



Ottawa, Thursday, May 7, 1992

Appeal Nos. AP-89-151 and AP-89-165

IN THE MATTER OF appeals heard on February 24 and 25, 1992, under section 67 of the *Customs Act*, R.S.C., 1985, c. 1 (2nd Supp.) as amended;

AND IN THE MATTER OF two decisions of the Deputy Minister of National Revenue for Customs and Excise dated May 18, 1989, and June 12, 1989, with respect to requests for re-determination pursuant to section 63 of the *Customs Act*.

BETWEEN

POLYGRAM INC.

Appellant

AND

**THE DEPUTY MINISTER OF NATIONAL REVENUE
FOR CUSTOMS AND EXCISE**

Respondent

AND

THE CANADIAN RECORDING INDUSTRY ASSOCIATION

Intervenor

DECISION OF THE TRIBUNAL

The appeals are dismissed. The "all-in fee" paid by the appellant is a royalty or licence fee paid directly in respect of the sound recordings and as a condition of the sale of the sound recordings for export to Canada. It should, therefore, be added to the transaction value of the imported sound recordings pursuant to subparagraph 48(5)(a)(iv) of the *Customs Act* and be subject to the payment of customs duty.

Kathleen E. Macmillan

Kathleen E. Macmillan
Presiding Member

W. Roy Hines

W. Roy Hines
Member

Robert C. Coates, Q.C.

Robert C. Coates, Q.C.
Member

Robert J. Martin

Robert J. Martin
Secretary

UNOFFICIAL SUMMARY

Appeal Nos. AP-89-151 and AP-89-165

POLYGRAM INC.

Appellant

and

**THE DEPUTY MINISTER OF NATIONAL REVENUE
FOR CUSTOMS AND EXCISE**

Respondent

and

THE CANADIAN RECORDING INDUSTRY ASSOCIATION

Intervenor

The appellant, Polygram Inc., imported sound recordings from Polygram Record Service B.V. (Polygram B.V.) and Polygram Record Service GmbH. The recordings were imported in market-ready form for resale in Canada. Polygram Inc. was invoiced for the cost of making the recordings by the foreign Polygram manufacturers at the time of importation.

The appellant entered into a licence agreement (the Polygram contract) with Polygram B.V. Under the licence, the appellant is entitled to promote the music and artists of Polygram B.V.'s repertoire and to distribute and sell the recordings to the public. For these rights, the appellant must pay Polygram B.V. an "all-in fee" that is calculated on the basis of "net retail price."

The issue in these appeals is whether the "all-in fee," as paid by the appellant to Polygram B.V., should be added to the transaction value of the imported sound recordings pursuant to subparagraph 48(5)(a)(iv) of the Customs Act and, thus, be subject to the payment of customs duty.

HELD: *The appeals are dismissed. The "all-in fee" paid by the appellant is a royalty or licence fee paid directly in respect of the sound recordings and as a condition of the sale of the sound recordings for export to Canada. It should, therefore, be added to the transaction value of the imported sound recordings pursuant to subparagraph 48(5)(a)(iv) of the Customs Act and be subject to the payment of customs duty.*

*Place of Hearing: Ottawa, Ontario
Date of Hearing: February 24 and 25, 1992
Date of Decision: May 7, 1992*

*Tribunal Members: Kathleen E. Macmillan, Presiding Member
W. Roy Hines, Member
Robert C. Coates, Q.C., Member*

Counsel for the Tribunal: David M. Attwater

Clerk of the Tribunal: Janet Rumball

*Appearances: Michael Kaylor, for the appellant
Peter M. Southey, for the respondent
R.H. Kesler, for the intervenor*

Appeal Nos. AP-89-151 and AP-89-165

POLYGRAM INC.

Appellant

and

**THE DEPUTY MINISTER OF NATIONAL REVENUE
FOR CUSTOMS AND EXCISE**

Respondent

and

THE CANADIAN RECORDING INDUSTRY ASSOCIATION

Intervenor

TRIBUNAL: KATHLEEN E. MACMILLAN, Presiding Member
W. ROY HINES, Member
ROBERT C. COATES, Q.C., Member

REASONS FOR DECISION

The appellant, Polygram Inc., is a Canadian corporation that imported sound recordings from Polygram Record Service B.V. (Polygram B.V.) and Polygram Record Service GmbH. The sound recordings were imported in market-ready form for resale in Canada. Polygram Inc. was invoiced for the cost of making the recordings by the foreign Polygram manufacturers at the time of importation. Polygram Inc. also has sound recordings domestically produced from imported master tapes acquired through Polygram B.V.

The appellant entered into a licence agreement (the Polygram contract) with Polygram B.V. Under the licence, the appellant is entitled to promote the music and artists of Polygram B.V.'s repertoire and to distribute and sell the sound recordings to the public (to "exploit" the music). For these rights, the appellant must pay Polygram B.V. an "all-in fee" (the fee) that is calculated on the basis of the "net retail price" of the recordings. The appellant pays the fee based on its net sale of sound recordings in Canada after subtracting free goods, promotional goods and returned goods. The fee is paid whether the sound recordings are imported or domestically produced.

Under clause 2 of the Polygram contract, the following rights to exploit the sound recordings and master tapes are granted to the appellant: (i) the exclusive right to use master tapes for manufacturing purposes in Canada; (ii) the exclusive right to market, distribute and sell sound recordings through regular wholesale and retail trade channels; (iii) the non-exclusive right to market, distribute and sell sound recordings through record clubs, etc.; (iv) the non-exclusive right to perform publicly or to permit the public performance of sound recordings subject to certain limitations; (v) the non-exclusive right to use the name, likeness and biography of each artist whose performance is embodied in the sound recording in conjunction with the advertising, publicizing and sale of sound recordings; and (vi) the non-exclusive right to use the artwork supplied by Polygram B.V. in the manufacture of sleeves, jackets and other packaging of sound recordings and in association with the advertising, publicizing and sale of sound recordings.

The issue in these appeals is whether the fee, as paid by the appellant to Polygram B.V., should be added to the transaction value of the imported sound recordings pursuant to subparagraph 48(5)(a)(iv) of the *Customs Act* (the Act) and, thus, be subject to the payment of customs duty.

For purposes of these appeals, the following provisions of the Act are relevant.

48. (1) Subject to subsection (6), the value for duty of goods is the transaction value of the goods if the goods are sold for export to Canada and the price paid or payable for the goods can be determined ...

(5) The price paid or payable in the sale of goods for export to Canada shall be adjusted

(a) by adding thereto amounts, to the extent that each such amount is not already included in the price paid or payable for the goods, equal to

(...)

(iv) royalties and licence fees, including payments for patents, trade-marks and copyrights, in respect of the goods that the purchaser of the goods must pay, directly or indirectly, as a condition of the sale of the goods for export to Canada, exclusive of charges for the right to reproduce the goods in Canada,

Counsel for the appellant noted that in order for the fee to be dutiable it must be payable by the appellant "in respect of" the sound recordings and be payable "as a condition of" the sale of the sound recordings for export to Canada. If the payments made by the appellant do not meet these requirements they are not dutiable.

Counsel argued that clause 2 of the Polygram contract sets out the consideration for which the fee payments are made. None of the rights are with respect to goods that are imported. Rather, they are with respect to activities of exploitation, such as the exclusive right to market, distribute and sell the sound recordings, which are given to the appellant for use in Canada following importation of the goods. Furthermore, the Polygram contract does not tie the grant of these rights to the purchase of imported sound recordings.

Counsel submitted that a useful test in determining whether the fee payment related to the sound recordings was whether the importer could have purchased the goods without payment of the fee. If so, a separate value could be established for each.¹ In this regard, counsel noted that there is an independent value for both the imported sound recordings and the fee payment. As such, it cannot be argued that the price of an imported sound recording is artificially low with the fee payment compensating for this low value. Both values are set in the marketplace and vary depending on the source of the goods and content of the sound recording. Also, the fee is paid regardless of the source of the sound recording.

1. In support of this proposition, counsel referred to S. Sherman and H. Glashoff, Customs Valuation: Commentary on the GATT Customs Valuation Code (ICC Publishing S.A., 1987) paragraph 295 at p. 124.

In addressing the question of whether the fee is payable as a condition of the sale of the goods sold for export, counsel submitted that there are three considerations. First, counsel noted that Polygram Inc. is required to pay the fee only if a sound recording is sold in Canada and only after the sale occurs. Second, counsel maintained that payment of the fee is not a condition of importation. Sound recordings can be imported into Canada without any legal liability or obligation to make a fee payment. Finally, the Polygram contract makes no distinction or requirement regarding domestically produced or imported sound recordings. The fee is payable on sound recordings from both sources.

The Canadian Recording Industry Association (CRIA) appeared as an intervenor at the hearing. The CRIA represents various corporations, which are engaged in, amongst other things, the production and distribution of sound recordings in Canada. The objectives of the CRIA are to promote the interests of this industry and to provide a forum for discussion of issues of common interest.

In addition to supporting many of the arguments made by counsel for the appellant, counsel for the intervenor maintained that when the appellant imports goods into Canada, it is not possible to ascertain the amount of royalty payable, if at all. A royalty will only be payable if there are net sales in Canada. Consequently, the charging provisions of section 48 have no application because there may never be a duty payable. Counsel argued that the royalty is not dutiable as there is commercial severability between the importation of the goods and payment of the royalty. Counsel noted that it is not enough to say that the fee was payable in connection with the sale of the goods for export.

Counsel for the respondent argued that the transaction value of the sound recordings is more than simply the pressing or manufacturing costs of the physical product. The actual value to the importer includes the value of the music that is included on the recordings as well as the artwork contained on the jacket cover.

Counsel maintained that since Polygram Inc. was obliged to agree in advance to pay the fee, the payment is a proper addition to the price paid or payable to reflect the real transaction value of the recordings. This situation is provided for in article 8 of the *Customs Valuation Agreement*² (the Agreement). In paraphrasing the effect of article 8, counsel stated that in determining the true transaction value on which duties are payable, payments that are incurred by the buyer subsequent to those incurred at the time of importation must be added together.³ Subparagraph 48(5)(a)(iv) of the Act reflects the intention of the Agreement in this regard and deals with payments not already included in the price paid or payable.

Counsel noted that pursuant to the Polygram contract, the fee is payable at the time of importation. During the first few years of the appellant's business, the fee had to be paid at this time. However, though the contract has not changed, the practice of the parties is such that the appellant is now paying the fee subsequent to the sale of the recordings.

Regarding imports of master tapes, counsel for the respondent pointed out that the appellant was not assessed duty on master tapes that it imported. Counsel explained that this is based on the concluding words of subparagraph (iv) which states that additions to the price paid or payable for

2. Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade, signed in Geneva, Switzerland, on April 12, 1979, GATT BISD, Supp. 26, p. 116.

3. In support of this proposition, counsel referred to S. Sherman and H. Glashoff, *supra*, note 1, paragraphs 272 to 274, pp. 120-1.

goods exported to Canada shall be "exclusive of charges for the right to reproduce the goods in Canada." Payment of duty on the importation of master tapes was not in issue in these appeals.

In determining whether the fee payment falls within the meaning of subparagraph 48(5)(a)(iv), three key criteria must be met: (1) the payment is a royalty or licence fee paid directly or indirectly; (2) in respect of the goods; and (3) as a condition of the sale of the goods for export to Canada. There is no dispute on the first point.

The Tribunal accepts that the fee is payable only on the sale of the sound recordings in Canada by Polygram Inc. and not at the time when the goods were imported into Canada or sold to the appellant by its parent or affiliate. However, the Act, in stipulating that certain amounts should be included in calculating the transaction value of goods, encompasses this situation when it requires that various amounts be added "to the extent" that they are "not already included in the price paid or payable for the goods." Whether these charges are payable at the time of importation, sale of the goods or some other time is therefore made irrelevant by the wording of the legislation.

The Tribunal views the fee as a payment made in respect of the goods. Testimony by industry witnesses established that the fee, payable on a particular sound recording, varies according to the price at which it is released. The price will vary according to the artist and cost of producing the recording. Therefore, the fee payable on different sound recordings may be different. It is not a general payment unaffected by the specific sound recording. Rather, it is made in respect of the particular goods being sold.

The Tribunal also concludes that payment of the fee is a condition of the sale of the goods for export to Canada. In the Tribunal's view, without the signed fee agreement, which clearly sets out the appellant's obligation to pay the fee, the appellant would not have been able to purchase the sound recordings from its foreign affiliates and import them into Canada. As such, purchase of the goods being imported is inseparable from payment of the fee. Accordingly, the fee was paid as a condition of the sale of the goods for export to Canada.

The appeals are dismissed. The fee paid by the appellant is a royalty or licence fee paid directly in respect of the sound recordings and as a condition of the sale of the sound recordings for export to Canada. It should, therefore, be added to the transaction value of the imported sound recordings pursuant to subparagraph 48(5)(a)(iv) of the Act and be subject to the payment of customs duty.

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