

## **Advisory Opinion 4.17**

### **Royalties and licence fees under Article 8.1 (c) of the Agreement**

1. Company A (importer, buyer and franchisee) in country I entered into a franchise agreement with company B (exporter, seller, franchisor) of country E to operate stores under the brands of the Franchisor in country I. Under the franchise agreement, company A may buy only from company B, or from those authorized by company B, the inputs it must use in order to manufacture in country I the products which company A sells in its stores. The inputs are unpatented and are not protected by any intellectual property rights. In addition, company A may purchase the inputs from third party suppliers selling at lower prices, where duly authorized by company B to meet the quality requirements. As a condition of the franchise agreement, company A pays company B for the use of the brands and system, royalties which are calculated as a percentage of company A's gross sales of final products manufactured using inputs imported by company A.

In this case, when the imported inputs are not protected by patent or by any intellectual property rights as mentioned above, 'brands' means the registered brands or service marks and other commercial symbols in the operation of the stores. 'System' refers to business systems and processes connected to the operation of the stores.

The issue is whether the royalties paid under the franchise agreement are to be added to the price actually paid or payable under Article 8.1(c) of the Agreement for the imported goods.

2. The Technical Committee on Customs Valuation expressed the following view :

In the determination of the Customs value under the provisions of Article 1 of the Agreement, there shall be added to the price actually paid or payable for the imported goods royalties and licence fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a condition of sale of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable, as provided in Article 8.1(c) of the Agreement.

In this case, the imported goods (inputs) being valued, though necessary and essential to the manufacture of the products and required to be purchased from the franchisor or from a third party authorized by the franchisor to meet the quality requirements, are not branded goods nor are they patented, or manufactured under a patented process, for which a payment is made.

The payment of royalties is not related to the imported goods but is related to the use of the brands and system of the franchisor in the manufacture and sale of the products bearing the intellectual property (brand) of the franchisor.

The royalties paid by the franchisee are not to be added to the price actually paid or payable for the imported goods under the provisions of Article 8.1(c).