HQ H233376

September 19, 2016

OT:RR:CTF:VS H233376 CMR

CATEGORY: Valuation

Area Port Director
U.S. Customs and Border Protection
101 E. Main Street
Norfolk, VA 23510

RE: Internal Advice Request for Dutiability of Patent Royalty Fees

Dear Mr. Laria:

This is in response to your memorandum of September 7, 2012, forwarding a request for internal advice regarding the dutiability of certain royalty fees for the right to use licensed patented technology related to certain merchandise imported by the company [the importer]. A Focused Assessment audit of [X], *i.e.,* the parent of the company, conducted by the Office of Regulatory Audit found certain undeclared royalty fees. Counsel for the company submitted a request for internal advice on June 15, 2012 to the Port Director in Kansas City, Missouri, which you forwarded to this office.

The Focused Assessment audit included all of the divisions of the parent. The internal advice request submitted by counsel on behalf of the company addressed only one licensing agreement. However, the Assessment Compliance Testing Report, dated March 19, 2012, indicated that Regulatory Audit found there were royalty payments made under seven (7) licensing agreements. Regulatory Audit considered all of the royalty payments to be dutiable. This office has not received further information regarding the additional licensing agreements and therefore, we will only address the dutiability of the royalty payments under the licensing agreement for which the company sought internal advice.

FACTS:

The merchandise at issue is imported by the company, a division, or subsidiary, of its parent. However, the royalty payments at issue are made to the licensor, [Company A] (a U.S. patent holder who is not related to the company or to the manufacturer of the imported merchandise), by [Company B], the parent of the company's parent. Your port and the Office of Regulatory Audit believe that the royalty payments are proper additions to the price actually paid or payable for the merchandise, *i.e.*, the invoice price, as a condition of sale. However, the company believes that the royalty fees are not dutiable.

The company contracts with an unrelated Malaysian manufacturer to produce merchandise for importation into the United States. The company pays the manufacturer and seller of the merchandise the invoice price for the imported merchandise and declares that value as the dutiable value of the goods. The company also pays an unrelated U.S. licensor [Company A] royalty fees which become due and payable upon the company's sale of the merchandise to an unrelated party in the United States after importation. We note that although the "Licensed Territory" is defined in the licensing agreement as: ". . .mean[ing] the world" and therefore, the royalty fees become due and payable based on worldwide sales to third parties, we are only concerned with the portion of the royalty payments attributable to sales of the Licensed devices imported into the U.S. In addition, Counsel's June 15, 2012, submission informs us that:

> The patents on which the royalties are paid are covered by USPTO [U.S. Patent and Trademark Office] and foreign registrations. However, the work embodied in the patents was undertaken in the United States, and the United States registrations were first in time.

Counsel submits that the proper licensing agreement for consideration is the agreement between the U.S. licensor and the company, as successor in interest,[1] dated January 2, 2004, and its amendments. We note that, as with the licensing agreement, a manufacturing agreement was originally concluded between the predecessor [Company C], of which the company is the successor in interest, and the Malaysian manufacturer.[2]

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[1] We note that the company purchased [Company C], and became its successor in interest with regard to the licensing agreement. Further, the licensing agreement provided by counsel has redactions throughout it. This office was informed the importer is unable to provide an unredacted copy of the agreement as it does not have one.

[2] With regard to the licensing agreement, we first note that there was initial confusion as to which licensing agreement was at issue since there were two licensing agreements involving this licensor. The port and the Office of Regulatory Audit referred a licensing agreement to this office for consideration between the licensor and the parent [X] (doing business as [Y)], dated September 5, 2008, as it was the agreement provided to the Customs and Border Protection (CBP) audit team by the company. However, counsel for

Relevant provisions from the 2004 licensing agreement, as amended, between the company and the U.S. licensor were submitted for our review and include a definition of the "licensed device," along with a list of patent numbers. We note that all of the patents are utility patents. The licensing agreement specifies that the licensed patents include patents filed in other countries which correspond to the enumerated patents and are owned or controlled by the licensor. In addition, the agreement also defines the "licensed process," "licensed information," and "confidential information."

The Licensing Agreement provides, with regard to the grant of the license to the company, in relevant part:

> (a) Licensor hereby grants to Licensee an exclusive license for the Licensed Device in the Licensed Field, with right to sublicense upon written permission from the Licensor that will not be unreasonably withheld, under the Licensed Patents and the Licensed Information to practice Licensed Processes and **to make, have made, use, sell, offer for sale and import Licensed Devices** in the Licensed Territory, but not otherwise. . . .
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> (b) In accordance with the Development Agreement, and the parties' Confidentiality Agreement dated September 26, 2003, Licensor shall continue to deliver to Licensee such Licensed Information which, in the opinion of Licensor, is useful in the manufacture, use or sale of Licensed Devices in the Licensed Field. Such Licensed Information shall be manifested in documents, prototypes, computer-based data and other tangible materials to the extent possible, or, where not susceptible to such transfer, shall be disclosed orally or by demonstration at Licensor's facilities.

* * * *

Bold added.

The manufacturing agreement, at paragraph 2.1, requires the company to:

> (a) disclose to the Manufacturer such of the [company's] Technology as is necessary to enable the Manufacturer to manufacture the Products in accordance with the Specifications;
> (b) supply the Manufacturer with the Equipment for use at the Manufacturer's premises; and

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the company informed this office via email, dated October 20, 2014, that no products covered by this 2008 agreement were ever imported into the United States because these products never reached the production and importation stage.

(c) supply components and subassemblies not included in the scope of work provided by the Manufacturer.

Further, with regard to intellectual property, the manufacturing agreement, at paragraph 5.1, provides:

> The [company] authorises the Manufacturer:
>
> (a) to use the Technology disclosed pursuant to clause 2.1 and any Intellectual Property of the [company] in respect of the Technology; and
>
> (b) to apply the Trade Marks to the Products,
>
> for the sole purpose of exercising its rights and performing its obligations under this Agreement.

Based on our understanding of the definition of "Licensed Device," from the licensing agreement, the contract between the company and the manufacturer is for the production of licensed devices which are the imported goods at issue.

ISSUE:

Whether the royalty fees the company pays to an unrelated patent holder in the U.S. for use of patents in the production of the imported good are an addition to the price actually paid or payable under 19 U.S.C. § 1401a(b)(1).

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 method of appraisement under the TAA is transaction value, defined as "the price actually paid or payable for the merchandise when sold for exportation to the United States," plus certain enumerated additions, including "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). This addition applies only if it is not already included in the price actually paid or payable. For purposes of this decision, we assume that transaction value is the appropriate method of appraisement.

The imported merchandise at issue, and not a component of the imported merchandise, falls within the definition of "Licensed Device." The company paid the licensor for the right to make, have made, use, sell, offer for sale and import licensed devices in the licensed territory, in other words, in the world. The Licensing Agreement allowed the company to use the patents held by the licensor to make the licensed device.

The manufacturing agreement provides for the disclosure of the licensed intellectual property from the company to the manufacturer in order to produce the imported goods at paragraph 2.1(a). Paragraphs 2.1(b) and 2.1(c) provide for assists from the company to the manufacturer in the form of equipment, components and subassemblies not included in the scope of work to be performed by the manufacturer.

Based on the language of the statute, and considering the terms of the licensing agreement and the manufacturing agreement, the license fee is related to the imported merchandise because it could not have been manufactured or imported without first obtaining the rights conferred under the Licensing Agreement for the patent. In addition, the company is required to pay the licensor directly for these rights under the Licensing Agreement. The only remaining element of the statutory language to answer is whether the royalty payments are a condition of the sale of the imported merchandise for exportation to the U.S.

In 1993, the U.S. Customs Service (now, U.S. Customs and Border Protection (CBP) established a three-part test for determining the dutiability of royalty payments in the *General Notice, Dutiability of Royalty Payments,* Vol. 27, No. 6 Cust. B. & Dec. at 1 (February 10, 1993) ("Hasbro II ruling"). The formulation of the test was based upon a review of court cases under the valuation law prior to the TAA and the factors the courts used in determining whether a royalty was dutiable. The legislative history of the Trade Agreements Act of 1979 in the *General Notice, supra,* was discussed and the House and Senate Reports were cited for their language regarding the treatment of royalties. In House Report No. 317, 96th Congress, 1st Session (1979), at 80, the Ways and Means Committee report states, in relevant part:

> Since transactions involving royalties, license fees, patents, and copyrights are complex business arrangements tailored to cover a specific set of conditions, each case must be carefully examined before the U.S. Customs Service can reach a final decision.
>
> **The existing treatment under law of royalties for customs purposes is intended to continue under the operation and administration of section 402(b)(1).** Therefore, certain elements called "royalties" may fall within the scope of the language under either new section 402(b)(1)(D) or 402(b)(1)(E) or

> both. Similarly, some elements called "royalties" may not be dutiable under either 402(b)(1)(D) or 402(b)(1)(E). [Emphasis added.]

See also Senate Report No. 249, 96th Congress, 1st Session (1979), at 120, which also stated that:

> . . . the provisions for additions for certain royalties and license fees and for the proceeds accruing to the seller of any subsequent resale, disposal or use of the imported merchandise generally would follow current practice. Customs Service officials will make a decision as to whether an addition will be made on a case-by-case basis.

Based on the language in both reports, Congress expressed its intent that the existing treatment under the law, at the time the Trade Agreements Act of 1979 was enacted, was to continue with respect to the dutiability of royalties. In the *General Notice*, Customs acknowledged this and formulated a test consisting of three questions: (1) was the imported merchandise manufactured under 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? Under the three-part test, affirmative responses to factors one and two and a negative response to factor three would indicate that the payments were a condition of sale and, therefore, dutiable as royalty payments. In this case, the answers to the three-part test are, in brief, yes – the merchandise was manufactured under a patent; yes – the royalty was involved in the production or sale of the imported merchandise; and, no – the company could not buy the merchandise without paying the fee. Accordingly, based on the responses to these questions, the royalty should be added to the price actually paid or payable. Nonetheless, counsel for the company argues against the dutiability of the royalty payments.

Decisions under the pre-1979 valuation law support the view that a royalty paid for a patent necessary to produce the imported good is a dutiable element of transaction value. In the *General Notice, supra*, three court decisions issued prior to the TAA were discussed in which the dutiability of royalties under export value were at issue. Although these three discussed cases, *U.S. v. Rohner Gehrig & Co., Inc.*, 9 Cust. Ct. 591, R.D. 5724; *United States v. Imperial Products, Inc.*, 65 CCPA 38, C.A.D. 1203, 570 F.2d 337 (1978); and *BBP Prestressed Tanks, Inc. v. United States*, 64 Cust. Ct. 787 (1970); are not analogous to the situation here, in Treasury Decision (T.D.) 76-133(1), dated May 4, 1976, Customs addressed the dutiability "of certain royalties paid by the importer, an American company, to the United States owner of patents on certain automobile equipment." In discussing the royalty payment for the right to use the patent in the production of the imported merchandise, the decision states:

> It is the position of the Customs Service that the royalties are properly included in dutiable value. The royalty payment is for the right to use the patented process which, in turn, is an integral part of the assembly of the merchandise. Without a license to use the patented process, the process could not be used. Therefore, since the royalty is a necessary cost of assembly, it is properly a part of constructed value. The mere deferral of payment of the royalty until sale of the automobile parts in the United States does not change the fact that the payment is a necessary expense in the production of the finished products. . . .
>
> . . . . The courts have consistently ruled that it is immaterial who bears the actual cost of the royalty. In this regards, see *Ford Motor Company v. United States*, A.R.D. 9 (1952), wherein the court said that the purpose of the cost of production statute is to "derive not the manufacturer's actual cost, but the actual cost of manufacture." The case of *Goodrich-Gulf Chemicals Inc. v. United States*, R.D. 11733, (1971), applied the same principle to the constructed value basis of appraisement.

By contrast, in C.S.D. 79-166 (HQ 055232), dated October 5, 1978, in holding that a royalty paid for the right to use a patented machine exclusively in a designated area was not part of the dutiable value of the machine purchased by the importer, Customs stated:

> The license agreement confers on the buyer of the equipment a specific, "exclusive" right of use that is not normally considered an incident of ownership. This right is the "exclusive" right to use the purchased machine within a certain area for a definite period of time. Although the sale and the license agreement may be inseparable in the sense that neither would exist without the other, the royalty is not part of the sale or offering price or cost of production of the imported merchandise. Accordingly, it is not part of dutiable value, regardless of the statutory basis for valuation which the appraising office applies to this case.

We can infer from the language cited from C.S.D. 79-166 that a royalty related to the production of a good is dutiable. This inference is in accord with the SAA's statement regarding royalties for patents, *i.e.*, ". . . royalties and license fees for patents covering processes to manufacture the imported merchandise will generally be dutiable[.]"

Counsel for the company argues that a royalty or license fee paid to a third party cannot be dutiable because it is not a payment to, or for the benefit of, the seller of the merchandise. However, the language of the statute does not impose that requirement with regard to royalty payments. The statute requires royalty payments be related to the imported merchandise and requires they be payments that the buyer must make, directly or indirectly, as a condition of the sale of the merchandise. In Headquarters Ruling Letter (HQ) H168397, dated February 14, 2012, CBP examined the dutiability of a royalty payment paid by an importer to a U.S. patent holder for the right to use his intellectual property to produce inflatable mattresses in China. The ruling is directly on point to the case herein as it involved a patent from a U.S. patent holder, secured by the importer and provided by the importer to the manufacturer of the merchandise to be imported. In HQ H168397, we stated, in part, ". . . in regard to patents, the framers of the TAA recognized that royalties paid to unrelated third parties could constitute a condition of the sale and, hence be dutiable. . . So, in considering royalties paid for the use of a patent covering manufacturing processes, it is of little to no relevance to whom the payments are made; what is relevant is whether the royalty is involved in the production or sale of the imported merchandise. *See* HQ H168397 and rulings cited therein.

In addition, in HQ W563404, dated March 3, 2006, a related party importer and manufacturer structured their transaction so that the manufacturer/seller secured rights to use a patent from a U.S. patent holder. The quarterly patent royalties were paid as a distinct payment by the importer to its related manufacturer who sent the monies to the U.S. patent holder. Counsel in that case argued that the royalties were not dutiable because they did not inure to the benefit of the seller, *i.e.*, the manufacturer, and they were ultimately made to a U.S. patent holder. In HQ W563404, CBP stated that "the nationality or location of the patent holder is immaterial for purposes of determining if a royalty is dutiable." Relying on *Generra Sportswear Co. v. United States*, 905 F 2d. 377 (Fed. Cir. 1990), CBP determined that, as the importer failed to rebut the presumption under *Generra*, the royalty payments to the manufacturer were part of the price actually paid or payable. CBP also analyzed whether the royalty payments would be dutiable as an addition to the price actually paid or payable. With regard to whether the payments were a condition of the sale, CBP stated:

> It is evident, upon examination of the Agreement, that the thermal cyclers will be manufactured, imported and subsequently resold only on the understanding or condition that the royalties are paid. . . . [Company A] thus imports the thermal cyclers with the full expectation that it will resell them and pay royalties to [Company B]. . . . Thus, [Company A] cannot buy the thermal cyclers without paying the royalty. There is a clear, substantial nexus between the imported thermal cyclers, the patented technology, and the royalty payments.

In both HQ H168397 and HQ W563404, CBP determined that the royalties for the patents related to the imported merchandise and were a condition of the sale. The royalty payments in each case were to U.S. patent holders, as in this case. The difference between this case and HQ W563404 is that in this case, the importer pays the royalty directly to the U.S. patent holder, whereas in HQ W563404 the importer paid the royalty fee to the seller/manufacturer who passed the payment on to the U.S. patent holder. We note that HQ H168397 and HQ W563404 distinguished earlier rulings which were cited to argue that the patent royalty payments in those decisions were not dutiable.

Counsel for the company has cited some of the same rulings distinguished in HQ H168397 and HQ W563404 to support the view that the royalty payments are not dutiable additions to the price actually paid or payable in this case. Specifically, counsel refers to HQ H024979, dated May 6, 2009; HQ 542926, dated January 21, 1983; and, Customs Service Decision (C.S.D.) 82-134 (HQ 542818) dated May 27, 1982.

In C.S.D.82-134, a U.S. importer entered into an agreement with a U.S. patent holder for the "'non-exclusive right to make, have made, use and/or sell' the licensed product throughout the world." The patent related to a type of computerized game. The ruling noted that all research and development of the product was undertaken by the Licensor in the United States. The license fee was assessed based on a set amount per each licensed product received by the importer from the manufacturer. A portion of the fee related to tooling furnished to the manufacturer by the Licensor. The portion related to the tooling was agreed to be a dutiable assist. Only the portion of the fee related to the patent was at issue. The ruling held that as the royalty payments were made to a U.S. patent holder, and not to the seller, the payments were "not a 'condition of the sale of the imported merchandise for exportation to the United States,' but [were] rather (for the most part) for the right to obtain and use the U.S. patent, and for other related rights. To this extent, such royalty payments [were] not dutiable."

However, the file for C.S.D. 82-134, shows the ruling request primarily dealt with whether research and development resulting in a patent and undertaken wholly in the U.S. was an assist within the meaning of 19 U.S.C. § 1401a(h)(1)(A)(iv). As stated in HQ H168397, C.S.D. 82-134 "did not deal with the specific issue of whether the merchandise was manufactured under patent (as articulated in the [General Notice*, 'Dutiability of Royalty Payments', supra*])." A review of the ruling request reveals that the request stated that "[i]t is unnecessary to reach the issue as to whether the patent is 'necessary for the production' of the computerized . . . game . . . [as] the game can easily be produced with existing technology and know-how, and the royalty agreement is essentially for the legal right to market the product." Therefore, we believe C.S.D. 82-134 is distinguishable from the case under consideration as the licensed patents in this matter are required to produce the imported merchandise.

Counsel also relies upon HQ 542926 for the proposition that a “royalty payment made to [a] seller [is] not a dutiable addition to value because it inure[s] to [the] benefit of [the] U.S. patent holder, not [the] seller.” Counsel cites language from the decision that:

> In prior cases arising under the Trade Agreements Act of 1979 (TAA), we have held that royalty payments made to an unrelated U.S. patent holder and not to the foreign seller were not dutiable since such payments were not a “condition of the sale of the imported merchandise for exportation to the United States.”

However, C.S.D. 82-134, cited for support of the quoted statement, is distinguished above. In addition, the facts of HQ 542926 set it apart from the present case. In HQ 542926, the manufacturer and the importer entered into an agreement for the manufacture and export to the U.S. of certain merchandise. In that agreement, the parties agreed to consult regarding the necessity to obtain a license under a third party’s (a U.S. company) patents if a problem with infringement arose for the importer to market the imported merchandise. If a licensing arrangement was agreed to, the royalties paid to the third party would be with the importer’s consent and made for the importer’s account. If the importer refused to consent to royalty payments to the third party patent holder, the importer would bear the consequences. Subsequently, the parties entered into a supplemental agreement whereby the manufacturer agreed to obtain a license from the third party and the manufacturer and the importer would share the cost of the royalty fee. The manufacturer would pay the fee and bill the importer his portion. Customs determined that the royalty payments by the importer were not a condition of the sale based on the sales contract between the manufacturer and the importer. It was clear that the manufacturer would sell the merchandise to the importer whether or not the importer paid any royalty fees to the third party patent holder. If a problem with patent infringement arose, the importer would bear the consequences, not the manufacturer.

Here the company must obtain the patent information to provide to the manufacturer to produce the merchandise to be imported. It is in the manufacturing agreement that the company will supply the manufacturer with the technology necessary to enable the manufacturer to produce the merchandise at issue. *See* Paragraph 2.1(a) of the Manufacturing Agreement. Without entering into the licensing agreement and committing to the payment of the royalties, the company would not have the requisite technology to provide to the manufacturer to produce the imported merchandise. As in HQ W563404, there is a clear nexus between the imported merchandise, the patented technology, and the royalty payments.

Finally, counsel points to HQ H024979, dated May 6, 2009, which was a ruling request, primarily involving design patents with work undertaken in the U.S. and royalties for the patents paid to a U.S. licensor, not related to the seller. In H024979, it was state that there was "no indication in the Licensing Agreement that royalty payments are necessary in order for the Licensee to manufacture the merchandise," and it was held that the royalties were not dutiable. In H024979, a minimum annual royalty was payable, which is not the situation here. The decision also found similarity with HQ 542152 (TAA #13), dated December 4, 1980 where the design patents undertaken in the U.S. were found to fall within the language of 19 U.S.C. §1401a(h)(1)(A)(iv), as assists. *See also* HQ H004991, dated April 2, 2007 distinguishing the design patent of HQ 545379 from patents which relate to the physical composition of a sole, and which were found dutiable although "not technically cover[ing] the process by which the imported product is manufactured;" and HQ 548373, dated November 24, 2003, wherein CBP held that royalties paid to a U.S. patent holder (related to the seller) by an importer for the right to make use of certain equipment (which is manufactured under the U.S. patent) was dutiable.

With regard to the patents at issue and the dutiability of the royalties paid by the company for the right to use the information afforded by the patents in the production of the imported merchandise, we have been informed that the company provides the manufacturer drawings and specifications. The licensed device which is the subject of the Licensing Agreement is the imported merchandise at issue, and it is manufactured as a result of the utility patent of the licensor.

With regard to utility patents, such as those at issue herein, we have numerous rulings, both pre-TAA and post-TAA, that support a finding that royalties paid to a U.S. licensee for the right to use such patents in the production of the imported merchandise are dutiable additions to the price actually paid or payable. As discussed above, in such cases the patent goes to the production of the imported merchandise and such merchandise would not exist, but for, the patented process or invention involved in the manufacture of the merchandise. In addition, without obtaining the license to produce the merchandise under patent and import it into the U.S., the importer would not be able to legally import the merchandise into the U.S. In other words, without the license, importation of the merchandise into the U.S. would infringe the patent holder's rights under the patent.

Counsel also sets forth two more arguments why the royalty payment should not be considered a condition of the sale and cites to the definition of "condition" from *Black's Law Dictionary (Second Pocket Edition, 2001)* defining "a 'condition' in pertinent part at page 124 as 'A stipulation or prerequisite in a contract, will, or other instrument, constituting the essence of the instrument.'" Although counsel refers to the interpretation of the statutory language based on its common meaning, counsel's argument that "condition" be construed "in accordance with U.S. laws and practices regarding contracts between parties for the sale of goods" is an interpretation based upon a legalistic understanding of the term "condition" and not one based on a "common meaning" understanding of the term.

Regarding the proper interpretation of the term "condition" as it relates to whether a royalty payment is "a condition of the sale," we note that the courts have frequently spoken to the proper interpretation of statutory language directing us to look to the ordinary, common meaning of terms unless it is evident that Congress intended some other meaning to apply. In *Indian Harbor Insurance Company v. United States*, 704 F.3d 949, 954 (2013), the Court stated:

> In reviewing the statute's text, we give the words "their 'ordinary, contemporary, common meaning,' absent an indication Congress intended them to bear some different import." *Williams*, 529 U.S. at 431 (*quoting Walters v. Metro. Educ. Enters., Inc.*, 519 U.S. 202, 207, 117 S. Ct. 660, 136 L. Ed. 2d 644 (1997) . . . .

In determining the meaning of "as a condition of the sale" in 19 U.S.C. § 1401a(b)(1)(D), we will look to the common and ordinary meaning of the term "condition." In addition to *Black's Law Dictionary*, we note "condition" means:

> Condition *noun* (AGREED LIMITATION)
> [C] something that must exist before something else can happen.[3]
>
> 5. Something indispensable to the appearance or occurrence of something else: PREREQUISITE . . . .10. *Law* a. A provision making the effect of a legal instrument contingent upon the occurrence of an uncertain future event.[4]

Keeping Congressional intent in mind that the existing treatment with respect to the dutiability of royalties at the time of the enactment of the TAA continue without change, we find that an examination of the treatment of patent royalties under the valuation law prior to the enactment of the TAA reveals the proper interpretation of the language "as a condition of the sale" in 19 U.S.C. § 1401a(b)(D) includes situations in which the patent royalty or licensing agreement is a prerequisite to the sale of the imported merchandise. In other words, the language "as a condition of the sale" includes situations in which the right to use the patent must be secured, either by the

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[3] http://dictionary.cambridge.org/dictionary/english/condition
[4] *Webster's II, New Riverside University Dictionary* (1984), at 295. The same definition may be found in the *American Heritage Dictionary of the English Language Fifth Edition* (2011), *See* http://www.thefreedictionary.com/condition

buyer or the manufacturer because the patent is necessary to produce the merchandise to be sold for export to the United States. *i.e.*, the imported merchandise would not exist if the rights to the patent were not obtained. In such a case, the royalty paid for the patent is a dutiable element of transaction value if not already part of the price actually paid or payable, such as when the manufacturer secures the patent and then builds that cost into the price charged to the importer for the imported merchandise. The royalty may be an addition when the buyer pays the royalty to the manufacturer as a separate payment or when the buyer secures the license from the patent holder, paying the patent holder the royalties, and then provides the patent to the manufacturer, which is the situation in this case.

This interpretation of "as a condition of the sale" does not preclude situations in which parties may contractually link patent payments to sales of merchandise such that the merchandise cannot be purchased and imported into the U.S., though the merchandise may be produced, without the buyer of the goods paying royalties for a patent. *See* C.S.D. 84-25 (HQ 543070), dated July 28, 1983, in which a license fee was paid for a patented process to be used with the purchased imported machinery. The license fee was part of the sales contract and if additional machines were purchased, each individual machine would be subject to a new contract and license fee. The license fee was not related to the production of the imported merchandise, but to its use after importation. Customs found the license fee to be dutiable as a condition of the sale of the imported merchandise based on the terms of the sales contract, although the seller passed the license fee on to the patent holder. CBP believes that the language "as a condition of the sale" is susceptible to both a practical interpretation as set forth in the previous paragraph and a contractual approach as was taken in C.S.D. 84-25. The phrase should not be so narrowly construed as to be subject to only one interpretation. It is for this reason we believe the legislative history refers to a case-by-case review by Customs to determine if royalties are dutiable.

The practical, common sense view that a royalty paid for a patent necessary to produce the imported good is a dutiable element of transaction value is supported by the decisions on royalties under the prior and current valuation laws. In addition, this view is also supported by the Statement of Administrative Action (SAA), which provides, in relevant part, with regard to royalties:

> 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. (Statute) In this regard, **royalties and license fees for patents covering processes to manufacture the imported merchandise will generally be dutiable** . . . . However, the dutiable status of royalties and license fees paid by the buyer must

> be determined on 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. . . . (Regulation)

Statement of Administrative Action, H.R. Doc. No. 153, 96 Cong., 1st Sess., Pt II, at 443 – 444 (1979). Emphasis added.

Thus, we find that obtaining the license from the patent holder is a prerequisite, or condition, of the sale for importation to the U.S. for the importer. Lastly, Counsel cites to the decision of the Supreme Court of Canada in *Mattel Canada, Inc. v. The Queen*, 2001 SCC 36, [2001] 2. S.C.R. 100, interpreting the Canadian law implementing the same provision from the WTO Valuation Agreement for the additions of royalties to the price actually paid or payable to determine the dutiable transaction value. Counsel states: "The Court found that the term 'condition of sale' is a term of art with a 'settled legal meaning[.]'"

While a decision from another country interpreting similar language implementing a provision of an international agreement to which the U.S. is a party may be of interest, foreign court decisions are not binding on CBP. *See Wilton Industries, Inc. v. United States*, 31 CIT 863, 493 F. Supp. 2d 1294 (2007) wherein the court noted, in footnote 17:

> Of course, as both parties agree, the decisions of foreign tribunals are not binding on the courts of the United States . . . Such decisions are, however, entitled to "respectful consideration," and may have persuasive power. . . . [Citations omitted.]

The issue in the *Mattel* decision was a trademark royalty and the royalty at issue herein is a patent royalty. While counsel argues there should be no distinction between trademark and patent royalties in determining dutiability, it is clear from the legislative history and decisions prior to the enactment of the TAA, both administrative and case law, that a distinction did exist in U.S. law and was intended by Congress to continue to exist. Therefore, the *Mattel* decision has little bearing on this matter.

Furthermore, C.S.D. 79-46 (HQ 541445), dated October 13, 1977, a decision regarding the dutiability of trademark royalties, contains the following relevant discussion on the distinction between the dutiability of patent royalties and trademark royalties. In footnote 3 of the decision, it states:

Though there have been numerous Customs Court cases concerning the dutiability of royalties, the vast majority of them concern royalty payments made pursuant to a patent agreement. It is well established that there is a fundamental distinction between a patent and a trademark. *See* McCarthy, “Trademarks and Unfair Competition,” sec. 6 (1973). In a sense it was our understanding of the differences between these terms that led to a change in our position. . . .

In footnote 5 of the decision, it states:

Note the significant distinction between the rights granted pursuant to a trademark and the rights granted pursuant to receiving a license to use a patented process. The latter is unequivocally a dutiable element, whereas the nature of the former is one of a nondutiable selling expense incurred by the importer in the United States.

Therefore, we find that the royalty for the license is a dutiable element of the value of the imported merchandise.

HOLDING:

Based on the information provided, the royalty at issue is a dutiable addition to the price actually paid or payable under 19 U.S.C. § 1401a(b)(1)(D).

Sixty days from the date of this letter, Regulations and Rulings of the Office of International Trade will take steps to make this decision available to Customs and Border Protection ("CBP") personnel and to the public on the CBP Home Page on the World Wide Web at www.cbp.gov, by means of the Freedom of Information Act, and other methods of public distribution.

Sincerely,

Monika R. Brenner, Chief
Valuation and Special Programs Branch