



DEPARTMENT OF THE TREASURY  
U.S. CUSTOMS SERVICE

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**CATEGORY: VALUATION**

Donald J. Unger, Esq.  
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200 East Randolph Drive  
Suite 7920  
Chicago, Illinois 60601

**RE:** Dutiability of certain trademark licensing payments; royalties; proceeds; related parties; assists; section 402(b)(1)(D); section 402(b)(1)(E); section 402(g); Section 402(h)(1)(A)

Dear Mr. Unger:

This is in reply to your ruling request, on behalf of your client [ ] (importer/licensee) regarding whether certain royalty payments paid to [ ] are dutiable. You also ask if samples and sketches are assists. You made several additional submissions. The most recent submission is dated January 5, 1996. On August 31, 1995, a meeting was held at our office in Washington, D.C. with you, and another attorney from your firm, and members of my staff to discuss this case. You have requested that information contained in your submissions be kept confidential. Pursuant to your January 5, 1996 request, as clarified in a April 2, 1997 telephone conversation, the specific names of the parties and the places will not be referred to in this ruling or will be bracketed and be deleted in copies of the ruling made available to the public. In addition, documents released to the public will not contain this information. We regret the delay in responding.

**FACTS:**

The importer is a U.S. company that sells garments through its catalogs. The garments in question are purchased from [ ] (seller). In September 1985, the importer entered into a written agreement with [ ] (licensor) of [ ], which granted the importer an exclusive license to use the trademark [ ] and sell merchandise with that trademark in the United States. A copy of the license agreement and the subsequent amendments was submitted. The agreement provides that the importer is the sole distributor of the trademarked merchandise in the United States. In consideration for use of the trademark, the importer was to pay the licensor [ ] of the net sales of the importer's trademarked merchandise and [ ] of the net sales of non-current licensor's merchandise listed in the importer's own catalog. Such payment was to be made twice a year on May 31 and September 30. The agreement further provides that the

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licensor would supply the importer with the complete color separations of all inner and cover pages and proofing scales for its catalogs. The importer would have the catalogs printed at its own expense, but the licensor would specify the printer. The importer could then source the goods through manufacturers specified by the licensor. Under Section 2.3 of the agreement, the licensor will undertake to provide a sample of each item to appear in the catalog. The licensor will inform the importer of the name of the supplier/manufacturer and the net selling price for each article at the same time as it supplies the sample. Section 2.3 further states that when placing orders with suppliers/manufacturers, the licensor shall use its best endeavors to ensure that they will also supply the importer, providing that the importer has given reasonable notice to the licensor of such instructions.

In November of 1985, [ ], a private company, purchased 50% of the licensor. The remaining 50% of the licensor is held in trust by a [ ] trust company. The sole life beneficiary of such trust is [ ].

On June 13, 1986, the agreement was amended by the parties to 1) extend the agreement to December 31, 1991, 2) specify that payment to the licensor was to be made twice per year on November 30, and May 31, and 3) allow the importer to sell the licensor's line of merchandise through its retail outlets. The agreement was again amended on June 2, 1988, by a supplemental agreement No. 3, which provided for four payments to the licensor yearly on February 28, May 31, August 31, and November 30.

The agreement was amended for a fourth time to change the payment schedule. You state that the importer has complied with the payment terms of the agreement, importing the goods, and paying the licensor pursuant to the agreed upon schedule. However, the parties did not comply strictly with the other terms of the agreement, but have instead instituted terms through their course of dealings. For example, prior to 1989, the sourcing for trademarked merchandise was always done directly by the importer through its overseas offices with suppliers. It is the importer's understanding that none of these suppliers were related in any way to the licensor.

In 1989, [ ] (seller) was formed. Your latest submission indicates that the [ ] owns 40% of the seller and [ ] owns the remaining 60%. Two executive directors of the licensor are outside directors of the seller, but the licensor and the seller do not share any officers or any salaried employees. The licensor maintains an office in [ ] that is in the same building as the seller, but they are physically separated. The importer sources between 80% and 85% of the trademarked merchandise from the seller with the remaining merchandise supplied through other independent sources. (If there are sales agreements, we do not have copies to review.)

According to the importer, twice a year its representatives attend meetings in [ ] with the licensor. At those meetings, the following year's merchandise is selected. The selections are made from conceptual sketches produced by the licensor's staff. The seller generally does not attend such meetings. Samples are produced in the licensor's [ ] office. These samples

usually are oversized and are used to convey a concept. You indicate that the licensor provides the oversized samples to the seller and the seller is invoiced and pays for all samples it receives from the licensor. From this oversized sample, the seller produces a pattern for the production of the garments and grades the pattern to accommodate several different sizes. The end product made from the seller produced pattern will always convey the original concept of the oversized sample garment supplied by the licensor, but will often be a modified version of the sample.

You indicate that the licensor's conceptual work is general in nature, and that the seller does the actual fittings and pattern making with the assistance of the seller's representatives who are domiciled in the United States. The merchandise that is manufactured by the seller is sold to the importer via documents against payment. The price for the merchandise covers its costs of production including any design or pattern works. The importer's broker handles the import transactions.

You claim that the importer is not committed to buy from the seller and can obtain the licensor's merchandise from parties other than the seller. The buyer has chosen to use the seller for only trademarked merchandise and not as a source for other non-trademarked merchandise. Regardless of where the trademarked merchandise is sourced, the importer will still pay the licensor a royalty provided for in the licensing agreement. Payment is made to the licensor through a wire transfer to a bank account in [     ].

**ISSUE:**

Whether the described royalty payments from the importer to the licensor, are dutiable as part of the transaction value of the imported licensed products?

Whether the value of sketches and samples supplied to the seller should be added to the price actually paid as assists?

**LAW AND ANALYSIS:**

Merchandise imported into the United States is appraised in accordance with section 402 of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979 (TAA: 19 U.S.C. § 1401a). The preferred method of appraisement is transaction value, which is defined as the "price actually paid or payable for merchandise when sold for exportation to the United States," plus certain enumerated additions. The term "price actually paid or payable" is defined in section 402(b)(4)(A) of the TAA as "the total payment (whether direct or indirect,...) made, or to be made, for imported merchandise by the buyer to, or for the benefit of, the seller." 19 U.S.C. §1401a(b)(4)(A).

## ROYALTY PAYMENTS

Section 402(b)(1) of the TAA provides for five additions to the price actually paid or payable. Two of the statutory additions to the price actually paid or payable are found in sections 402(b)(1)(D) and (E) which provide for additions to the price actually paid or payable for:

(D) any royalty or license fee related to the imported merchandise that the buyer is required to pay, directly or indirectly as a condition of the sale of the imported merchandise for exportation to the United States; and

(E) the proceeds of any subsequent resale, disposal or use of the imported merchandise that accrue, directly or indirectly to the seller.

In regard to the dutiability of royalties and license fees, the Statement of Administrative Action (SAA) adopted by Congress with the passage of the TAA provides in the relevant part:

Additions for royalties and license fees will be limited to those that the buyer is required to pay directly or indirectly, as a condition of sale of the imported merchandise for exportation to the United States. In this regard, royalties and license fees for patents covering processes to manufacture the imported merchandise will generally be dutiable, where as royalties and license fees paid to third parties for use, in the United States, of copyrights and trademarks related the imported merchandise, will generally be considered as selling expenses of the buyer and therefore will not be dutiable. **However, the dutiable status of royalties and license fees paid by the buyer must be determined on a case-by-case basis and will ultimately depend on: (i) whether the buyer was required to pay them as a condition of sale of the imported merchandise for exportation to the United States; and (ii) to whom and under what circumstances they were paid.** For example, if the buyer pays a third party for the right to use, in the United States, a trademark or copyright relating to the imported merchandise, and such payment was not a condition of the sale of the merchandise for exportation to the United States, such payment will not be added to the price actually paid or payable. However, if such payment was made by the buyer as a condition of sale of the merchandise for exportation to the United States, an addition will be made. (emphasis added)

Statement of Administrative Action , H.R. Doc. No. 153 96 Cong., 1st Sess., pt 2 reprinted in, Department of the Treasury, Customs Valuation under the Trade Agreements Act of 1979 (October 1981) at 48-49.

The question of whether the royalty payments are dutiable or not was analyzed in our notice on the Dutiability of royalty payments, which was published in the Custom Bulletin on February 10, 1993, Vol 27 Cust. B. & Dec. No.6 (commonly referred to as "Hasbro II"). In that notice we indicated that several questions must be answered in order to determine whether a royalty payment is related to imported merchandise and required as a condition of sale. As set

forth in the notice the questions are: (1) was the imported merchandise manufactured under the patent? (2) was the royalty involved in the production or sale of the imported merchandise? and (3) could the importer buy the product without paying the fee? 27:6 Cust. B. & Dec. 1 at 9-11. Negative responses to the first and second questions, and an affirmative response to the third, suggest that a royalty payment is non-dutiable under section 402(b)(1)(D) of the TAA.

In Headquarters Ruling Letter (HRL) 545361, July 20, 1995, we pointed out that the dutiable status of the trademark royalties depended largely on to whom they were paid. In that case, we considered whether royalties paid by a licensee/buyer to the trademark owner for the right to use the latter's trademark were dutiable under section 402(b)(1)(D) or (E) as an addition to the price actually paid or payable of the imported licensed products. Three scenarios were presented. The underlying facts in each scenario were the same except with regard to whom the royalties were paid. In each case, the royalties were based on a percentage of the net sales price of all products manufactured and sold by licensee using the licensed trademark. Liability for payment of the royalty was triggered by the resale of the trademarked product by the licensee/buyer.

In the first scenario of HRL 545361, the licensee/buyer purchases and imports trademarked merchandise manufactured and sold by a seller unrelated either to the licensor or the licensee. Customs determined that the royalty payments were not dutiable as royalties because there was no indication such payment was a condition of sale of the imported merchandise. However, in the second scenario the licensor and the seller were the same person, and the royalty payment was made to the licensor/seller. Under these circumstances Customs found that the royalty was a condition of the sale of the merchandise for exportation to the United States and dutiable under 402(b)(1)(D):

The payment is not optional, but must be made to the licensor in its capacity as seller of the merchandise. The agreement provides that the licensee/buyer must pay an amount equal to a percentage of the net sales price of all products that use the licensor/seller's trademarks and trade names, and an equal percentage amount on the net sale price of all products sold to trademarked retail shops. Draft license agreement at 5. Therefore to the extent that the products described by the draft agreement are imported, the payment of the royalty is a condition of sale and as such an addition should be made to the price actually paid or payable.

In the third scenario, the licensee/buyer purchases the imported merchandise from a seller related to the licensor. Customs concluded that the royalty was a condition of sale and dutiable under section 402(b)(1)(D):

Under section 402(b)(1)(D). . . , royalties payments are included in transaction value if the buyer is required to pay them directly or indirectly, as a condition of sale. 19 U.S.C. §1401a(b)(1)(D); see also, SAA, reprinted in Dept. Treas., Customs Valuation under the TAA at 49. In this

scenario, it is our position that the royalty is paid indirectly as a condition of the sale for exportation to the U.S. CF., HRL 542984, dated April 8, 1983 (a payment by the buyer to a third party, required as a condition of sale, was included in transaction value as part of the price actually paid or payable). The instant payment is not optional. Under the terms of the agreement it must be made to the licensor. Although in this particular scenario the payment is made to the licensor in respect of merchandise purchased from a seller related to the licensor, we find that it is no less a condition of sale than in the second scenario since the agreement provides the licensee/buyer must pay the royalty on all products, to include the imported merchandise, that use the licensor's trademarks and trade names, or that are sold to the trademarked retail shops.

In subsequent rulings, we have held that royalties due on all licensed trademarked goods imported and sold by the importer will be added to price actually paid or payable if the royalties are paid to a party related to the seller. See HRL 545035 August 23, 1995 and HRL 545728, November 30, 1995. You contend that this case is distinguishable from these and similar cases because the licensor and the seller are not related. Accordingly, it is your position the first scenario outlined in HRL 545361 would apply, and that the royalty payments would not be dutiable. However, we cannot agree with your contention that the licensor and the seller in this case are not related parties.

In section 402(g)(1) of the TAA, related parties are defined as follows:

The persons specified in any of the following subparagraph shall be treated as persons who are related:

- (A) Members of the same family, including brothers and sisters (whether by whole or half bloods), spouse, ancestors, and lineal descendants.
- (B) Any officer or director of an organization and such organization.
- (C) An officer or director of an organization and an officer or director of another organization, if each such individual is also an officer or director in the other organization.
- (D) Partners
- (E) Employer and employee
- (F) Any person directly or indirectly owning, controlling, or holding with power to vote, 5 percent or more of the outstanding voting stock or shares of any organization and such organization.
- (G) Two or more persons directly or indirectly controlling, controlled by or under common control with any person.

In elaborating on subsection (G), the SAA further explains that "the phrase two or more persons directly or indirectly controlling, controlled by or under common control with any person is understood to cover the following situations:

- (1) where one of them directly or indirectly controls the other;
- (2) where both of them are directly or indirectly controlled by a third person; or
- (3) where together they directly or indirectly control a third person. (Practice)"

While we agree that the licensor and the seller are not considered related parties under 402(g)(1)(A)-(F), we cannot agree with your contention that they would not be considered related parties under subsection (G). In this case, ownership of the licensor is evenly split between [ ]. The same two persons own the seller, with [ ] owning a majority of the voting shares. You contend that because the licensor's ownership is evenly split between these two parties, neither party controls the licensor. Thus, you conclude that [ ] does not control the licensor and the seller.

We disagree. First, we conclude that your interpretation of the statute is too narrow and that the provision should be read to include situations like the one here where the same multiple persons control both parties. In other words, if the parties are under the control of the same one or more persons, they would be considered related parties. In this case, both the seller and the licensor are totally owned by the same two entities [ ].

However, even under a literal reading of subsection (G), we conclude that the parties are related in that they are controlled by the same person. In arguing that the licensor and the seller are not controlled by the same party [i.e., ] even though it owns 50% of the licensor's voting shares, and 60% of the seller's voting shares, you are assuming that control means owning more than 50% of the voting shares. Although the term control is not defined in the statute, there is no requirement that a party must own a majority of the voting shares in order to control another party. For example, in HRL 545481, September 14, 1994, Customs determined that an importer and its distributors were related parties because the former controlled the latter by virtue of a distributorship agreement and by virtue of the market control it enjoyed as the exclusive importer of the imported merchandise. In the decision, we also pointed out that the U.S. valuation law was enacted to implement the Customs Valuation Code. 19 U.S.C. 2502(1). The Code elaborates on the definition of control, in the Interpretative Note to Article 15, paragraph 4(e), that "one person shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter."

Absent evidence to the contrary, [ ] ownership of 50% and 60% of the stock in the licensor and the seller, respectively, implies that it is in a position to exercise restraint and direction over both parties and thus exert control. It is difficult to imagine that [ ] would not have a great deal of influence over the both the licensor and the seller and that they would be free to take actions which would adversely affect [ ] without its permission. We also note that under the valuation statute, a party need not own a majority of the stock of a company to be

considered related to that company. Under 402(g)(1)(F), parties are considered related when one party owns, controls or holds with power to vote, only 5 percent or more of the shares of the other party. Based on the above considerations, we conclude that the licensor and the seller are considered related parties under the valuation law.

Accordingly, because the licensor and seller are considered related parties, the third scenario outlined in HRL 545361 is the most relevant to this case. As in that case, the importer must pay to the licensor the subject royalties upon the sale of all the imported trademarked merchandise. Moreover, under the terms of license agreement the licensor determines who the sellers will be. Indeed, it appears that most if not all the merchandise with the [ ] trademark is purchased from the licensor's related company. We conclude that the royalty payments for the use of the trademark from the importer to the licensor are related to the imported merchandise and a condition of sale and thus dutiable under section 402(b)(1)(D).

Based on the above considerations, we find that the royalty payments should be added to the price actually paid or payable under section 402(b)(1)(D) of the TAA for merchandise purchased from the seller. Having reached this conclusion, we do not address whether these payments could be considered dutiable under section 402(b)(1)(E) of the TAA.

### **ASSISTS**

You also inquire whether sketches and samples that the licensor provides to the seller should be added to the price actually paid or payable as assists. According to your submission, the licensor creates conceptual sketches of garments that the importer will sell in the United States. After the importer makes selections from the licensor's sketches, the licensor's employees prepare a sample garment that is oversized. You indicate that the purpose of the garment is to convey a general concept. You state that the licensor provides the sample to the seller. The seller is invoiced and pays for the samples it received from the licensor. From a sample, the seller produces a pattern for garment production and grades a pattern to accommodate several different sizes. You indicate that many samples supplied to the licensor are not feasible for mass production. Therefore, to make garments feasible for mass production, with the buyer's approval the seller often modifies the samples. You contend that because the samples are oversized, because they are often modified to suit them to mass production and because of the seller's expertise in manufacturing garments, the samples are not necessary for the production of the final product, and should not be treated as assists. You also point to the fact they are not furnished by the buyer free of charge or at reduced cost. Rather, you indicate that they are furnished by the licensor and that the seller pays for them and that such costs are passed on to the buyer as part of the cost of the imported goods. We assume that the samples are not supplied at a reduced cost.

The definition of the term "assists" in section 402(h)(1)(A) of the TAA specifies those items or services which are treated as assists when supplied directly or indirectly, free of charge or at a reduced cost, by the buyer for use in connection with the production or the sale for export to the United States of imported merchandise. Assists include: engineering, development, artwork,

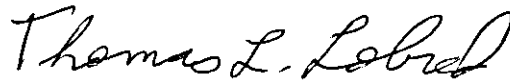
design work, plans, and sketches undertaken elsewhere than in the U.S. that are necessary for the production of the imported merchandise. 19 U.S.C. § 1401a(h)(1)(A).

We conclude that the samples in question do not constitute assists because as you state in your submission, the seller pays the licensor for the samples of the merchandise and their cost is presumably included in the price that the seller charges the buyer for the merchandise. Thus, it appears that the samples are not supplied directly or indirectly and free of charge or at a reduced cost by the buyer required by 402(h)(1)(A) of the TAA. Accordingly, the samples supplied to the seller do not constitute additions to the price actually paid or payable as assists.

**HOLDING:**

Pursuant to the foregoing, and assuming that transaction value is the appropriate method of appraisal, license fees paid by the buyer to the licensor for use of a trademark on the imported merchandise purchased from the seller, a party related to the licensor, are additions to the price actually paid or payable of the imported licensed product as royalties under section 402(b)(1)(D) of TAA. Based on the information provided, it appears that the value of samples supplied to the seller by the licensor do not constitute an addition to the price paid or payable of the imported merchandise as assists.

Sincerely,



Acting Director  
International Trade Compliance Division