Canada Customs and Revenue Agency / Agence des douanes et du revenu du Canada

Ottawa, November 25, 2003

MEMORANDUM D13-4-9

In Brief

ROYALTIES AND LICENCE FEES
(*CUSTOMS ACT*, SECTION 48)

1. This memorandum has been amended to reflect changes to CCRA policy arising as a consequence of the effect of judicial decisions on the interpretation of the "condition of sale" element included in subparagraph 48(5)(*a*)(iv) of the *Customs Act*.

2. The amended memorandum also addresses circumstances in which a payment is made for more than the use of a protected right by the purchaser of imported goods, and its treatment with respect to the provisions of subsection 45(1) and subparagraph 48(5)(*a*) of the *Customs Act*.

3. A Legislation, Regulations and Jurisprudence section has been included to provide excerpts of relevant legislation and references to the judicial decisions that have prompted the changes to policy. An Additional Information section has been included to provide useful telephone and internet contacts.

4. Appendices to the text of the memorandum have been added to provide (in Appendix A) examples relevant to existing policy and (in Appendix B) a summary of (quasi)-judicial decisions which supported former policy.

5. The amended memorandum replaces the March 28, 2001 version of D13-4-9.

Ottawa, November 25, 2003

MEMORANDUM D13-4-9

ROYALTIES AND LICENCE FEES (*CUSTOMS ACT*, SECTION 48)

This Memorandum provides guidance on the treatment of payments for royalties and licence fees when determining the value for duty of imported goods under the transaction value method (section 48 of the *Customs Act*).

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LEGISLATION, REGULATIONS AND JURISPRUDENCE

Legislation

The legislative excerpts provided herein are included in Part III of the *Customs Act*:

45.(1) In this section and sections 46 to 55

"price paid or payable" in respect of the sale of goods for export to Canada, means the aggregate of all payments made or to be made, directly or indirectly, in respect of the goods by the purchaser to or for the benefit of the vendor;

"sufficient information" in respect of the determination of any amount, diffeorence or adjustment, means objective and quantifiable information that establishes the accuracy of the amount, difference or adjustment;

48.(1) Subject to subsections (6) and (7), the value for duty of goods is the transaction value of the goods if the goods are sold for export to Canada to a purchaser in Canada and the price paid or payable for the goods can be determined and if…

(4) The transaction value of goods shall be determined by ascertaining the price paid or payable for the goods when the goods are sold for export to Canada and adjusting the price paid or payable in accordance with subsection (5).

(5) The price paid or payable in the sale of goods for export to Canada shall be adjusted

(*a*) by adding thereto amounts, to the extent that each such amount is not already included in the price paid or payable for the goods, equal to...

(iv) royalties and licence fees, including payments for patents, trade-marks and copyrights, in respect of the goods that the purchaser of the goods must pay, directly or indirectly, as a condition of the sale of the goods for export to Canada, exclusive of charges for the right to reproduce the goods in Canada,

(v) the value of any part of the proceeds of any subsequent resale, disposal or use of the goods by the purchaser thereof that accrues or is to accrue, directly or indirectly, to the vendor

(c) by disregarding any rebate of, or other decrease in, the price paid or payable of goods that is effected after the goods are imported.

(6) Where there is not sufficient information to determine any of the amounts required to be added to the price paid or payable in respect of any goods being appraised, the value for duty of the goods shall not be appraised under this section.

152(3) …in any proceeding under this Act, the burden of proof in any question relating to

(d) the compliance with any of the provision of this Act or the regulations in respect of any goods lies on the person other than Her Majesty, who is a party to the proceeding…and not on Her Majesty.

All references to legislative provisions in this memorandum are references to the provisions of the *Customs Act* (March 2002).

Key Jurisprudence

The Supreme Court of Canada (SCC), the Federal Court of Appeal (FCA) and the Canadian International Trade Tribunal (CITT) have provided advice on the interpretation of the legislation regarding royalties and licence fees.

Key SCC, FCA and CITT decisions which guide the Canada Customs and Revenue Agency's interpretation of the legislation include:

Polygram Inc. (CITT Appeal nos. AP-89-151 and AP-89-165)
Reebok (CITT Appeal no. AP-92-224)
Mattel Canada (SCC Citation 2001 SCC 36)
Reebok (FCA Decision A-642-97) – referred to hereafter as the *Rockport* decision.

Summaries of these cases and their effect on the interpretation of the legislation, as well as summaries of other judicial decisions occurring prior to the *Mattel Canada* and *Rockport* decisions and addressing the interpretation of the legislation are included in Appendix B to this Memorandum.

GUIDELINES AND GENERAL INFORMATION

1. Royalties and licence fees are regarded for customs purposes as payments made, or to be made, for acquiring or using a protected right. Examples of such payments include (but are not limited to):

(a) payments made to an author (copyright holder) to acquire the right to sell the author's book within a geographic region;

(b) payments to an inventor (patent holder) of a production process for the use of that process during a specified period of time; and

(c) payments to a licence holder of a trademarked name or brand for the right to market goods that are so marked.

2. Patents, trademarks, and copyrights are rights to intellectual property that are recognized by national law. Intellectual property may evolve from literary, artistic, or scientific work, which are the subject of proprietary rights and which may be sold and assigned, or licenced. When the intellectual property rights are licenced, the holder of the right usually requires that a royalty or licence fee agreement be signed. The agreement will specify the rights and obligations of both the licensor and the licensee.

3. Amounts for acquiring or using a protected right that are included in the invoice price of imported goods and not separately identified are to be considered part of the price paid or payable of the goods under subsection 45(1). There is no legislative provision to exclude such an amount from the price paid or payable. If, subsequent to importation, a downward adjustment to the amount of a royalty or licence fee payment already included in the price paid or payable is made, no adjustment to value for duty will result. Paragraph 48(5)(*c*) precludes any decrease in the price paid or payable of goods after importation.

4. Royalty or licence fee payments that are not already included in, or considered as being part of, the price paid or payable of imported goods may be included in value for duty calculated under the transaction value method if the requirements of the factors identified in subparagraph 48(5)(*a*)(iv) have been met.

APPLICATION OF SUBPARAGRAPH 48(5)(*a*)(iv)

5. Subparagraph 48(5)(*a*)(iv) provides for the addition of royalty and licence fee payments to the price paid or payable of imported goods. Three factors must be considered, and met, before the payment of a royalty or licence fee is added to the price paid or payable. The payment:

(a) must be a royalty or licence fee;

(b) must be in respect of the goods; and

(c) must be a condition of sale of the goods.

Royalty or Licence Fees

6. A payment made for the acquisition or use of a protected right is a royalty or licence fee payment. The CITT determined in the *Reebok* decision that the use of the word "including" in the context of subparagraph 48(5)(*a*)(iv) does not limit the type of royalty or licence fee payment that may be added to the price paid or payable for goods to payments for patents, trademarks and copyrights. In accordance with the SCC's *Mattel Canada* decision, payments identified as royalty or licence fee payments can only be identified as additions to the price paid or payable of imported goods under subparagraph 48(5)(*a*)(iv). Payments or amounts provided for elsewhere in paragraph 48(5)(*a*) are not to be identified as additions to the price payable under this subparagraph.

7. A purchaser may enter into an agreement to pay an amount for more than the acquisition or use of a protected right. If charges or amounts other than royalties or licence fees are identified together with royalties or licence fees in a

single agreement, and the charges or amounts are itemized separately, then the individual charges or amounts shall not be considered as additions to price paid or payable under the authority of subparagraph 48(5)(*a*)(iv) but rather may be considered as additions to price paid or payable under the authority of the alternative provisions of paragraph 48(5)(*a*), or as an element of the price paid or payable as required by subsection 45(1).

8. If charges or amounts other than royalties or licence fees are identified together with royalties or licence fees in a single agreement but are not itemized seperately, the importer must be able to substantiate their apportionment. The apportioned charges or amounts may then be considered as additions to price paid or payable under the authority of the alternative provisions or paragraph 48(5)(*a*), or as an element of the price paid or payable as required by subsection 45(1).

9. Paragraph 152(3)(*d*) indicates that the burden of proof in any question relating to compliance with the provisions of the *Customs Act* lies on the person (other than the Crown) who is a party to the proceeding. If charges or amounts other than royalties or licence fees that are enumerated in an alternative provision of paragraph 48(5)(*a*) are identified together with royalties or licence fees in a single agreement and are not itemized separately and the importer cannot provide sufficient information in support of apportionment of the charge or amount, then subsection 48(6) precludes the calculation of value for duty under the transaction value method and an alternative valuation method applies.

10. Example no. 4 of Appendix A to this Memorandum is an example of a payment made for more than the right to the acquisition or use of a protected right and in which charges can be separately identified and individually considered under separate provisions of paragraph 48(5)(*a*).

11. In accordance with the *Mattel Canada* decision, an amount identified as a royalty or licence fee payment is **not** to be considered as an addition to price paid or payable as a subsequent proceed pursuant to subparagraph 48(5)(*a*)(v). Royalty and licence fee payments must **only** be considered as a possible addition to the price paid or payable under subparagraph 48(5)(*a*)(iv).

In Respect of the Goods

12. The phrase "payments made in respect of the goods" means that the royalty or licence fee payment made to the vendor or a third party is in some way related to the goods being imported. For example, when a payment is calculated as a percentage of the price at which the goods are sold or resold, the payment is in respect of those goods.

13. In the *Polygram* decision, the CITT ruled that the amount of the royalty payment, which varied according to the price at which the imported sound recordings were sold, was made in respect of the goods. The amount to be added to the price paid or payable of imported goods did not have to be limited to only general payments.

14. The timing of when the royalty or licence fee must be paid does not affect the decision of whether or not the fee is in respect of the goods. A royalty or licence fee payment may be added to the price paid or payable regardless of whether it is to be paid at the time of importation, time of resale, or any other time.

Condition of the Sale of the Goods

15. The phrase "a condition of the sale of the goods for export to Canada" in the context of subparagraph 48(5)(*a*)(iv) means that the transfer of ownership of the goods being imported is dependent upon the payment of the amount of the royalty or license fee by the purchaser. Prior to the *Mattel Canada* decision, this phrase was interpreted to mean that a royalty or licence fee payment was a condition of the sale even if the vendor did not derive a direct benefit from the payment of the royalties or did not own the rights for which payment was made.

16. The *Mattel Canada* decision provided clear and unambiguous meaning to this requirement: a royalty or licence fee is only to be added to price paid or payable of imported goods if it is in respect of the goods and if the failure by the purchaser to pay the royalty or licence fee entitles the vendor to refuse to sell the licenced goods or to repudiate the contract for their sale.

17. Prior to the sale of goods upon which a royalty or licence fee may be payable, a royalty or licence fee agreement is usually in place. This agreement ordinarily specifies the rights and obligations of both licensor and licensee, and may include a statement indicating that the sale for export of the licensed goods may be repudiated by the vendor if the royalty or licence fee payment is not made. The purchaser's obligation to make payment or else suffer loss of access to the licensed goods may also be stated in the terms of a sales agreement or commercial invoice between the purchaser and the vendor, or in other correspondence among the purchaser, vendor or licensor. The vendor's prerogative to refuse to sell or to repudiate the contract of sale if the purchaser fails to make the royalty or licence fee payment must be explicitly stated in the commercial documentation between the purchaser and the vendor or in the license agreement if the vendor is also the licensor, for the royalty or licence fee payment to be considered a condition of the sale.

18. Situations may occur where the licensor is party to a royalty or license agreement with the vendor, however the purchaser must make the royalty or license fee payment to satisfy the vendor's obligation to the licensor. The *Mattel Canada* decision involved an importation where the purchaser made a royalty payment to a vendor who was not

the licensor of the imported goods. The payment was made to the vendor only to "flow through" to a third party licence holder. If a royalty or licence fee payment is a "flow through" payment, the amount of the payment is not to be added to the price paid or payable of the imported goods unless failure to pay would result in the vendor's refusal to sell the licenced goods to the purchaser or repudiate the contract of sale between the vendor and purchaser. The purchaser's obligation to make the payment to ensure the completion of the sale must be explicitly stated in the documentation between the purchaser and vendor or licensor for the royalty payment to be considered a condition of sale.

19. The FCA's *Rockport* decision supported the SCC's interpretation of condition of sale and addressed the issue of payments of royalties or licence fees to a vendor who was also the licensor where an open-ended contract exists; if an importer enters into an agreement with a vendor for a continuing supply of goods at a specified price and is also obligated to make a royalty payment (to the vendor, or to a third party) in respect of the goods, the obligation to make the royalty payment to ensure the continuing supply of goods must be explicitly stated in the documentation between the purchaser and vendor or licensor for the royalty payment to be considered a condition of sale.

ADJUSTMENT TO PRICE PAID OR PAYABLE

20. If a payment is a royalty or licence fee, is "in respect of the goods," and is an explicitly stated "condition of sale," the amount of the royalty or licence fee payment is to be added to the price paid or payable of imported goods in accordance with subparagraph 48(5)(*a*)(iv). All three factors must be met for an adjustment to be made. Appendix A to this memorandum includes examples illustrating the identification of a royalty or licence fee payment as an addition to the price paid or payable of imported goods.

Right to Reproduce

21. Subparagraph 48(5)(*a*)(iv) excludes royalty or licence fee payments made for the right to reproduce imported goods in Canada from being added to the price paid or payable of the imported goods. The right to reproduce refers not only to the physical reproduction of imported goods but also to the right to reproduce an invention, creation, thought, or idea incorporated in, or reflected by, the imported goods. For example, royalties calculated on the sale in Canada of compact discs produced domestically from an imported master recording would not be added to the price paid or payable for the master recording.

Right to Distribute or Resell

22. Payments for the right to distribute or resell goods in Canada are usually made before any sale of goods for export to Canada occurs. Such payments are usually in a lump-sum amount (for example a franchise fee) determined independently of the selling price or quantity of goods sold in Canada. Royalty or licence fee payments made for the right to distribute or resell imported goods in Canada are only to be added to the price paid or payable of imported goods if the documentation between the purchaser and the vendor or licensor explicity indicates that any failure by the purchaser to pay the royalty or licence fee entitles the vendor to refuse to sell the licenced goods or to repudiate the contract for their sale.

ACCOUNTING FOR ROYALTIES AND LICENCE FEES

23. If the terms of a royalty or licence agreement require periodic payment of a royalty or license fee based on a percentage of the purchaser's resale price, an importer may have to amend customs accournting data if (upon calculation of the actual amount of royalty or licence fee payable) a correction to declared value for duty is required. Customs Memoradum D11-6-6, *Self-adjustments to Declarations of Origin, Tariff Classification, Value for Duty and Diversion of Goods* provides additional information on amendments to customs accounting data, including requirements for reporting of adjustments to value for duty.

24. Customs Memoranda D13-4-3 *Customs Valaution: Price Paid or Payable* and D13-4-7 *Adjustments to the Price Paid or Payable* provide additional information on the requirements necessary to establish value for duty under the transaction value method.

ADDITIONAL INFORMATION

25. Appendix A to this Memorandum contains examples illustrating the treatment of royalties and licence fees in accordance with section 48 of the *Customs Act*.

26. For more information on the treatment of royalties and licence fees telephone the CCRA's Automated Customs Information Service at 1-800-461-9999 for service in English or 1-800-959-2036 for service in French. Alternatively, access the Small and Medium-size Enterprises Info Centre at **www.ccra.gc.ca/sme**. This memorandum and all other D13-series Memoranda are available at no charge from internet site **www.ccra.gc.ca/customs/business/importing/methods-e.html**.

27. Supreme Court of Canada decision 2001 SC 366 can be reviewed at internet site **http://www.lexum.umontreal.ca/csc-scc/en/pub/vol2/html/2001/scr2 0100.html**.

28. Federal Court decision A-642-97 can be reviewed at internet site **http://www.decisions.fct-cf.gc.ca/fct/2002/2002fcal133.html**.

29. Canadian International Trade Tribunal decisions included in this Memorandum can be reviewed at internet site **http://www.citt.gc.ca/appeals/index e.asp**. Copies of decisions can be obtained by contacting the CITT at facsimile no. (613) 990-2439 and quoting the appeal number, or by post at the following address:

Records and Mail
Canadian International Trade Tribunal
15th floor
333 Laurier Avenue West
Ottawa ON K1R 1G7

Telephone: (613) 990-2444 or (613) 990-2446

APPENDIX A

EXAMPLES

1. A Canadian importer agrees to pay a royalty fee to a U.S. licensor (the trademark holder) for the right to use their registered trademark. The trademark is woven into shirts purchased by the importer from a vendor in Hong Kong. The vendor will provide 1,000 shirts per week to the importer over a twelve week period. The importer will coordinate delivery of the shirts to their domestic retail outlets. The licensor is not related to the vendor. Under the terms of the royalty agreement between the importer and the licensor, a royalty payment of $ 5.00 will be made to the licensor for every shirt sold in Canada that bears the licensor's trademark, payable bimonthly. No indication is provided in documentation relevant to either the sale or the royalty agreement that the vendor will stop shipping shirts to the importer if the royalty payment is not made.

The royalty payment is not to be added to the price paid or payable for the shirts imported from Hong Kong. The payment is a royalty payment, and is in respect of the goods. However the payment is not a condition of sale, as the consequence of the failure to make payment is not explicitly identified in the documentation between the purchaser and either the vendor or licensor.

The Canadian importer purchases goods from the Hong Kong vendor and pays the royalty to the U.S. licensor. The licensor is not related to the vendor. Even if the licensor and vendor were related, the payment would not be a condition of sale unless the consequence of the failure to make payment was explicitly identified in the documentation between the purchaser and either the vendor or licensor.

2. Purchco, a Canadian manufacturer of packaged foods, wishes to make Nameco brand biscuits in Canada and sell them to domestic grocery retailers. Purchco and Nameco plc of the United Kingdom, the licensor, enter into an agreement in which Purchco. will pay Nameco plc a royalty of $25,000 on January 1 of each of the next five years for the right to make and sell the biscuits in Canada under the Nameco brand name until the last day of the fifth year. After entering the agreement, Purcho decides to purchase and import one of the ingredients for the biscuits from Nameco plc's subsidiary Subco of Barbados. The sales agreement between the purchaser (Purchco) and the vendor (Subco) makes no reference to the royalty agreement between Purchco and Nameco plc or any consequences if Purchco fails to make the royalty payments.

The royalty payments are not to be added to the price paid or payable of any importation of the ingredient purchased from Subco. The royalty payments made to Nameco plc are for the right to make and sell Nameco biscuits in Canada and are not payments made in respect of the imported goods nor are they a condition of their sale for export to Canada.

Even if the sales agreement explicitly indicated that the failure to make the royalty payments would result in Subco's refusal to sell the ingredient to Purchco or in the repudiation of any contract of sale, the amount of the royalty payments would not be added to the price paid or payable for the ingredient. The royalty payments are not made in respect of the imported ingredient, but for the right to make and sell finished goods.

3. A Canadian retailer purchases action figures from a U.S. distributor. The U.S. distributor has obtained worldwide selling and distribution rights to the action figure from its U.S. licensor, and in return, has guaranteed the licensor that a royalty will be paid for each action figure sold to the public. Under the purchase agreement between the purchaser (the Canadian retailer) and the vendor (the U.S. distributor), the purchaser is required to pay the licensor a monthly royalty equal to five per cent of the Canadian retail price of each action figure sold in that month. The Canadian retailer is required to remit this amount to the U.S. distributor, who will pass it on to the licensor. The purchase agreement adds that if the royalty payment is not made to the licensor by the last day of the subsequent calendar month the distributor will repudiate the purchase agreement, effectively stopping the retailer from offering the action figure for sale in Canada and curtailing any further supply from the distributor.

The royalty payment is to be added to the price paid or payable for the action figures. The royalty payment is in respect of the goods since it is made as a result of the importation and resale of the action figures and is based on the price at which they are sold in Canada. The payment is also a condition of sale of the goods, as the distributor's right to repudiate their contract with the retailer in the event the royalty payment is not made is communicated in the purchase agreement. The payment made by the retailer is a "flow-through" payment, made by the retailer through the U.S. distributor to the licensor.

4. A Canadian importer enters into a license agreement with an Italian clothing designer to have dresses manufactured that will be marketed under the designer's label. The importer will purchase the finished dresses from a manufacturer in Thailand. Under the terms of the license agreement, the designer consents to the manufacture of goods bearing their label, in exchange for a fee of 10% of the resale price of the goods in Canada. The agreement further stipulates that half (5%) of the amount of the license fee is for the use of the licensor's label, and half (5%) is for design specifications and colour and

material recommendations to be supplied by the licensor from Italy directly to the Thai manufacturer. The importer and the Thai manufacturer are party to a separate sales agreement identifying the number of units to be produced and their price. Neither the license agreement nor the contract of sale between the manufacturer and the importer indicates that the Thai manufacturer will refuse to sell the the dresses to the importer if the payment to the licensor is not made.

The license fee payment is not to be added to the price paid or payable for the dresses under subparagraph 48(5)(*a*)(iv) of the *Customs Act*. The license fee payment is in respect of the imported goods, but it is not a condition of their sale for export to Canada as the consequences of the failure to make the fee payment are not explicitly identified.

**However, half of the payment is for design specifications and content recommendations and should be added to the price paid or payable of the imported dresses as an "assist."
Clause 48(5)(*a*)(iii)(D) of the *Customs Act* states that a payment for design work undertaken elsewhere than in Canada and necessary for the production of imported goods is to be included in the value for duty of the imported goods.**

D13-1-1 *Value for Duty Regulations*, D13-3-12 *Assists (Customs Act, Sections 48 to 53)*, and D13-4-8 *Assists (Customs Act, Section 48)* provide additional information on the treatment of assists.

5. A Canadian wholesaler wishes to import and resell portable radios in Canada. The wholesaler identifies a foreign manufacturer who agrees to supply 50,000 radios to the wholesaler at a cost of $5.00/unit and who also provides the wholesaler with exclusive distribution rights to the radios in Canada for a $10,000 fee. The foreign manufacturer provides the wholesaler with an invoice for the radios showing a single amount owing of $260,000. (The manufacturer charges the wholesaler a single fee for the entire order and for the right to distribute). A separate document prepared by the vendor confers exclusive distribution rights in Canada on the wholesaler, but does not refer to the amount of the fee or the consequences if the fee payment is not made.

A payment for the right to distribute goods separate from the price paid or payable of the goods is not a royalty or license fee identified under subparagraph 48(5)(*a*)(iv). However, in the circumstances provided, the right to distribute forms part of the price paid or payable for the goods in accordance with subsection 48(1), and will be represented in the value for duty of the goods. There is no provision in the *Customs Act* to reduce the price paid or payable for goods to exclude the amount of a royalty or licence fee included in the price.

6. A Canadian importer enters into a royalty agreement with a U.S. licensor for the right to use their registered trademark. The importer engages a factory in Haiti to supply 5,000 footballs in each of the next twenty-four months. The licensor's trademark will be imprinted on the footballs at the factory. Under the terms of the royalty agreement, a royalty payment of $10.00 will be made to the licensor for every trademarked football sold in Canada, payable quarterly. The licensor is a part-owner of the factory in Haiti, and the sales invoice between the importer and the factory includes a statement indicating that the supply of the footballs will cease in the event a royalty payment is not made.

The royalty payment is to be added to the price paid or payable for the footballs imported from Haiti. The payment is a royalty payment, and is in respect of the goods (the trademarked footballs). The royalty payment is a condition of sale, as the documentation between the vendor and purchaser explicity identifies the requirement to make the royalty payment to ensure the continuing supply of the trademarked goods.

APPENDIX B

SUMMARIES OF JURSIPRUDENCE

Decisions of the Supreme Court of Canada (SCC), the Federal Court of Appeal (FCA) and the Canadian International Trade Tribunal (CITT) that give meaning to the interpretation of the "condition of sale" requirement of subparagraph 48(5)(*a*)(iv) of the *Customs Act* are included in paragraphs 1 through 4 of this Appendix:

1. The CITT ruled in the *Polygram Inc*. appeal (Appeal Nos. AP-89-151 and AP-89-165, May 7, 1992) that the "all-in fee" paid by Polygram Inc. is a royalty or licence fee and should be added to the transaction value of imported sound recordings pursuant to subparagraph 48(5)(*a*)(iv) and be subject to the payment of customs duty. Polygram Inc. had entered into a licence agreement with vendor Polygram B.V. which entitled it to promote the music and artists of Polygram B.V.'s repertoire and to distribute and sell their recordings to the public for which it would pay an all-in fee calculated on the net retail price of the recordings.

The CITT concluded that the fee payment was not a general payment unaffected by the sound recordings; the payment was calculated on the retail price and was made in respect of the imported goods. The CITT indicated that the payment of the fee was a condition of the sale for export to Canada of the goods, as the purchaser could not obtain the goods without first signing the licence agreement.

2. The CITT built on its interpretation of subparagraph 48(5)(*a*)(iv) in its decision in the *Reebok* appeal (AP-92-224, September 1, 1993), in which it ruled that the types of fees to be included in value for duty calculated under the transaction value method were not limited to fees paid for patents, trademarks and copyrights. The CITT ruled that the trade-mark fee paid by the importer Reebok for the "intellectual property rights" inherent in the imported goods was not to be treated any differently than other payments added to the price paid or payable of imported goods as royalties or license fees.

The CITT added that even if a fee is not required to be paid pursuant to the terms of the purchase of the goods, it may still be considered to be a condition of the sale, as long as there is some connection between the payment of the fee and the purchase of the imported goods.

3. A further interpetation of the "condition of sale" requirement was made by the SCC in the *Mattel Canada* decision (Citation 2001 SCC 36, June 7, 2001); if a royalty or licence fee payment is required to be made the importer must be aware that, in the event of failure to make the payment, the source of supply of the imported goods may be stopped. The SCC ruled that the royalty payment made by Mattel Canada on behalf of their parent vendor was not a payment made as a condition of the sale for export of the goods to Canada, and in paragraph 68 of their decision interpreted the phrase "condition of sale" as follows:

"Unless a vendor is entitled to refuse to sell licenced goods to the purchaser or repudiate the contract of sale where the purchaser fails to pay the royalties or licence fees, s 48(5)(*a*)(iv) is inapplicable."

This SCC decision also indicated that payments identified as royalty or licence fee payments can only be added to the price paid or payable of imported goods if the requirements of subparagrah 48(5)(*a*)(iv) are met, and are not to be considered under the requrements of subparagraph 48(5)(*a*)(v) as subsequent proceeds.

As Canada's highest level of judicial appeal, the SCC decision superseded all previous judicial decisions on the interpretation of the "condition of sale" requirement of subparagraph 48(5)(*a*)(iv).

4. The *Mattel Canada* decision indicated how royalties and licence fees were to be treated where the vendor and licensor are not the same party nor related to each other. The FCA in the *Rockport* appeal (decision no. A-642-97, April 10, 2002) addressed the treatment of royalty payments made to a vendor of imported goods who is also the licensor. The FCA supported the SCC decision and ruled that the words "condition of sale" were clear and unambiguous; the fact that a vendor of imported goods was also the licensor was not sufficient to establish that the payment of the royalty was a condition of sale of the goods. The requirement to make payment or else suffer loss of access to the goods upon which the amount of royalty is calculated must be communicated by the vendor/licensor to the purchaser.

The *Mattel Canada* and *Rockport* decisions have clarified the "condition of sale" requirement of subparagraph 48(5)(*a*)(iv). This requirement is addressed further in paragraphs 15-19 of this Memorandum.

Decisions of the Federal Court of Appeal (FCA) and the CITT that were rendered prior to the *Mattel Canada* and *Rockport* decisions are identified in paragraphs 5 through 7 below. These decisions are included herein only to illustrate previous interpretations of the "condition of sale" requirement.

5. The CITT found in the *Jana & Company* appeal (decision no. AP-94-150, September 3, 1996) that royalty payments to third party licensors are not to be added to the price paid or payable of imported goods where there is no evidence of any relationship, contractual or otherwise, between the manufacturer of imported goods and third party licensors to suggest that there is a connection between the sale for export to Canada and the payment of the royalty to the licensor. This decision contradicted the CITT's previous decision in *Reebok,* which stated that a condition of sale existed provided that there was some connection between payment of the fee and purchase of the goods.

6. In the *Leeds Neckwear Inc.* appeal to the CITT (decision no. AP-95-182, July 28, 1998) the importer entered into agreements with licensors that allowed the licensors to monitor the processing and product quality of manufactured goods bearing their trademarks. The goods were purchased and imported by the appellants from a foreign manufacturer or its subcontractor without any involvement of the licensors. The CITT found no evidence of affiliation between the licensors and the manufacturer/vendor which suggests that a connection or relationship exists between the sale for export to Canada of the manufactured goods and the payment of royalties by the importer to the licensors. The importer's ability to purchase the goods was not restricted by any failure to pay royalties owing to the licensors. The CITT was of the opinion that the lack of control over the manufacturer by the licensors affected the "connection" between payment of the fee and the purchase of the goods identified in the *Reebok* decision.

7. The FCA in the *Nike Canada Inc*. appeal (Appeal no. 905 97, January 13, 1999) reversed an earlier decision of the CITT (decision nos. AP-95-197-202, AP-95-206-212, October 10, 1997). Nike Canada Inc. paid a royalty to a related licensor upon resale in Canada of goods manufactured by unrelated vendors. The CITT had ruled that, similar to the *Reebok* case, that payments relating to valuable intellectual property rights made to the related licensor were a condition of sale in that there was a connection between the purchase of the goods and the payment of the royalty, and that the royalty payments should be added to the price paid or payable of the imported goods in accordance with subparagraph 48(5)(*a*)(iv) of the *Customs Act*. The FCA reversed this decision and ruled that the obligation to pay the royalty to the related licensor arose from a separate agreement unrelated to the sale for of export of the goods, and was not a condition of sale of the imported goods.

REFERENCES

ISSUING OFFICE –	HEADQUARTERS FILE –
Origin and Valuation Division Trade Policy and Interpretation Directorate	79070-4-4
LEGISLATIVE REFERENCES –	**OTHER REFERENCES –**
Customs Act, section 45, 48, 152	D13-1-1, D13-3-12, D13-4-3, D13-4-7, D13-4-8
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