New customs valuation on goods imported under franchise agreements

By Virusha Subban, Lee-Ann Annandale and Busisiwe Vil

24 Jul 2017

Importers in South Africa should be aware of the new customs valuation development affecting goods imported under franchise agreements, as this could affect the price they pay for the goods.

The World Trade Organisation (WTO) has issued an advisory opinion relating to the Customs Valuation Agreement and this is binding on all members, including SARS. The advisory opinion deals specifically with franchise agreements that involve imported goods, which are neither patented nor protected by any intellectual property rights.

When to add royalties and licence fees to the price

Customs valuation is one of the core tools for facilitating trade while securing revenue for SARS. In an attempt to create a uniform system for the valuation of imported goods for customs purposes, the WTO Customs Valuation Agreement was created. It provides that the customs value of the imported goods is the price actually paid or payable for the goods when sold for export to the country of importation.

This is where royalties and licence fees come in. If the franchise agreement requires the buyer to pay licence fees or royalties on the imported goods as a condition of sale, these must be added to the price actually paid or payable for the goods being valued. That is provided for in article 8 of the WTO's Customs Valuation Agreement and section 67 of South Africa's Customs and Excise Act, 1964.

The royalties and licence fees may include payments in respect of patents, trademarks and copyrights, among other things. It is important to note that payments the buyer makes for the right to distribute or resell the imported goods shall not be added to the price actually paid or payable unless such payments are a condition of the sale.

The key is to determine whether a royalty or licence fee is related to the goods being valued. For this purpose, Commentary 25.1 to Article 8.1(c) of the Customs Valuation Agreement applies. It provides that royalties or licence fees may commonly be considered to relate to the goods being valued where the goods incorporate the intellectual property and/or are manufactured using intellectual property covered by the licence. Going further, the Commentary explains that, in determining whether the buyer must pay the royalty as a condition of the sale, it must be confirmed that the buyer is otherwise unable to purchase the imported goods.

Position with unpatented inputs

Now light has been shed on royalties paid, under a franchise agreement, in which the imported goods (inputs) are unpatented and not protected by any intellectual property rights. The WTO's recently released advisory opinion 4.17 focuses on whether royalties paid under a franchise agreement are to be added to the price actually paid or payable.

The advisory opinion deals specifically with inputs considered necessary and essential to the manufacture of the final products (by the franchisee). In terms of the franchise agreement, these goods can only be purchased from the franchisor or from a third party authorised by the franchisor to meet the quality requirements.

The opinion concludes that the royalties paid by the franchisee are not to be added to the price actually paid or payable for these imported goods. It explains that where the imported goods being valued are not branded, patented or manufactured under a patented process for which payment is made, the payment of royalties cannot be said to relate to the imported goods, and thus cannot be included in the price actually paid or payable.

Status of the advisory opinion

Although advisory opinions are subject to approval by the World Customs Organisation Council, they are regularly cited by customs authorities worldwide and serve as guidelines to the trading countries that are subject to the Valuation Agreement.

In South Africa, the Customs and Excise Act, 1964 provides that the WTO's Customs Valuation Agreement and advisory opinions apply when interpreting the following:

1. Value for duty purposes on any goods imported into the Republic;
2. The transaction value of these goods; and
3. Adjustments to the price actually paid or payable.

The Act does not specify whether such interpretations will be subject to the advisory opinions only once the Council approves these. However, the persuasive nature of the advisory opinions, even before the Council approves them, are indicative of their impact on all members of the Agreement including South Africa.

Importantly, the impending Customs Duty Act, 2014 specifically provides that advisory opinions will be binding on the valuation of any goods imported into the Republic.

In effect, the new advisory opinion can be said to be binding on SARS, therefore requiring importers in South Africa to take note when importing under a franchise agreement.

ABOUT THE AUTHOR

Virusha Subban is a partner, Lee-Ann Annandale, an associate, and Busisiwe Vilakazi, a candidate attorney, at Bowmans.