

SPC&B Update

January 15, 2016 - In This Issue: Dutiability of Royalties in the EU

EU Changes Treatment of Royalties



EU Changes Treatment of Royalties for Duty Purposes

Further to our January 13, 2016, SPC&B Update, set forth below is a discussion of the impact of the new EU value regulation, Union Customs Code ("UCC") Article 71(1)(c) on royalties and license fees. Specifically, two core issues look to be subject to significant changes when the new regulations go into effect on May 1, 2016.

Royalties Generally-Condition of Sale Shifts Focus to Include the Buyer

Traditionally, the question of the dutiability of royalty payments has hinged on the "condition of sale" requirement. Under the old Community Customs Code ("CCC"), the payment of a royalty would be considered a condition of sale of the imported merchandise when the seller or someone related to it requires the buyer to pay the royalty before the goods may be sold to the buyer. When the buyer pays a royalty to a third-party licensor unrelated to the seller or to whom the seller owes no obligation, the seller has no interest in its payment and therefore will generally not require the buyer to pay it.

However, under the new UCC regulations, royalty payments are to be considered a condition of sale if any of three requirements are met: 1) the "relatedness requirement" in which the seller or someone related to the seller requires the buyer to pay the royalty; 2) the buyer's payment of the royalty satisfies some obligation of the seller in accordance with contractual obligations; OR 3) the goods cannot be sold to, **or purchased by**, the buyer without payment of the royalty to a licensor.

While the first two requirements do not represent a departure from the existing treatment of royalties, the third, particularly the "or purchased by" language, may result in a lot more "dutable" royalties.

In this regard, any time a licensed product is being sold (apart from gray market goods), the licensor would likely insist on royalty payments, which, under the new language in the UCC regulations, would render the payments a condition of sale and, therefore, dutiable.

Treatment of Trademark Royalties

Under the old CCC's implementing regulations, the dutiability of royalties paid in respect of the right to use a trademark was expressly limited to a narrow set of circumstances, due to the fact that most trademark royalties were tied to after-importation sales, rather than the import shipment. This special treatment of trademark royalties has been eliminated in the new UCC implementing regulations. Accordingly, it appears that trademark royalties will be subject to the new interpretation of condition of sale discussed above, rendering most of them dutiable.

Conclusion

Although these new provisions will not go into effect until May 1, 2016, and it is, as yet, unclear how customs authorities in the member states will enforce these provisions, it does not seem as if there is tremendous leeway in the regulatory language. Indeed, the UK's MH Revenue and Customs has issued a guidance regarding the changes to the royalty provisions by stating, simply, "Royalty payments will generally need to be included in the calculation of the customs value after 30 April 2016."

One possible strategy currently being discussed within the industry is to disconnect the importation and the royalty payment by having the foreign seller sell the goods to EU Company 1—who does not pay royalties—and then have EU Company 1 sell the goods, after entry into free circulation, to EU Company 2, the party from whom the licensor requires the payment of the royalties. We note however, that where EU Company 1 and EU Company 2 are related, and the fact that Company 1 has entered into an agreement with Company 2 to purchase the goods, could lead the Customs authorities to conclude that the last sale is the appropriate sale upon which to base the transaction value, thereby causing the royalty payments made by Company 2 to the licensor to be dutiable.

Regardless, it is essential that any royalty agreements which include the right to purchase and import be carefully examined since starting May 1, 2016, customs authorities may begin aggressive inquiries into royalties in an attempt to include royalty payments in import valuations.

For advice on mitigating the impact of these changes, and/or for more information on Customs valuation in the EU and other areas, please contact Gail T. Cumins at gcumins@spcblaw.com, Alli Baron at abarons@spcblaw.com, Donna Shira at dshira@spcblaw.com, or Ken Paley at kpaley@spcblaw.com, or call us at 212-425-0055.

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