

**PRETEXT**  
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## **Changes to the dutiable treatment of royalties**

Further to Pretext 30/2007 of 20 April, the World Customs Organisation (WCO) Technical Committee on Customs Valuation met earlier this week. One of the agenda items was to discuss the wording of some case studies relating to the dutiable treatment of royalties.

After two and a half days of intense discussion, agreement on a number of principles was reached, but the texts of the case studies have been sent back to the WCO Secretariat for further revision to be finalised by the Committee at its next meeting in April 2008.

However, our understanding is that several member countries, who have now spent quite a bit of time discussing these issues, will apply the principles of the case studies without waiting for their formal publication. This will mean that, in many cases, trademark royalties that were previously not regarded as dutiable will become so. The European Commission, for example, has published a commentary, which very much relies on the text of the case studies and this is likely to lead to stricter interpretation of the royalty provisions in a number of member states, including the UK. Other jurisdictions, such as Thailand, have already implemented new provisions based on the case studies and have even issued assessments for under-declared duty on royalties.

We strongly recommend that anyone charging and/or paying trademark royalties should review their agreements to see whether the dutiable position is correct in all the countries into which goods are imported. Where trademark royalties that have previously not been regarded as dutiable become so as a result of this new interpretation, it is possible that elements of the royalty payment can be excluded from the value for duty.

I attach a final draft of a bulletin that will be sent to our clients tomorrow on this issue but I would, of course, be happy to discuss this in more detail with anyone who thinks their company may be affected

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## Change in treatment of trademark royalties

In a move that could cost importers of certain branded products millions of pounds in extra customs duty, the World Customs Organisation (WCO) this week discussed revised interpretation of the underlying legislation that will almost certainly result in the majority of trademark royalties becoming liable to customs duty as part of the cost of the imported product. This is coupled with new guidance issued by the European Commission on the same topic.

Trademark royalties are not generally included in the value for customs duty at importation, as the payment is distinct from the price paid for the imported goods.

However, the correct interpretation of the dutiable treatment of trademark royalty/licence payments has been one of the most contentious items raised in the WCO Technical Committee on Customs Valuation: two years ago it set up a sub-committee to establish a comprehensive set of case studies that would confirm the treatment of these payments.

### WCO decision

At the October 2007 WCO meeting, two key case studies were considered over three days, one from Japan and one from Canada. It was agreed that trademark royalties paid to a licence holder unrelated to the manufacturer of the goods could still be dutiable where the customs authority deemed that there was an element of control exercised by the licence holder over the manufacturer. This position is expected to be formally documented at the next meeting of the committee in April 2008. However, it is clear that, following the current discussions, the member country customs representatives attending have now developed sufficient understanding of the subject to begin challenging existing positions.

### European Commission decision

Earlier this year, the European Commission's valuation committee issued Commentary No.11, which incorporates many of the points raised in the WCO case studies. This new guidance is likely to significantly enhance EU customs

authorities' ability to challenge the dutiable treatment of companies' royalties

### Key implications

As a consequence, the bulk of trademark royalties are likely to be deemed dutiable as part of the customs value of the imported goods, regardless of when and to whom the royalty is paid. Customs authorities are already using the case studies to raise assessments against affected businesses.

For affected businesses it will mean significant annual duty increases amounting, in some cases, to tens of millions of pounds globally. But that is not all. Import VAT will also increase, guarantee levels may need to be increased and the amount of indirect tax where goods are held in duty suspension regimes will increase. It is also possible that customs authorities may seek to apply this guidance retrospectively, which could have additional significant cost implications for companies affected.

However, there may be opportunities to mitigate the effect.

### What should you do now?

Businesses most likely to be affected are those that have a global brand that is incorporated in a finished product. Companies with trademarks in consumer goods and industrial products are amongst those most likely to be affected in the EU. Other sectors that will not face this issue in the EU, but will potentially do so in other regions, include aviation, pharmaceuticals, IT and mobile phone companies.

The delay in the WCO issuing formal guidance on this subject gives companies

scope to review their current contractual arrangements and procedures to determine whether they are likely to be affected by these changes. There are means to reduce the impact going forward, but these will require careful consideration from a customs and tax point of view.

### Further issues to consider

This is not an issue limited to the European Union (EU). It is a global issue requiring a global solution, and will affect businesses that trade both within and outside the EU. A key issue will be the time that WCO members take to finalise and act on this guidance, and also the extent to which companies are willing to challenge any unfavourable rulings through legal proceedings.

### Contacts

For further information on the implications of this development for your business, please speak to your usual PwC advisor, or to one of the people named below.

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