Ottawa, Monday, December 22, 1997

Appeal Nos. AP-94-212 and AP-94-213

IN THE MATTER OF appeals heard on February 5 and 6, 1997, under section 67 of the *Customs Act*, R.S.C. 1985, c. 1 (2nd Supp.);

AND IN THE MATTER OF decisions of the Deputy Minister of National Revenue dated July 29, 1994, with respect to a request for re-determination under section 63 of the *Customs Act*.

BETWEEN

CHAPS RALPH LAUREN, A DIVISION OF 131384 CANADA INC. AND MODES ALTO-REGAL, INC. **Appellants**

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

AND

GFT MODE CANADA INC. **Intervener**

DECISION OF THE TRIBUNAL

The appeals are allowed in part.

Arthur B. Trudeau
Arthur B. Trudeau
Presiding Member

Patricia M. Close
Patricia M. Close
Member

Charles A. Gracey
Charles A. Gracey
Member

Michel P. Granger
Michel P. Granger
Secretary

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UNOFFICIAL SUMMARY

Appeal Nos. AP-94-212 and AP-94-213

CHAPS RALPH LAUREN, A DIVISION OF 131384 CANADA INC. AND MODES ALTO-REGAL, INC. **Appellants**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

and

GFT MODE CANADA INC. **Intervener**

These are appeals under section 67 of the *Customs Act* (the Act) from decisions of the Deputy Minister of National Revenue under subsection 63(3) of the Act which maintained rulings dated February 26, 1993, that required the appellants to add to the value for duty of their imports of certain clothing fees paid by the appellants pursuant to certain agreements. The issues in these appeals are: (1) whether royalties paid under the licence agreements for use of the trademarks "Chaps by Ralph Lauren" and "Polo by Ralph Lauren" were properly added to the value for duty of imported men's apparel bearing those trademarks pursuant to subparagraph 48(5)(*a*)(iv) of the Act; (2) whether fees paid pursuant to design agreements to obtain the services of Ralph Lauren Design Studio in connection with the creation and design of the men's apparel bearing the "Chaps by Ralph Lauren" and "Polo by Ralph Lauren" trademarks were properly added to the value for duty of the imported apparel bearing those trademarks pursuant to clause 48(5)(*a*)(iii)(D) of the Act; and (3) whether fees paid pursuant to a sublicence of the licence and design agreements relating to the trademark "Chaps by Ralph Lauren" were properly added to the value for duty of imported men's apparel bearing that trademark pursuant to subparagraph 48(5)(*a*)(iv) of the Act.

HELD: The appeals are allowed in part. With respect to the royalties paid pursuant to the licence agreements, the Tribunal finds that these payments are similar to those considered by the Federal Court - Trial Division in its decision in *Reebok Canada*, *A Division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise* to be "royalties" under subparagraph 48(5)(*a*)(iv) of the Act. The Tribunal further finds that, insofar as the agent, that acted on behalf of the appellants and approved the licensed products in issue for export, was owned by the licensor, the relationship between the agent and the licensor was such that, if the royalties were not paid, the appellants would not be able to conclude their sales for export through the agent. Therefore, the Tribunal finds that the payments are royalties paid as a condition of the sales of the goods in issue for export to Canada and should be included in the value for duty of the goods in issue.

With respect to the fees paid pursuant to the design agreements, the Tribunal is persuaded, based on the provisions of the design agreements and the testimony of the witnesses, that what is being provided under the design agreements and, in turn, supplied to the overseas manufacturers by the appellants qualify as goods or services for use in the production of the imported clothing in issue, which goods or services constitute "design work," as that term is commonly defined, and which are undertaken elsewhere than in Canada and are necessary for the production of the imported goods. As a result, the fees are "assists" under clause 48(5)(*a*)(iii)(D) of the Act.

With respect to the fees paid by 131384 Canada Inc. pursuant to the sublicence agreement with Modes Alto-Regal, Inc., the Tribunal finds that, while the fees may be considered to be "in respect of" the imported clothing in that they are calculated based on net sales of the imported clothing, it cannot accept that the fees are paid, directly or indirectly, as a condition of the sale for export. It is the fees paid by Modes Alto-Regal, Inc. to Polo Ralph Lauren Corporation, not the fees paid pursuant to the sublicence agreement, that are paid as a condition of the sale for export to Canada..

Place of Hearing:	Ottawa, Ontario
Dates of Hearing:	February 5 and 6, 1997
Date of Decision:	December 22, 1997
Tribunal Members:	Arthur B. Trudeau, Presiding Member Patricia M. Close, Member Charles A. Gracey, Member
Counsel for the Tribunal:	Shelley Rowe
Clerk of the Tribunal:	Anne Jamieson
Appearances:	Richard G. Dearden and Kim G. Conboy, for the appellants Anne M. Turley, for the respondent Dean A. Peroff, for the intervener

CANADIAN INTERNATIONAL TRADE TRIBUNAL | TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal Nos. AP-94-212 and AP-94-213

CHAPS RALPH LAUREN, A DIVISION OF 131384 CANADA INC. AND MODES ALTO-REGAL, INC. **Appellants**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

and

GFT MODE CANADA INC. **Intervener**

TRIBUNAL: ARTHUR B. TRUDEAU, Presiding Member
PATRICIA M. CLOSE, Member
CHARLES A. GRACEY, Member

REASONS FOR DECISION

These are appeals under section 67 of the *Customs Act*[1] (the Act) from decisions of the Deputy Minister of National Revenue under subsection 63(3) of the Act which maintained rulings dated February 26, 1993, that required the appellants to add to the value for duty of their imports of certain clothing fees paid by the appellants pursuant to certain agreements.

The issues in these appeals are: (1) whether royalties paid under the licence agreements for use of the trademarks "Chaps by Ralph Lauren" and "Polo by Ralph Lauren" were properly added to the value for duty of imported men's apparel bearing those trademarks pursuant to subparagraph 48(5)(*a*)(iv) of the Act; (2) whether fees paid pursuant to design agreements to obtain the services of Ralph Lauren Design Studio in connection with the creation and design of the men's apparel bearing the "Chaps by Ralph Lauren" and "Polo by Ralph Lauren" trademarks were properly added to the value for duty of the imported apparel bearing those trademarks pursuant to clause 48(5)(*a*)(iii)(D) of the Act; and (3) whether fees paid pursuant to a sublicence of the licence and design agreements relating to the trademark "Chaps by Ralph Lauren" were properly added to the value for duty of imported men's apparel bearing that trademark pursuant to subparagraph 48(5)(*a*)(iv) of the Act. Clause 48(5)(*a*)(iii)(D) and subparagraph 48(5)(*a*)(iv) of the Act provide as follows:

> (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
>
> (iii) the value of any of the following goods and services, determined in the manner prescribed, that are supplied, directly or indirectly, by the purchaser of the goods free of charge or at a reduced cost for use in connection with the production and sale for export of the imported goods, apportioned to the imported goods in a reasonable manner and in accordance with generally accepted accounting principles:

1. R.S.C. 1985, c. 1 (2nd Supp.).

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> (D) engineering, development work, art work, design work, plans and sketches undertaken elsewhere than in Canada and necessary for the production of the imported goods.
>
> (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.

Two witnesses appeared on behalf of the appellants: Mr. Michael Belcourt, President of Modes Alto-Regal, Inc. and Chaps Ralph Lauren, A Division of 131384 Canada Inc.; and Mr. Edward E. Kable, Associate General Counsel to Polo Ralph Lauren Corporation (Polo US). As a preliminary matter, the Tribunal granted a request by counsel for the respondent to have Mr. Kable excluded from the hearing during Mr. Belcourt's testimony.

Mr. Belcourt referred to the various agreements that cover the transactions at issue. There is a licence agreement dated October 23, 1982, between Modes Alto-Regal, Inc. (Modes) and Polo Fashions, Inc., now Polo US, with respect to the use of the trademarks "Polo by Ralph Lauren," "Ralph (Polo Player Design) Lauren" and the representation of the Polo Player (Polo Licence Agreement)[2] in connection with the importation, manufacture and sale of certain men's apparel bearing the trademarks "Polo by Ralph Lauren," "Ralph (Polo Player Design) Lauren" and the representation of the Polo Player. The Polo Licence Agreement also provides that Modes shall pay to Polo US earned royalties equal to a stated percentage of the net sale price of all licensed products sold under the agreement.

Also on October 23, 1982, Mr. Ralph Lauren, doing business under the name Ralph Lauren Design Studio (R.L. Design Studio), entered into a design agreement with Modes (Polo Design Agreement).[3] The Polo Design Agreement provides, in part, that Modes "desires, in order to exploit the rights granted to it under the [Polo Licence Agreement], to engage and retain Lauren to create and provide to [it] the designs for its line of Licensed Products." It is further provided that Mr. Lauren is willing to furnish such designs and render such services on the basis set forth in the Polo Design Agreement. Also included in the Polo Design Agreement are provisions for Mr. Lauren's compensation. Modes is required to pay to Mr. Lauren earned compensation based on the net sale price of products sold under the Polo Design Agreement, and the compensation is to be a stated percentage of the net sales of all licensed products sold under the Polo Design Agreement.

There is also a licence agreement between Modes and Polo US dated May 1, 1984, with respect to the use of the trademark "Chaps by Ralph Lauren" in connection with the importation, manufacture, distribution and sale of certain men's apparel bearing the trademark "Chaps by Ralph Lauren" (Chaps Licence Agreement)[4] which is almost identical to the Polo Licence Agreement. The Chaps Licence Agreement provides, among other things, that Modes shall pay to Polo US earned royalties equal to a stated percentage of the net sales of all licensed products sold under the agreement.

Also on May 1, 1984, Mr. Lauren, doing business under R.L. Design Studio, entered into a design agreement with Modes (Chaps Design Agreement).[5] The Chaps Design Agreement provides, in part, that

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2. The Polo Licence Agreement was amended on May 8, 1986, and November 21, 1988.
3. The Polo Design Agreement was amended on May 8, 1986, and November 21, 1988.
4. The Chaps Licence Agreement was amended on January 1, 1986, February 1, 1988, and November 1, 1989.
5. The Chaps Design Agreement was amended on January 1, 1986, February 1, 1988, and November 1, 1989.

Modes "desires, in order to exploit the rights granted to it under the [Chaps Licence Agreement], to engage and retain Lauren to create and provide to [it] the designs for its line of Licensed Products." It is further provided that Mr. Lauren is willing to furnish such designs and render such services on the basis set forth in the Chaps Design Agreement. Also included in the Chaps Design Agreement are provisions for Mr. Lauren's compensation. Modes is required to pay to Mr. Lauren earned compensation based on the net sale price of products sold under the Chaps Design Agreement, and the compensation is to be a stated percentage of the net sales of all licensed products sold under the Chaps Design Agreement.

Design concepts for goods bearing the "Chaps by Ralph Lauren" trademark "may be furnished" by other entities, such as Warnaco, Inc. (Warnaco), which is the licensee for Chaps Ralph Lauren men's apparel in the United States.[6] Mr. Belcourt confirmed that Warnaco is not related to Polo US, Mr. Lauren or the appellants. Moreover, royalty payments are made to Polo US, and design fees are paid to R.L. Design Studio, not to Warnaco.

In November 1984, Modes and 131384 Canada Inc. entered into a sublicence agreement granted pursuant to the Chaps Licence Agreement and the Chaps Design Agreement to use the "Chaps by Ralph Lauren" trademark in connection with the manufacture and sale in Canada of certain men's apparel bearing the trademark "Chaps by Ralph Lauren." The sublicence agreement provides, in part, that Modes desires to sublicense to 131384 Canada Inc. certain of its rights under the Chaps Licence Agreement and the Chaps Design Agreement. The sublicence agreement also provides, among other things, that 131384 Canada Inc. shall pay to Modes earned royalties based on the net sale price of all licensed products sold under the sublicence agreement equal to a stated percentage of the net sales of all licensed products. This percentage is in excess of the sum of the earned royalties which Modes is required to pay to Polo US pursuant to the Chaps Licence Agreement and the amounts which Modes is required to pay to Mr. Lauren pursuant to the Chaps Design Agreement.[7] Mr. Belcourt explained that the payments made under the sublicence agreement remain in Canada.

Mr. Belcourt referred to statements that he made in a previous appeal before the Tribunal involving buying commissions[8] and adopted the description of his testimony set out in the reasons for decision in that appeal. In particular, he adopted the evidence that the appellants "have the final word on the … type and quality of merchandise, on the price to be paid for the garments and on the aspects relating to the shipping of such merchandise.[9]" He also adopted the evidence that "Polo [US] is a stranger to the contracts between the Canadian purchasers and the garment makers.[10]"

In addition, Mr. Belcourt testified that there is no corporate relationship between the appellants and the Asian manufacturers and that no overseas factory had any knowledge of the agreements between the

6. Paragraph 1.6 of the Chaps Design Agreement.
7. On November 19, 1992, the percentage of the royalty required to be paid by 131384 Canada Inc. to Modes was reduced to the sum of the percentages paid by Modes to Polo US under the Chaps Licence Agreement and to Mr. Lauren under the Chaps Design Agreement.
8. *Chaps-Ralph Lauren, Division of 131384 Canada Inc. and Modes Alto Regal* v. *The Deputy Minister of National Revenue*, Appeal Nos. AP-94-190 and AP-94-191, November 1, 1995.
9. *Ibid.* at 6-7.
10. *Ibid.* at 7.

appellants and Polo US. He further stated that the goods could be purchased from overseas factories without consideration of payment of the royalty.[11]

Focusing specifically on the fees paid pursuant to the Chaps Design Agreement and the Polo Design Agreement, Mr. Belcourt stated that these payments were always treated as royalty payments. In support of this statement, he referred to a letter from Polo US to Modes[12] and to a letter from the Department of National Revenue (Revenue Canada) to Polo Ralph Lauren, a division of Modes Alto-Regal, Inc.[13] In further support, Mr. Belcourt indicated that there is a non-resident tax withheld on the payments made under those two agreements, and he entered as exhibits returns for 1991[14] and 1992[15] showing that there was tax withheld. Mr. Belcourt also introduced a page from a guide prepared by Revenue Canada for filing such returns which provides that the income code under which the payments under the design agreements were made covers "[r]oyalties and similar payments for the use of, or the right to use, other properties.[16]"

Mr. Belcourt described for the Tribunal what is meant by "broad design themes and concepts" which are to be provided by Mr. Lauren to the appellants pursuant to the Polo Design Agreement and the Chaps Design Agreement. Every season, the design studio comes up with ideas for a fashion collection, referred to as "themes." Each fashion collection or theme is supplemented by the basic, traditional merchandise which is in the clothing line each year. By way of example of fashion groupings, he referred to the "Grand Canyon," "Tahiti" and "Vermont Holiday" groupings and indicated that each grouping would have a certain amount of clothing portraying a theme or a lifestyle. Initially, the appellants receive a written description and photographs. From these fashion groupings, the appellants decide which concepts they are going to develop.

At the next stage, the appellants receive concept boards and colour stats. The appellants may be provided with approximately 200 to 300 concept boards by R.L. Design Studio. The concept boards and colour stats provide more detailed information concerning the style, colours and fabrics for the items in the fashion grouping, as well as specifications, if they are available, fabric swatches, colour chips and information about the fabric mill. In some circumstances, the appellants would get fabric swatches on their own or from the manufacturers and submit them to the design department. The specifications could be different for each licensee around the world, and there are several different versions of individual pieces of clothing.

Using this information, the appellants make up a merchandise selection list which is sent to R.L. Design Studio for comment. The merchandise selection list and corresponding concept boards are then sent to the appellants' agent[17] or directly to the manufacturer in order to have a prototype produced, which is sent to an international licensing group in New York and/or, in some cases, to R.L. Design Studio for approval, and the prototype may be returned to the manufacturer for alterations. The agent then

11. *Transcript of Public Hearing*, February 5, 1997, at 59-60.
12. Exhibit A-1.
13. Exhibit A-2.
14. Exhibit A-5.
15. Exhibit A-4.
16. Exhibit A-6.
17. At the time that the transactions at issue took place, the appellants used Polo Ralph Lauren Sourcing Pte. Ltd. (Polo Sourcing) as an agent for purchases from the Far East. Polo Sourcing was, at that time, a subsidiary of Polo US and owned and controlled by Mr. Lauren. See *Chaps-Ralph Lauren*, *supra* note 8.

communicates with manufacturers to obtain quotations of prices and delivery, and the appellants choose manufacturers, some of which may be the same as those used by Polo US, to produce prototypes of the selected clothing using the specifications and the colour chips or an example of the clothing. Then the appellants make a final decision based on the price and quality offered by those manufacturers. Once the prototypes are approved, the manufacturers make graded paper patterns and markers (paper which includes all the sizes and pieces of the garment and which is stretched out to fit exactly on top of the fabric) from which they make a production sample which is the item on which the appellants place their orders for clothing. The appellants do not receive patterns for the clothing from Polo US unless requested and, if so requested, the appellants must pay an additional fee for these items.

Mr. Belcourt confirmed that, as a licensee of a trademark, it is important that the appellants adhere to the quality standards that are imposed by the licensor under the licence and design agreements and, in turn, ensure that manufacturers of clothing bearing that trademark also adhere to such standards. The appellants use Polo Sourcing in the Far East to ensure that quality standards, which are imposed upon them by Polo US, are met by the manufacturers. Once Polo Sourcing determines that clothing meets the quality standards, it signs off on an inspection certificate and then the manufacturers may cash the letter of credit. Although the design agreements provide that Polo US has the right to inspect the clothing, Mr. Belcourt indicated that it has never exercised this right.

Mr. Belcourt entered as an exhibit a document entitled “Transaction between Modes Alto-Regal Inc. and Bond Manufacturing.[18]” Although this document included a concept board and colour stats, in Mr. Belcourt’s view, the manufacturers do not require concept boards and colour stats in order to manufacture the requested clothing.

Polo US price lists for “Classics Spring 1996” and “Traditional Classics Fall 1996” were also introduced by Mr. Belcourt.[19] He explained that “classics” are traditional, timeless merchandise that the appellants have been showing in the “Ralph Lauren” line for years and that would be comprised of such items as basic “Polo” knit shirts, “Oxford” cloth button-down shirts, etc. The classics are offered in the classic colours and also in the colours shown on the particular concept board for the item of clothing for a particular season. According to Mr. Belcourt, classic basics bearing the “Polo by Ralph Lauren” trademark represent 57 percent of total sales and classic basics bearing the “Chaps by Ralph Lauren” trademark represent 39 percent of total sales. Mr. Belcourt testified that, even if the appellants sold only classics, they would still have to pay the fees under the design agreements.

Mr. Belcourt acknowledged that the licence agreements can be terminated for a variety of reasons, including non-payment of royalties, and that, upon termination, Polo US has the option to purchase inventory in Modes possession or under its control at a price determined according to a formula set out in those agreements.

The appellants’ second witness, Mr. Kable, confirmed that the appellants do not have any corporate relationships with any of the Polo US companies or Warnaco and that the only relationship that exists is the licensee relationship. Mr. Kable also confirmed that Polo US does not own any of the overseas factories.

Although Mr. Kable did not draft the agreements at issue, he gave his view on the intent and purpose of certain of the clauses in the licence and design agreements. In particular, he referred to

18. Exhibit A-15.
19. Exhibits A-16 (single copy) and A-17 (single copy).

paragraph 16.4 of the Polo Licence Agreement which states, in part, that the "Licensee may employ subcontractors, subject to the approval of Licensor, solely for the manufacture of the Licensed Products; provided, however, that the supervision of production of Licensed Products shall remain under the control of Licensee in accordance with the terms of this Agreement and such subcontractor shall comply with the quality requirements of this Agreement." Mr. Kable indicated that such a provision is standard and that all trademark owners include it in a trademark agreement to protect the trademark and good name in the marketplace by assuring the quality of the products. Mr. Kable indicated that it is the licensee's responsibility to ensure compliance with the quality standards and that, in his view, paragraph 16.4 does not give the licensor any rights to compel a subcontractor to abide by the quality standard obligations in the agreements.

Mr. Kable was also referred to the default and termination provisions in the Polo Licence Agreement under paragraphs 9.2 and 10.1. Paragraph 9.2 provides, in part, that, in the event of default, which includes the non-payment of royalties, the licensor has the right, exercisable in its sole discretion, to terminate the agreement. Paragraph 10.1 provides, in part, that upon termination of the agreement, the licensor has the option to purchase from the licensee all or any part of the licensee's existing inventory upon certain terms and conditions. Paragraph 10.2 provides, in part, that, if the licensor does not exercise this option, the licensee can, subject to certain conditions, dispose of the licensed products which are on hand or in the process of being manufactured at that time. Mr. Kable indicated that these provisions are intended to ensure that there is a constant supply of merchandise for customers in the event of a default by the licensee. In Mr. Kable's view, paragraph 10.1 refers to inventory in Canada that has already been imported, as demonstrated by the language clause 10.1(ii) which provides, in part, that inventory other than that manufactured in Canada shall be purchased by the licensor at the licensee's land costs, which means the FOB price of the licensed products together with customs, duties, brokerage, freight and insurance.

Counsel for the appellants referred Mr. Kable to Exhibit A-1, a letter dated June 17, 1993, from the Vice-President and General Counsel for Polo US to Modes, in which it is stated that "all payments, past and future, made by the Company to Polo and Lauren pursuant to the Agreements, are and have been in fact royalty payments based on a percentage of sales in Canada." Mr. Kable confirmed the view of Polo US that the payments are royalties and that he is aware that taxes are withheld in respect of all payments.

In cross-examination, counsel for the respondent referred Mr. Kable to article 11 of the Polo Licence Agreement which talks about the effect of termination. Article 11 provides, in part, that "[u]pon and after the termination of this Licence, all rights granted to Licensee ... shall forthwith and without further act or instrument be assigned to and revert to Licensor." Article 11 also provides, in part, that "Licensee will execute any instruments requested by Licensor which are necessary to accomplish or confirm" the assignment and reversion. Counsel suggested to Mr. Kable that one of the rights that would revert to the licensor in the case of a termination would be the right to manufacture and that, in such a case, the licensor would have rights over any goods being manufactured. Mr. Kable disagreed and stated that what are being transferred are intellectual property rights and not property rights over goods being manufactured outside Canada.

In argument, counsel for the appellants submitted that the basic rule of statutory interpretation requires that effect be given to the legislature's intention and that, to discover that intention, a reviewing tribunal must read the text of the relevant act in its entire context and consider the plain and ordinary meaning of the words harmoniously with the scheme of the act.[20] Counsel further submitted that the *Agreement on*

20. *Canada* v. *Antosko*, [1994] 2 S.C.R. 312 at 326.

Implementation of Article VII of the General Agreement on Tariffs and Trade[21] and advisory opinions of the Technical Committee on Customs Valuation[22] can be referred to in interpreting section 48 of the Act, as was held by the Tribunal in *Jana & Company* v. *The Deputy Minister of National Revenue*.[23]

Counsel for the appellants submitted that the royalties paid pursuant to the licence agreements are not dutiable pursuant to subparagraph 48(5)(*a*)(iv) of the Act, as these payments were not "in respect of" the imported clothing nor a "condition of the sale of the goods for export to Canada."

First, with respect to the royalties, counsel for the appellants submitted, on the basis of the Tribunal's decisions in *Reebok Canada Inc., A Division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise*,[24] *Jana*, *PMI Food Equipment Group Canada, A Division of Premark Canada Inc.* v. *The Deputy Minister of National Revenue*[25] and *Mattel Canada Inc.* v. *The Deputy Minister of National Revenue*,[26] that payment of a fee is not a condition of the sale if the purchaser can purchase and import the goods without the payment of that fee. Counsel submitted that there is no relationship, contractual or otherwise, between the overseas manufacturers of the appellants' imported clothing and licensors which might suggest that there was some connection or relationship between the sale of the clothing by the overseas manufacturers for export to the appellants in Canada and the payment of the royalties by the appellants to the licensors. Moreover, counsel referred to a previous decision of the Tribunal[27] involving the appellants to support their contention that the licensors do not exercise a substantial degree of control over the overseas manufacturers such that the appellants' ability to purchase the clothing from those manufacturers would be restricted if the appellants did not pay the royalties to the licensors. In particular, counsel relied on the evidence that the appellants have the final word on the choice of manufacturers and quality of the merchandise.

Counsel for the appellants referred to the specific provisions in the licence and sublicence agreements concerning compliance by subcontractors with quality provisions, default, termination and reversion of rights on which counsel for the respondent relied as evidence of a connection between Polo US and the overseas manufacturers. Counsel for the appellants submitted that the licensors are strangers to the contracts between the appellants and the overseas manufacturers and that the provisions in the licence and sublicence agreements are binding on the appellants, not on the overseas manufacturers. As a result, the licence and sublicence agreements do not give the licensors the right to compel third-party overseas manufacturers to comply with the provisions or to put themselves in the place of the appellants as a party to a contract with an overseas manufacturer for the sale of the clothing for export to Canada. Moreover, counsel for the appellants submitted that the fact that the licence and sublicence agreements refer to the licensors purchasing inventory at the landed cost indicates that it was contemplated that the appellants would complete the import transaction and that the licensors would then purchase the clothing once it was in the appellants' inventory in Canada.

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21. Geneva, March 1980, GATT BISD, 26th Supp. at 116.
22. *GATT Agreement and Texts of the Technical Committee on Customs Valuation*, Customs Co-operation Council, Brussels.
23. Appeal No. AP-94-150, September 3, 1996, at 9-10.
24. Appeal No. AP-92-224, September 1, 1993.
25. Appeal No. AP-95-123, January 10, 1997.
26. Appeal Nos. AP-95-126 and AP-95-255, January 15, 1997.
27. *Chaps-Ralph Lauren, Division of 131384 Canada Inc. and Modes Alto-Regal* v. *The Deputy Minister of National Revenue*, Appeal Nos. AP-94-190 and AP-94-191, November 1, 1995.

In argument concerning the fees paid pursuant to the design agreements, counsel for the appellants submitted that these payments are not assists, as contemplated within the meaning of clause 48(5)(*a*)(iii)(D) of the Act and that these payments are, in fact, royalties for the right to use the name and image of "Ralph Lauren" in association with the appellants' imported clothing. Counsel submitted that Revenue Canada's ruling dated February 26, 1993, provided virtually no rationale for its rejection of the appellants' claim that the design fees are, in fact, "royalties" notwithstanding that the design agreements are structured in a fashion similar to the licence agreements and require minimum payments based on a percentage of net sales as opposed to payments for distinct services as envisaged by clause 48(5)(*a*)(iii)(D) of the Act. Counsel submitted that the appellants treat the payments made pursuant to the design agreements as royalties for accounting purposes and withhold tax on these payments as royalties.

Counsel for the appellants submitted that the design agreements are a *de facto* split of the costs associated with the ongoing development of the value of the "Ralph Lauren" trademarks and of the products bearing them. In counsel's view, the fees are for the purpose of securing the right to use the image and reputation of "Ralph Lauren" in Canada in association with the licensed trademarks and not for securing the designs themselves. Moreover, counsel submitted that the parties to the design agreements intended the payments under those agreements to be royalty payments, that the payments were treated as such for income tax purposes, that a large proportion of the clothing at issue comprised classic items and that payments for "earned compensation" were not expressly called design fees.

In submissions concerning the applicability of clause 48(5)(*a*)(iii)(D) of the Act to the fees paid under the design agreements, counsel for the appellants submitted that design work covered by that provision must be undertaken elsewhere than in Canada and be necessary for the production of the imported goods, in other words, essential and indispensable to produce the goods. Counsel referred to the French version of clause 48(5)(*a*)(iii)(D) which provides, in part, that the design work provided must be "*utilisés lors de la production*." Counsel submitted that this suggests that the design work must be used "during" or "while" production is taking place. In counsel's view, intangibles, such as broad concept themes, do not fall within the scope of the provisions of clause 48(5)(*a*)(iii)(D) of the Act. Moreover, counsel submitted, with respect to the fees paid under the Chaps Design Agreement, that those fees could not be considered assists, as they are paid to Mr. Lauren, although the design work is received from Warnaco.

Counsel for the intervener argued in support of the appellants. Counsel submitted that the respondent's position that the payments at issue should be included in the value for duty for certain imported clothing is contrary to the authority that has been evolving before the Tribunal and to general principles of customs and commercial law. Counsel referred to the Tribunal's decisions in *Reebok* and *Jana* which, he submitted, are authority for the view that the licensor must be related to the vendor and exercise substantial control over the vendor for royalties to be dutiable. This view, counsel submitted, is re-affirmed in the Tribunal's decisions in *Mattel* and *PMI*.

In the view of counsel for the intervener, the issue in these appeals is whether the vendor has a right to terminate the agreement for the sale of the goods for export to Canada in the event of non-payment of a royalty. Counsel submitted that, in order for a royalty payment to be dutiable, there must be an obligation to pay the royalty under the agreement for the sale of the goods for export to Canada. In support of this view, he referred to Advisory Opinion 4.8 of the Technical Committee on Customs Valuation.[28]

Counsel for the intervener specifically addressed counsel for the respondent's argument concerning certain quality control provisions in the licence agreements. He pointed out that similar provisions appeared in agreements previously considered by the Tribunal in other appeals and were not found to be determinative of the issue of the dutiability of royalty payments. He submitted that the existence of quality control rights, absent any commercial relationship between the licensor and the manufacturers, does not constitute the licensor and manufacturers related. Moreover, he submitted that trademark law requires that a trademark holder exercise certain quality control rights to maintain his proprietary interest.

In addition, counsel for the intervener specifically addressed the fact that counsel for the respondent relied on certain termination provisions in the licence agreements and submitted that these provisions relate to the licence agreements and not to the agreements for the sale of the goods for export to Canada.

In argument about the issue of the dutiability of the fees paid under the design agreements, counsel for the intervener referred to an excerpt from *Customs Valuation in Canada*,[29] as well as to a US Customs ruling,[30] and submitted that a distinction should be drawn between specifications for ordering product and designs for manufacture. Only the latter, he submitted, is for the actual manufacture of the goods and, therefore, dutiable. He also submitted that a distinction should be drawn between general design concepts and specific design concepts and that only the latter is necessary for production and, therefore, dutiable. Finally, counsel submitted that a distinction should be drawn between unique design work and derivative design work. In his view, if the design work is not unique, it is not dutiable.

Counsel for the respondent submitted that, in order for the fees paid pursuant to the licence and sublicence agreements at issue to be added to the value for duty of the imported clothing, they must be royalties or licence fees, be paid in respect of the imported goods and be paid either directly or indirectly by the appellants as a condition of the sale of the clothing for export to Canada. In counsel's submission, all three of these conditions are met in these appeals.

First, counsel for the respondent submitted that it is clear from the wording of the licence and the sublicence agreements that the payments are royalty payments and that the appellants are not disputing that the payments are royalty payments.

In argument about whether the payments are "in respect of" the imported clothing, counsel for the respondent submitted, based on the decision of the Supreme Court of Canada in *Gene A. Nowegijick* v. *Her Majesty the Queen*,[31] that these words must be given the widest possible meaning. Counsel submitted that the royalties paid under the licence and sublicence agreements are calculated based on a percentage of net

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28. This opinion provides that a royalty would not constitute a royalty paid directly or indirectly as a condition of the sale for export if the "obligation results from a separate agreement unrelated to the sale for export of the goods to the country of importation."
29. M. Irish (Don Mills: CCH Canadian, 1985) at 184.
30. File No. CLA-2 CO:R:CV:V 542830 BS, July 28, 1982. In that ruling, it was held that the designs, samples, prototypes, etc., were not dutiable as the manufacturer had "the capability to produce the desired garments without the necessity of using the photographs, sketches, designs, prototypes and patterns furnished by the importer."
31. [1983] 1 S.C.R. 29 at 39.

sales. Therefore, the royalties collected will vary and depend on the price at which the goods are sold and are, therefore, made in respect of the particular goods being sold. In addition, counsel pointed out that paragraph 1.1 of the Polo Licence Agreement provides that the royalty is paid for the "exclusive non-assignable right to use the Trademark in connection with the importation, manufacture and sale of Licensed Products."

With respect to the third condition, that is, whether the royalties were paid, directly or indirectly, as a condition of the sale for export of the clothing, counsel for the respondent relied on the Tribunal's decision in *Reebok* and, more particularly, on the statement that a fee may be a condition of a sale "as long as there is some connection between it and the goods purchased.[32]" In counsel's submission, there is a connection, since the licensed product may only be manufactured, imported and sold in accordance with the licence agreement and, according to the licence agreement, royalties are due and payable on a quarterly basis. Furthermore, counsel submitted that, although it is not necessary for there to be evidence of a licensor exercising substantial control over the manufacturer of the imported goods in order to find a connection, there is evidence that the licensors in these appeals exercised substantial control over the manufacturing process. In particular, counsel referred to several provisions in the licence agreements, including provisions relating to compliance with the design agreements,[33] provision of production samples to the licensor[34] and approval of subcontractors to manufacture licensed product.[35]

As further evidence of the control exercised by the licensor, counsel for the respondent referred to the fact that the appellants rely on the licensor for the designs and concepts and require the licensor's approval for all designs and prototypes before they are manufactured. The manufacturer, in turn, relies on the appellants for instructions, designs and design concepts. Counsel also referred to the default[36] and termination[37] provisions in the licence and sublicence agreements giving the licensor certain rights over the inventory and unfinished goods upon termination for default by the appellants in payment of the royalty. Furthermore, the licence agreements provide that, upon termination, any interest in the trademarks shall forthwith be assigned and revert back to the licensor.[38] Counsel submitted that the provisions must be interpreted in light of commercial reality such that, if the royalty payments are not made, the licences come to an end and the appellants do not have the legal right to manufacture, import and sell the licensed products. Based on all of these provisions, counsel submitted that the appellants cannot have the clothing manufactured and imported without the licences to manufacture, import and sell the licensed products.

32. *Supra* note 24 at 6.
33. Paragraphs 3.1 and 3.2 of the Chaps Licence Agreement and the Polo Licence Agreement and paragraphs 4.1 and 4.2 of the sublicence agreement.
34. Paragraph 3.2 of the Chaps Licence Agreement and the Polo Licence Agreement and paragraph 4.2 of the sublicence agreement.
35. Paragraph 16.4 of the Chaps Licence Agreement and the Polo Licence Agreement and paragraph 18.4 of the sublicence agreement.
36. Paragraph 9 of the Chaps Licence Agreement and the Polo Licence Agreement and Section X of the sublicence agreement.
37. Paragraph 10 of the Chaps Licence Agreement and the Polo Licence Agreement and Section XI of the sublicence agreement.
38. Paragraph 11 of the Chaps Licence Agreement and the Polo Licence Agreement and Section XII of the sublicence agreement.

Accordingly, counsel for the respondent argued that the royalty payments pursuant to the licence agreements had been correctly included in the value for duty for the imported clothing in issue.

In argument concerning the dutiability of the design fees, counsel for the respondent referred to various provisions in the design agreements which, she submitted, indicate that the fees paid pursuant to the design agreements are paid in exchange for the designs, design concepts or design services embodied in the imported garments and that this design work is necessary for the production of the licensed product.

To support her position that the design fees at issue are dutiable, counsel for the respondent referred to two case studies of the Technical Committee on Customs Valuation of the World Customs Organization on the issue of such fees. Case Study 8.1[39] involves an importer who paid a fee based on a percentage of sales to the licensor for the right to use paper patterns and designs developed by the licensor. The Committee determined that the value of the paper patterns should be included in the customs value as an assist. Case Study 8.2[40] deals with a master tape containing video music clips compiled by the licensor and supplied to the licensee/importer in exchange for a fee based on a percentage of sales. The Committee determined that the percentage paid did form part of the customs value of the imported goods on the basis that the "compilation is part of the design and development phase for the imported video laser discs.[41]"

Contrary to the argument of counsel for the appellants that the design fees are, in fact, royalties, counsel for the respondent submitted that the licence agreements make it clear that the fees are not royalties. In particular, counsel referred to paragraph 3.1 of the licence agreements which stipulates that the design agreements provide for the furnishing to the appellants by R.L. Design Studio of design concepts and other professional services. Paragraph 3.2 of the licence agreements further provides that there must be strict adherence to all details and characteristics embodied in the designs furnished pursuant to the design agreements.

Based on the foregoing, counsel for the respondent submitted that the fees paid pursuant to the Chaps Design Agreement and the Polo Design Agreement were properly included in the value for duty pursuant to clause 48(5)(*a*)(iii)(D) of the Act as "development work, art work,… plans and sketches undertaken elsewhere than in Canada and necessary for the production of the imported goods."

Prior to its decision and reasons being issued, the Tribunal became aware of the decision of the Federal Court - Trial Division in *Reebok Canada, A Division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise*[42] (*Reebok-FC*). By letter dated July 22, 1997, the Tribunal wrote to the parties and indicated that it was of the view that it should consider this case in coming to a decision in these appeals. The Tribunal recognized that the parties had not had an opportunity to address the impact of the Federal Court's decision and, therefore, gave the parties the opportunity to file submissions in this regard. All parties filed submissions in accordance with the Tribunal's directions.

Counsel for the appellants submitted that the decision confirms the correctness of the Tribunal's legal interpretation and approach to determine whether payments to licensors are dutiable pursuant to subparagraph 48(5)(*a*)(iv) of the Act. Counsel submitted that the Federal Court implicitly adopts substantial control as part of the legal test to determine whether there is some connection between the royalty payment to

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39. Annex IV to Doc. 39.000E.
40. Annex V to Doc. 39.000E.
41. *Ibid.* at para. 9.
42. Unreported, Court File No. T-864-94, June 30, 1997.

the licensor and the foreign manufacturers that produce the goods for export to the licensee. Counsel then went on to point out the key factual differences between *Reebok* and these appeals. In particular, counsel submitted that: (1) the appellants have the final word on the choice of manufacturers and factories; (2) the licensors are not privy to the contracts between the appellants and the manufacturers, and the licensors have no involvement at the factory level; (3) there are no corporate relationships between the appellants, the licensors and the factories that manufacture the goods sold for export; and (4) the licensors have never inspected a factory used by the appellants and have no rights to compel a factory to abide by the quality obligations in the licence agreements.

Counsel for the intervener submitted that the Federal Court paid particular curial deference not only to the Tribunal's decision in *Reebok* but also to the Tribunal's "evolving jurisprudence." He further submitted that the Federal Court deferred to the Tribunal's expertise because it expressly found the Tribunal to be "consistent" in its evolving jurisprudence concerning subparagraph 48(5)(*a*)(iv) of the Act and implicitly recognized the importance of reading the Tribunal's decision in the context of its other rulings. In counsel's view, *Jana* is at the centre of the Tribunal's evolving jurisprudence, given that it followed *Reebok* and preceded *Mattel* and *PMI*. He submitted, therefore, that the enhanced precedential value of *Reebok* and *Jana* is significant because he relied on these two decisions as authority for his arguments. In counsel's view, the Federal Court in *Reebok-FC* made an implicit finding that substantial control was a necessary precondition to the application of subparagraph 48(5)(*a*)(iv) of the Act and it is artificial to draw any distinctions between a "some connection" and "substantial control" test as, to be legally relevant, "substantial control" has to be a requirement under the "some connection" test.

Counsel for the respondent submitted that the Federal Court in *Reebok-FC*, in finding that the Tribunal did not err in concluding that the royalty was correctly added to the price paid or payable for the imported goods pursuant to subparagraph 48(5)(*a*)(iv) of the Act, recognized and relied on the fact that the failure to pay the royalties would give rise to a remedy in damages on the licensor's part and in the possibility of loss of the exclusive or any right to market the trademarked goods. Counsel argued that, in these appeals, the licence and sublicence agreements provide for such a remedy in that a failure to pay the royalties may result in the termination of the agreements and, on termination, all rights granted, namely, the right to manufacture, import and sell the trademarked goods, shall be assigned and shall revert back to the licensor. Counsel further submitted that, upon termination, those goods in the licensee's inventory would be purchased and taken over by the licensor, as would the goods in transit and the goods in the process of being manufactured. Counsel concluded that the *Reebok* decision supports the respondent's position that subparagraph 48(5)(*a*)(iv) of the Act must be interpreted in light of commercial reality, namely, that, if the royalty is not paid, the licence comes to an end, and the appellants no longer have the legal right to manufacture, import and sell the licensed goods.

With respect to the issue of "substantial control" as a factor in determining whether or not payment of a royalty is a condition of a sale, counsel for the respondent submitted that the Federal Court characterized the Tribunal's finding of substantial control in *Reebok* as a factual finding based on the evidence in that case. As such, it should not be imported and applied in all cases and does not constitute a legal precedent that evidence of substantial control is required to conclude that a royalty is a condition of the sale pursuant to subparagraph 48(5)(*a*)(iv) of the Act. In counsel's view, "substantial control" is but one of the ways to establish a connection between the royalty and the sale for export.

As described by counsel for the respondent, there are essentially three issues to be determined by the Tribunal in these appeals. First, the Tribunal must determine whether royalties paid by Modes pursuant to the Polo Licence Agreement and the Chaps Licence Agreement are dutiable pursuant to subparagraph 48(5)(*a*)(iv) of the Act as payments for trademarks in respect of the imported clothing that the appellants must pay, directly or indirectly, as a condition of the sale of the goods for export to Canada. Second, the Tribunal must determine whether design fees paid by Modes pursuant to the Polo Design Agreement and the Chaps Design Agreement are dutiable pursuant to clause 48(5)(*a*)(iii)(D) of the Act as fees paid for design work undertaken elsewhere than in Canada and necessary for the production of the imported clothing. The third and final issue is whether the royalties paid by 131384 Canada Inc. to Modes pursuant to the sublicence agreement are dutiable pursuant to subparagraph 48(5)(*a*)(iv) of the Act as payments for trademarks in respect of the imported clothing that the appellants must pay, directly or indirectly, as a condition of the sale of the goods for export to Canada.

In considering the first issue, the Tribunal has reviewed its previous decisions and those of the Federal Court concerning the issue of the inclusion of royalties in the value for duty of imported goods. The Tribunal has consistently stated that, in order for a royalty payment to be dutiable, it must: (1) be in respect of the imported goods; and (2) be paid, directly or indirectly, as a condition of the sale of the goods for export to Canada, as required by subparagraph 48(5)(*a*)(iv) of the Act.

The Tribunal finds that, in the circumstances of these appeals, the payments are royalties which are "in respect of" the goods in issue. The Tribunal has interpreted the phrase "in respect of the goods" to mean that the payment must not be a general payment unaffected by the specific goods being imported. In the Tribunal's view, this requirement is met in these appeals, since the amount of the royalty payments is based on the net sales of the imported goods in Canada and is, therefore, affected by the specific goods imported. However, the issue of whether the fees were paid, directly or indirectly, as a condition of sale for export to Canada is a more complicated matter.

The Tribunal notes that the Federal Court's decision in *Reebok-FC* affirms the Tribunal's decision in *Reebok* that the royalties were payments within the meaning of royalties, as defined in subparagraph 48(5)(*a*)(iv) of the Act. In its decision, the Federal Court states that the royalties related to the exclusive use and sale of goods bearing trademarks of value and were payments related to the valuable intellectual property rights associated with the purchase and sale of the goods in issue and that the Tribunal's decision was consistent with evolving jurisprudence in regard to this issue. The Federal Court then makes reference to the Tribunal's decision in *Polygram Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise*[43] and the Federal Court of Appeal's decision in *Signature Plaza Sport Inc.* v. *Her Majesty the Queen*.[44] The Tribunal wishes to comment on these decisions and decisions that it made subsequent to *Polygram* and *Reebok*, such as *Jana* and *Mattel*.

The Federal Court of Appeal emphasized, in *Signature Plaza*, that the issue of who is the vendor of the goods is critical to evaluating whether a royalty can be said to be a condition of sale for export. In the Tribunal's view, the evidence shows that it is the Asian manufacturers that are the vendors of the goods in issue and not Polo US. This makes these appeals different from *Signature Plaza*.

The Tribunal has indicated, in previous decisions, that it is of the view that the existence of a licence agreement and the obligation to pay a royalty is not sufficient, in themselves, to make a royalty payment a condition of sale between a licensee and a foreign manufacturer. Otherwise, there would almost never be a

43. Appeal Nos. AP-89-151 and AP-89-165, May 7, 1992.
44. (1994), 54 C.P.R. (3d) 526, File No. A-453-90, February 18, 1994.

case when such a payment would not be included in the value for duty under subparagraph 48(5)(*a*)(iv) of the Act. In the Tribunal's view, this is not intended by that provision. As indicated in the advisory opinions and discussed by the Tribunal in *Jana*, circumstances where the obligation to pay a royalty arises from a separate agreement unrelated to the sale for export of the goods or where the purchaser does not have to pay the royalty in order to purchase the goods are circumstances where the royalty should not be included in the value for duty of those goods.[45]

A review of the facts of the previous decisions that considered subparagraph 48(5)(*a*)(iv) of the Act indicates that royalty payments have been found to be a condition of the sale for export to Canada where there was evidence as to significant involvement of the licensor in the manufacture, purchase and importation of goods. For instance, in *Signature Plaza*, royalties paid by a Canadian purchaser to a licensee, which licensee arranged for the offshore purchase, cut, making and trimming of fabrics by offshore plants and the delivery to the Canadian purchaser of the finished products, were found to be dutiable. In *Reebok*, royalties paid to a licensor, which licensor had entered into manufacturing and trimming agreements with the overseas manufacturers, were found to be dutiable. In *Polygram*, *Reebok* and *PMI*, royalties paid to a licensor that was also the vendor and/or manufacturer were found to be dutiable.

In the Tribunal's view, the royalties paid pursuant to the licence agreements at issue can be characterized similarly to those in *Reebok-FC* which were found to be royalties under subparagraph 48(5)(*a*)(iv) of the Act. More particularly, the royalties at issue related to the exclusive use and sale of goods bearing the "Chaps by Ralph Lauren" and the "Polo by Ralph Lauren" trademarks and the valuable intellectual property rights associated with the purchase and sale of those goods.

In addition, the Tribunal has considered the relationships between the various parties involved in the import transactions at issue. The Tribunal is persuaded that the manufacturers in these appeals would not have sold the goods in issue to the appellants if the royalty payments were no longer being paid. While, in the normal course of business, there is no evidence of any requirement that the appellants establish that they have paid the royalties before the sale for export is completed, the Tribunal is persuaded that the commercial reality for the goods in issue is that the sale of those goods for export to Canada would not occur if the royalties were no longer being paid. Polo Sourcing, the agent for Modes, had to inspect the merchandise before the manufacturers could cash the letters of credit and ship the merchandise to Canada. Polo Sourcing was, at that time, a subsidiary of Polo US. Although Polo Sourcing was acting as agent for Modes in the day-to-day transactions, it would not necessarily do so in the case of the termination of the licence agreements, at which point, according to the licence agreements, the goods, which are in the process of being manufactured, come under the option of possession by the licensor.[46] For the above reasons, the Tribunal is of the view that the royalties paid by the appellants pursuant to the Chaps Licence Agreement and the Polo Licence Agreement were paid as a condition of the sale of the clothing in issue for export to Canada and were, therefore, correctly added to the price paid or payable for that clothing.

To decide the second issue, that is, whether the fees paid pursuant to the Polo Design Agreement and the Chaps Design Agreement are dutiable, the Tribunal must determine the following: (1) whether the fees are payments for design work; (2) whether the fees are for goods or services supplied, directly or indirectly, by the appellants, for use in the production and sale for export of the imported goods; and

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45. Advisory Opinions 4.8 and 4.13 respectively and s*upra* note 23.
46. Paragraph 10.2 of the Chaps Licence Agreement and the Polo Licence Agreement and paragraph 11.2 of the sublicence agreement.

(3) whether the design work is undertaken elsewhere than in Canada and is necessary for the production of the imported goods.

In considering whether the fees are payments for design work, the Tribunal notes that, in *Capital Garments Co. Inc.* v. *The Deputy Minister of National Revenue*,[47] it found that the term "design" may be interpreted as "an outline, sketch, or plan, as of the form and structure of a work of art, an edifice, or a machine to be executed or constructed.[48]" A "plan" was defined as "a formulated and esp. detailed method by which a thing is to be done; a design or scheme.[49]"

The evidence before the Tribunal indicates that what the appellants receive from Mr. Lauren pursuant to the design agreements are "broad design themes and concepts," written descriptions, photographs, concept boards and colour stats, which provide more detailed information concerning the style, colours and fabrics for the items present in the fashion grouping, as well as specifications, if they are available, and fabric swatches and information about the fabric mill. In the Tribunal's view, these goods and services qualify as "design work" as that term is commonly defined. While the Tribunal acknowledges that there are several classic designs that are produced year after year with little or no change, the evidence indicates that, even in those circumstances, certain features, such as colour, will change.

The Tribunal is persuaded by the evidence that the appellants supplied to the manufacturers, either directly or through their agent, the design details received from Mr. Lauren. In the Tribunal's view, without these design details, the manufacturers would not have been able to produce the "Ralph Lauren" clothing for that season. The Tribunal is satisfied, based on the provisions of the design agreements and the testimony of the witnesses, that what is being provided under the design agreements and, in turn, supplied to the overseas manufacturers by the appellants qualify as goods or services for use in the production and sale for export of the imported clothing in issue.

As to whether or not the design work is necessary for the production, the Tribunal is of the view that, without the goods and services described above, the appellants could only have the goods manufactured by waiting until a particular piece of clothing became publicly available and could be sent to a manufacturer to be copied. While it is noted that manufacturers require additional materials, such as patterns and fabric, there are many stages or steps involved in manufacturing a piece of clothing, and the Tribunal does not interpret the phrase "necessary for the production" so restrictively as to include only the actual manufacture of the clothing in the factory. Moreover, the sublicence agreement describes design concepts as those "to be used in the manufacture of the Licensed Products.[50]"

With respect to the last requirement, that the design work be undertaken elsewhere than in Canada and necessary for the production of the imported goods, the Tribunal is of the view that this requirement is met. This work is clearly undertaken by Mr. Lauren and/or R.L Design Studio in the United States.

Accordingly, the Tribunal finds that the fees paid by the appellants to Mr. Lauren and/or R.L. Design Studio pursuant to both the Polo Design Agreement and the Chaps Design Agreement are design fees dutiable under clause 48(5)(*a*)(iii)(D) of the Act.

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47. Canadian International Trade Tribunal, Appeal No. AP-96-002, June 3, 1997.
48. *Ibid.* at 7.
49. *Ibid.*
50. Paragraph 1.1 of the sublicence agreement.

The third and final issue is whether the royalties paid by 131384 Canada Inc. pursuant to the sublicence agreement with Modes are dutiable. The Tribunal finds that, while the fees may be considered to be "in respect of" the imported clothing in that they are calculated based on net sales of the imported clothing, it cannot accept that the fees are paid, directly or indirectly, as a condition of the sale for export. First, the sublicence agreement provides that 131384 Canada Inc., a Canadian company, is to pay the royalties to Modes, also a Canadian company and a company with the same ownership, management and staff as 131384 Canada Inc. 131384 Canada Inc. is, therefore, not assuming any of the responsibility to pay the royalties to Polo US pursuant to the Chaps Licence Agreement or to pay the design fees to Mr. Lauren pursuant to the Chaps Design Agreement. Modes continues to be responsible for paying the royalties and design fees. Whether 131384 Canada Inc. pays Modes or not has nothing to do with the condition of the sale for export to Canada. That condition is met by Modes paying the royalties and design fees to Polo US and not when, if or whether 131384 Canada Inc. pays the royalties and design fees to Modes. Moreover, although 131384 Canada Inc. and Modes are incorporated as two separate companies, they are really one and the same.

Accordingly, the appeals are allowed in part.

Arthur B. Trudeau
Arthur B. Trudeau
Presiding Member

Patricia M. Close
Patricia M. Close
Member

Charles A. Gracey
Charles A. Gracey
Member