HQ H077419

April 05, 2011

OT:RR:CTF:VS H077419 YAG

CATEGORY: Valuation

Mr. George R. Tuttle, III
Law Office of George R. Tuttle, P.C.
One Embarcadero Center, Suite 730
San Francisco, California 94111-4044

RE: Dutiability of Royalty Payments

Dear Mr. Tuttle:

This is in response to your submission, dated September 16, 2009, concerning HRL H047360, dated July 31, 2009, on behalf of your client, The Sports Authority Corporate Services, Inc. ("TSA," the Importer). This office has also received and considered your supplemental submission, dated January 26, 2010 and the Footwear Distributors and Retailers of America's ("FDRA") submission, dated September 24, 2009.

You have asked that certain information submitted in connection with this request for reconsideration be treated as confidential. Inasmuch as your request conforms to the requirements of 19 CFR 177.2(b)(7), your request for confidentiality is approved. The information concerning the names of the parties, other than TSA and all attachments to your submission, forwarded to our office, will not be released to the public and will be withheld from published versions of this ruling.

FACTS:

HRL H047360 concerns importations of fitness, outdoor, and sporting goods including

equipment, apparel, and footwear. As described in HRL H047360, Licensor owns a trademark in the United States. It has licensed the trademark for certain footwear product lines to Licensee, located in St. Louis, Missouri, who in turn, authorized another company, TSA, a U.S. importer, and its agents to import footwear into the United States that contains the trademark. This was authorized per a "Vendor Agreement" letter, dated May 30, 2007, a copy of which was provided for our review in HRL H047360. This letter was on letterhead referencing the trademark at issue and addressed to TSA, authorizing TSA to use the trademark, as licensed by the Licensee, located in Missouri. The letter was signed by a Vice-President of the Licensee in Missouri. In consideration of the rights granted to TSA by Licensee under the above-mentioned letter, TSA pays Licensee a royalty to use the licensed trademark. Under this arrangement, the letter states that TSA pays Licensee a royalty fee of 7% of the F.O.B./commercial invoice value based on the quantity of footwear exported from the factory to TSA that bear the subject trademark. The letter also states that Licensee, in turn, pays the royalty to the true license holder of the mark, Licensor. Further, the letter provides that the royalty fee of 7% is not billed or paid on the TSA commercial invoice, but on a separate invoice. Finally, the letter states that the authorization is given pursuant to the terms and conditions of the Vendor Agreement, entered into between the Licensee and TSA. A separate Vendor Agreement was submitted for review under HRL H047360. However, apart from the "Vendor Agreement" letter, no License Agreement between TSA and the Licensee was submitted for our consideration.

In consideration of H047360, upon our request, you furnished a letter from Licensor, dated June 18, 2009, confirming the existence of a license agreement granted, whereby Licensor authorizes Licensee to manufacture, design and sell pre-approved licensed footwear in the United States. In addition, for our review in HRL H047360, a separate buying agency agreement between TSA and the Licensee was provided. In HRL H047360, this office emphasized that the Licensing Agreement does not involve a patent related to the process or method by which the footwear is manufactured, and that the fee is not paid for the rights associated with the process to manufacture the imported footwear. However, based on the facts and supporting documentation, as presented in HRL H047360, CBP concluded that the payment of the royalty was made by the buyer as a condition of the sale of the merchandise for exportation to the United States.

You have now submitted a revised Trademark Licensing Agreement (the "Licensing Agreement"), effective December of 2009 (five months after our decision in H047360) and executed by TSA and the Licensee. Under this Licensing Agreement, the royalty is paid by the Importer (TSA) to a Licensee of the trademark owner for the right to sell footwear in the United States, bearing a trademark owned by the Licensor. As referenced previously, the royalty fee is calculated as a percentage of the Importer's purchase price. Additionally, under the Licensing Agreement, the royalty is paid by TSA to a Licensee of the trademark owner for the right to design, manufacture, advertise, promote, distribute, and sell through its affiliates, the merchandise bearing the trademark in the United States. TSA has the right to select third-party vendors and factories to manufacture the merchandise bearing the trademark; however, TSA may

select vendors and manufacturers recommended by a Licensee of the trademark owner. Under the Licensing Agreement, the royalty is billed separately from any invoice from a factory or supplier for goods purchased by TSA bearing the licensed trademark, and TSA pays the royalty directly to the Licensee of the ultimate Licensor.

Pursuant to your submission, the ultimate trademark owner is not related to the Importer, the seller, or the manufacturer of the imported merchandise. The Licensee and the Importer (TSA) are also not related to the seller or the manufacturer. Therefore, the royalty is paid to a third party licensor, unrelated to the seller. Further, you state that neither the seller nor the manufacturer of the merchandise receives a benefit from the Importer's payment of royalties to the license.

ISSUE:

Whether the royalty payments under consideration constitute an addition to the price actually paid or payable for the imported merchandise under 19 U.S.C. 1401a(b)(1)(D).

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"), codified at 19 U.S.C. 1401a. The preferred basis of appraisement under the TAA is transaction value, defined in Section 1401a(b)(1), as the "price actually paid or payable for the merchandise when sold for exportation to the United States" plus amounts for enumerated statutory additions to the extent not otherwise included in the price actually paid or payable. The additions include "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." 19 U.S.C. 1401a(b)(1)(D).

As a general matter, we note that royalty payments may be included in transaction value as part of the price actually paid or payable or as an addition thereto. *See*, *e.g.*, General Notice, "Dutiability of Royalty Payments," Vol. 27, No. 6 Cust. B. & Dec. at 1 (February 10, 1993); H.R. Rep. No. 317, 96th Cong., 1st. Sess., at 80 (1979). In the particular circumstances of this case, however, inasmuch as the royalty is not paid to the seller or a party related to the seller and no subsequent proceeds accrue directly or indirectly to the seller, our analysis is confined to whether the royalty payments are included in transaction value as an addition to the price actually paid or payable under 19 U.S.C. 1401a(b)(1)(D).

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With respect to the dutiability of royalty payments and license fees, the Statement of Administrative Action to the TAA provides, in pertinent part, that:

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 the 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, whereas royalties and license fees paid to third parties for use, in the United States, of copyrights and trademarks related to 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 the sale of the merchandise for exportation to the United States, an addition will be made. As a further example, an addition will be made for any royalty or license fee paid by the buyer to the seller, unless the buyer can establish that such payment is distinct from the price actually paid or payable for the imported merchandise, and was not a condition of the sale of the imported merchandise for exportation to the United States.

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

In the General Notice, "Dutiability of Royalty Payments," Vol. 27, No. 6 Cust. B. & Dec. at 1 (February 10, 1993), CBP articulated three factors or questions that assist in determining whether the royalty payments in question are related to the imported merchandise and are a condition of sale such that they are included in transaction value as an addition to the price actually paid or payable under 19 U.S.C. 1401a(b)(1). As set forth in the notice, the questions are:

1Was the imported merchandise manufactured under patent?

2Was the royalty involved in the production or sale of the imported merchandise?

3Could the importer buy the product without paying the fee?

The General Notice indicates that affirmative answers or responses to the first and second questions, and a negative response to the third, point towards dutiability.

In this case, based on the information provided in H047360, we concluded that the answer to the first question is no. The License Agreement specifically refers to the use of trademarks. Furthermore, with respect to the second question, we stated that because the royalty is paid to a third party, who is unrelated to the seller of the merchandise, the royalty is not involved in the production or sale of the imported merchandise. However, the issue here is the response to the third question of whether the trademark royalty which is based on the purchase price, as stated in the License Agreement, conveys the right to export the merchandise to the United States.

Thus, the answer to the third question goes to the heart of whether a payment is considered a condition of sale. *See* General Notice, "Dutiability of Royalty Payments," supra, at 11. Royalty payments and license fees are a condition of sale when they are paid on each and every importation and are inextricably intertwined with the imported merchandise. If the payments are optional and not inextricably intertwined with the imported merchandise, or are paid solely for the exclusive right to manufacture and sell in a designated area, they do not constitute additions to the price actually paid or payable under 19 U.S.C. 1401a(b)(1)(D). *See* HRL 546675 , dated June 23, 1999.

Please note that in order to obtain a ruling with respect to the dutiability of royalty or license fees, copies of any royalty agreements relating to the payment of the royalty or license fees in question and any purchase or supply agreements relating to the sale of the imported merchandise for exportation to the United States must be submitted to CBP with the request. If there are no such written agreements, this must be indicated in the ruling request. *See* General Notice, "Notice to Require Submission of Royalty and Purchase Supply Agreements in Ruling Requests Regarding Dutiability of Royalty or License Fees," Vol. 29, No. 36, Cust. B. & Dec. at 10 (September 6, 1995). *See also* 19 CFR 177.2(b). CBP's determination in HRL H047360 was made after a review of the "Vendor Agreement" letter, dated May 30, 2007, which was addressed to but not executed by TSA, and issued on behalf of the Licensee in Missouri. In the absence of the valid Licensing Agreement and given the fact that the "Vendor Agreement" letter referred to the Vendor Agreement between TSA and the Licensee, effectively making the Licensee a vendor in this transaction, the royalty payments were deemed to be a condition of sale, and, therefore, dutiable.

Specifically, in HRL H047360, it was noted that royalty payments and license fees are a condition of sale when they are paid on each and every importation and are inextricably intertwined with the imported merchandise. CBP concluded that because the royalty payment

was based on the quantity of footwear exported from the factory to TSA, even though the seller of footwear was unrelated to the license holder, payment of royalty conveyed the right to export the merchandise to the United States. In your submission, you claim that HRL H047360 did not apply the proper test to determine whether the royalty payment was a condition of sale because the issue is not the method of calculating the royalty, but whether the payment of the fee is inextricably intertwined with sale for exportation to the United States of the imported merchandise.

CBP in Hasbro II determined that the method of calculating the royalty, e.g., on the resale price of the goods, was not relevant to determining the dutiability of royalty payment. *See* General Notice, "Dutiability of Royalty Payments," *supra*, at 13. In light of this principle, CBP historically has ruled that a trademark royalty or license fee, regardless of the method of calculating the royalty, be it on the purchase price or net sales of the imported merchandise, is not dutiable. *See* HRL 545612 , dated May 25, 1995 (CBP found that royalty and license fees based on the purchase price and paid to unrelated third parties were not dutiable); HRL 545784 , dated June 6, 1995 (the imported product was a patented Net Making Machine which the importer purchased from its related parent. For the manufacturing know-how relating to the machine, the importer was to pay the seller royalties on all products manufactured using the imported machine. The supply agreement indicated that the importer shall not resell the machine because it includes the production know-how which is owned by the seller. In concluding that the sale of the machine to the importer is inextricably intertwined with the payment of the royalties and that in order to purchase and use this patented machine, the importer must pay the seller the royalties in question, CBP determined that the royalty fee based on a percentage of the sales price was not relevant).

Nevertheless, please note that in certain circumstances, CBP previously found that license fees paid by importers on the basis of the importer's purchase price for the imported merchandise, are relevant to the analysis of whether the royalty payments and licensee fees are inextricably intertwined with the imported merchandise. In HRL 545194 , dated September 13, 1995, the license fees were paid by the importer to the licensees (not the licensor), which were related to the sellers of the imported merchandise. The sellers' invoices specifically referred to the fact that license fees were to be paid by the importer, and the agreements entered into by the importer involving the licenses fees made no mention of the fact that such fees were paid to the licensor of the imported merchandise. Based on the information presented, CBP concluded that the license fees were actually part of the total payment for the imported merchandise because these fees were paid to a party related to the seller. *See also* HRL 547623 , dated February 21, 2000. Additionally, in HRL 546513 , dated February 11, 1998, in order to determine that the license fees were inextricably intertwined with the sale for exportation of the imported footwear, CBP considered the fact that the amount of the continuing royalties was based on a specified percentage of the invoiced price (less certain deductions) to the importer/buyers, and that the license agreements also contained provisions regarding the manufacture and sale of the licensed

products. In HRL 546513 , on each and every sale of imported product between the seller and the importer/buyers, the seller's related party was obliged to pay a license fee to the licensors, and such amount was actually paid by the importer/buyers to the licensors through the trust. So, the method of calculating the royalty might be relevant in determining whether the royalty or license fees are inextricably intertwined with the imported merchandise in certain circumstances, as specified in HRL 545194 and HRL 546513 . However, this is not the case here.

You have now submitted a revised Licensing Agreement effective December of 2009 and executed by TSA and the Licensee. This Licensing Agreement contains new information, which was not previously considered by this office in HRL H047360. According to your submission, the royalty is paid to the unrelated third party licensor, and is separate from the payments made to the foreign manufacturers. Additionally, all parties to this transaction are unrelated. We recognize the fact that the royalty payments made to an unrelated third party is not entirely determinative because the SAA provides that a royalty payment made by a buyer as a condition of the sale of the merchandise for exportation to the United States will be added to the price actually paid or payable. *See* HRL H004991, dated April 2, 2007. However, as indicated in our numerous rulings, the relationship of the parties, although not entirely determinative, is an important factor to consider in analyzing the transactions. *See* HRL 545361 , dated July 20, 1995; HRL 548552 , dated May 25, 2006.

Based on the new information submitted, we do not see anything in the License Agreement that obliges TSA to pay any license fees for merely purchasing the licensed products abroad and importing them into the United States. *See* HRL 547226 , dated July 27, 1999. Moreover, there is no evidence to suggest that the royalty is linked to the purchase order, the invoice, or the shipping documents for the imported merchandise. Also, the License Agreement does not provide for the sale of the imported merchandise. *See* HRL 545379 , dated July 7, 1995; HRL 546229 , dated May 31, 1996. Further, TSA clearly has the right to select its own suppliers without Licensor's or Licensee's approval. Accordingly, we find that in this situation, regardless of the method of calculating royalty payments, royalty fees are paid for the use of the trademark in the United States and are not a condition of sale of the imported merchandise.

HOLDING:

Based upon the information provided, we find that the royalty and license fees paid by Licensee to a third-party unrelated Licensor pursuant to the above-referenced License Agreement are not a condition of sale of the imported merchandise for export to the United States and do not constitute an addition to the price actually paid or payable for the imported merchandise under 19 U.S.C. 1401a(b)(1)(D).

A copy of this ruling letter should be attached to the entry documents filed at the time

this merchandise is entered. If the documents are filed without a copy, this ruling should be brought to the attention of the CBP officer handling the transaction.

Sincerely,

Monika R. Brenner, Chief

Valuation and Special Programs Branch