elements in the contracts and other documents in place between the parties. In a recent document approved as guidance regarding the interpretation and application of Article 8.1.(c) of the Agreement in cases like the one under analysis, the Technical Committee identified a series of factors that might be evidence of that type of condition. Where the condition of sale does not include an explicit statement that the buyer is to pay the royalties or license fee as a condition of sale, other factors must be examined in order to determine whether payment of the license fee is a condition of sale. Among such factors, the Committee pointed out the following: (a) there is a reference to the royalty or license fee in the sales agreement or related document; (b) there is a reference to the sale of goods in the license agreement; (c) according to the terms of the sales

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15 Article 143-1. For the purposes of this Title II, Ch. 3 of the Code and of this Title, persons shall be deemed to be related only if: […] (e) one of them directly or indirectly controls the other; […] This provision is similar to Art. 150(3)(e) of the Agreement.
14 TAXUD 800/2002/EN, Conclusion 24: Royalties and licence fees.
13 CS, Ford Argentina S.C.A. (TF 29/329-A) v. DGA, 28/5/13. It should be mentioned that the licence agreement in that case included specific, quantifiable data regarding the portion of the royalties to be paid by the licensee to the licensor in connection with the imported goods.
16 WCO, Technical Committee, Advisory Opinion 4.2.
17 WCO, Technical Committee, Advisory Opinions 4.3, 4.8, and 4.15.
agreement or the royalty or license agreement, the sales agreement can be terminated as a consequence of breaching the license agreement because the buyer does not pay the royalty to the licensor; (d) there is a term in the royalty or license agreement that indicates if the royalties or license fees are not paid, the manufacturer is forbidden to manufacture and sell the goods incorporating the licensor’s intellectual property to the importer; and (e) the royalty or license agreement contains terms that permit the licensor to manage the production or sale between the manufacturer and importer (sale for export to the country of importation) that go beyond quality control.\textsuperscript{19}

As is evident, in these cases the contracts include direct or indirect references to the payment of royalties, a factor evidencing that the sale is somehow conditional upon their payment; naturally, this is a rebuttable presumption.

\section{Conclusions}

In our opinion, the payment of royalties is a condition of the sale of imported goods where such payment is expressly provided for in the sales contract or where it is otherwise evidenced by the economic reality through facts such as the execution of separate sales and license agreements between the same parties in connection with the same goods, with the seller under one contract being the licensor of rights under the other, and the buyer and licensee of the rights being one and the same person, or where a relationship exists between a licensor and a seller contracting with the same buyer.

In all such cases, proof to the contrary can be produced to establish that the buyer could actually purchase the goods without paying the royalties.

\textsuperscript{19} WCO, Technical Committee, Commentary 25.1.
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