CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Wednesday, January 15, 1997

Appeal Nos. AP-95-126 and AP-95-255

IN THE MATTER OF appeals heard on September 24 and 25, 1996, 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 June 6 and December 19, 1995, with respect to a request for re-determination under section 63 of the *Customs Act*.

BETWEEN

MATTEL CANADA INC. **Appellant**

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeals are allowed in part.

Charles A. Gracey
Charles A. Gracey
Presiding Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Lyle M. Russell
Lyle M. Russell
Member

Susanne Grimes
Susanne Grimes
Acting Secretary

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UNOFFICIAL SUMMARY

Appeal Nos. AP-95-126 and AP-95-255

MATTEL CANADA INC. **Appellant**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

The appellant acquires goods through an ordering system controlled by Mattel, Inc. (Mattel). The selection of available goods and prices is also controlled by Mattel. When goods are manufactured and ready for shipment, Mattel T Company Limited (Mattel Trading) is invoiced for the goods. Mattel Trading invoices Mattel, which then invoices the appellant. Mattel Trading and Mattel both take title to the goods before it is transferred to the appellant. Goods are shipped directly from the manufacturers to the appellant

For the right to manufacture (or have manufactured), distribute and sell products based on certain licensed materials, the appellant is required to pay royalties to the licensor. The royalties are equal to a specified percentage of the appellant's net invoiced billings for the goods sold to customers in Canada. In addition, Mattel entered into several agreements with various parties (the master licensors) to obtain licence rights with respect to other products. The appellant makes periodic payments to Mattel that are intended to reimburse Mattel for the licence payments that it makes to the master licensors.

The issues in these appeals are: (1) which transaction should form the basis for determining the transaction value of the imported products; (2) whether the royalty payments made by the appellant to the licensor form part of the transaction value of the imported products; and (3) whether the payments made by the appellant to Mattel, in respect of the licence payments made by Mattel to the master licensors (the reimbursements), form part of the transaction value of the imported products.

HELD: The appeals are allowed in part. With regard to the first issue, the Tribunal is of the view that there was a single sale for export, being between Mattel as vendor and the appellant as purchaser. The manufacturers and Mattel Trading did not manifest the necessary degree of independence from Mattel to support a finding that true sales occurred between them. As a whole, the evidence supports the finding that Mattel was the principal as regards the supply of goods to the appellant. The Tribunal dismisses the appeals on the first issue.

The Tribunal allows the appeals on the second issue, as it finds that the payments were not made as a condition of the sale of the goods for export to Canada, as required by subparagraph 48(5)(*a*)(iv) of the *Customs Act*. The Tribunal is not persuaded that a sufficient nexus existed between the payments and the sales for export to say that they were made as a condition of those sales.

As to the third issue, the Tribunal considered the reimbursements to be indirect royalty payments to the master licensors. The Tribunal is of the view that the payments were not made as a condition of the sale of the goods for export to Canada, as required by subparagraph 48(5)(*a*)(iv) of the *Customs Act*. With regard to subparagraph 48(5)(*a*)(v) of the *Customs Act*, the Tribunal is of the view that the economic benefit or value of the indirect royalty payments passed through Mattel, the vendor of the goods, and accrued to the

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master licensors. As the conditions of both subparagraphs 48(5)(*a*)(iv) and (v) of the *Customs Act* have not been met, the Tribunal allows the appeals on this issue.

Place of Hearing:	Ottawa, Ontario
Dates of Hearing:	September 24 and 25, 1996
Date of Decision:	January 15, 1997
Tribunal Members:	Charles A. Gracey, Presiding Member Arthur B. Trudeau, Member Lyle M. Russell, Member
Counsel for the Tribunal:	David M. Attwater
Clerk of the Tribunal:	Anne Jamieson
Appearances:	Richard S. Gottlieb and Darrel H. Pearson, for the appellant Ian McCowan, for the respondent

CANADIAN INTERNATIONAL TRADE TRIBUNAL | TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal Nos. AP-95-126 and AP-95-255

MATTEL CANADA INC. **Appellant**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: CHARLES A. GRACEY, Presiding Member
ARTHUR B. TRUDEAU, Member
LYLE M. RUSSELL, Member

REASONS FOR DECISION

These are two appeals, heard together, under section 67 of the *Customs Act*[1] (the Act) from 11 decisions of the Deputy Minister of National Revenue made under subsection 63(3) of the Act. At issue is the transaction value of certain goods imported into Canada by the appellant. Much of the information received by the Tribunal during the hearing, and on which it renders its decision, was confidential.

Mr. Orest Matkowsky,[2] Vice-President of Finance, Mattel Canada Inc., explained that the appellant is wholly owned by Mattel Holdings, Ltd., which is wholly owned by Mattel, Inc. (Mattel) of the United States. Mattel also wholly owns Mattel T Company Limited (Mattel Trading) of Hong Kong and several manufacturing plants located in such places as Malaysia, Hong Kong, Indonesia and Mexico (the related manufacturers). Mr. Matkowsky told the Tribunal that Mattel Trading negotiates with and purchases goods from related and non-related manufacturers. It is also a "contact point" for all subsidiaries of Mattel.[3] Another subsidiary of Mattel is Mattel Toys Vendor Operations Ltd. (Vendor Operations) of Hong Kong, which sources goods from non-related manufacturers. Mr. Matkowsky acknowledged that Vendor Operations can be characterized as a type of buying agent that normally takes title to goods acquired from non-related manufacturers.

The appellant acquires goods through an ordering system controlled by Mattel. The selection of available goods and prices is also controlled by Mattel. The Tribunal was told that, when goods are manufactured and ready for shipment, then, depending on the source, Mattel Trading purchases them from the related manufacturers or from Vendor Operations. Goods are shipped directly from the manufacturers to the appellant,[4] which insures them from the time they leave the factory. Mattel Trading is invoiced when the goods are shipped; Mattel Trading then invoices Mattel, which, in turn, invoices the appellant. Mattel Trading and Mattel both take title to the goods before it is transferred to the appellant.

It was explained that the unit price for products invoiced at different levels is based on a pre-determined price list (Exhibit A-8 [protected]), which is updated on a monthly basis. Prices at the

1. R.S.C. 1985, c. 1 (2nd Supp.).
2. Mr. Matkowsky was part of a panel of witnesses that included Ms. Heather M^{c}Aneney, Customs/Traffic Manager, Mattel Canada Inc., and Ms. Marsela Pérez McGrane, who is in charge of import and export activities at Mattel, Inc.
3. Ms. McGrane stated that Mattel Trading was established for customs compliance and that it "holds all the tooling, design and development, general and administrative expenses, quality assurance, et cetera," *Transcript of Public Hearing*, September 24, 1996, at 82.
4. Much evidence was tendered to support the assertion that, when the goods were being manufactured, their destination to Canada was known. *Transcript of In Camera Hearing*, September 24, 1996, at 5-7.

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three levels are established to fully recover costs incurred for goods, services, overhead, etc., at each level and to make a profit.

For the right to manufacture (or have manufactured), distribute and sell products based on certain licensed materials, the appellant is required to pay royalties to the licensor. The royalties are equal to a specified percentage of the appellant's net invoiced billings for the goods sold to customers in Canada.

In addition, Mattel entered into several agreements with various parties (the master licensors) to obtain licence rights with respect to other products. The appellant makes periodic payments to Mattel that are intended to reimburse Mattel for the licence payments that it makes to the master licensors.

The issues in these appeals are: (1) which transaction should form the basis for determining the transaction value of the imported products; (2) whether the royalty payments made by the appellant to the licensor form part of the transaction value of the imported products; and (3) whether the payments made by the appellant to Mattel, in respect of the licence payments by Mattel to the master licensors (the reimbursements), form part of the transaction value of the imported products.

For purposes of these appeals, the relevant provisions of the Act read as follows.

> 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.
>
> (4) The transaction value of goods shall be determined by ascertaining the price paid or payable for the goods when the goods are sold for export to Canada and adjusting the price paid or payable in accordance with subsection (5).
>
> (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,
>
> (v) the value of any part of the proceeds of any subsequent resale, disposal or use of the goods by the purchaser thereof that accrues or is to accrue, directly or indirectly, to the vendor.

Counsel for the appellant noted that the Act requires that the transaction value of goods be the price paid or payable for goods when sold for export to Canada. It was submitted that the sales from the manufacturers to Mattel Trading, from Mattel Trading to Mattel and from Mattel to the appellant represent three sales for export to Canada. In each of these sales, there is a transfer of title in the goods for money consideration, and there is no evidence of a sham transaction or an attempt to split a single transaction into three. Furthermore, the Act and policy[5] of the Department of National Revenue (Revenue Canada) contemplate that there may be more than one sale for export to Canada. However, the Act does not specify which transaction should apply for valuation purposes.

Counsel for the appellant argued that there is no foundation for Revenue Canada's policy of considering the sale for export to be the sale that triggers the chain of events resulting in an international transfer of goods (in this case, being the sale between Mattel and the appellant).[6] In contradiction, a legislative intent can be gleaned from the Act to use, for valuation purposes, the lowest transaction value

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5. In support of this proposition, counsel for the appellant referred to paragraphs 9 and 10 of Memorandum D13-4-2, titled "Customs Valuation: Sold for Export to Canada (*Customs Act*, section 48)," Department of National Revenue, Customs and Excise, August 21, 1989.
6. *Ibid*. paragraph 7 at 3.

from those that may apply.[7] Counsel referred to the Tribunal's decision in *Harbour Sales (Windsor) Limited* v. *The Deputy Minister of National Revenue*[8] in support of the propositions that there may be more than one sale for export, that the purchaser in a sale for export need not be a Canadian resident[9] and that a non-resident purchaser in a sale for export may subsequently resell the goods to a Canadian resident, resulting in two sales for valuation purposes. Based on the scheme and objects of the Act, counsel argued that the sales from the manufacturers to Mattel Trading were the sales for export to Canada for valuation purposes. Furthermore, any doubt as to which transaction should be used for valuation purposes should be resolved in favour of the appellant.[10]

It was submitted that, where legislation in the United States is virtually identical to Canadian legislation, both are based on the same international treaty (in this case, the *Customs Valuation Code*[11]) and, because both countries rely on the same common law system for determining statutory interpretation, that regard should be had to decisions of US courts for purposes of interpreting the Canadian legislation. In this regard, counsel noted that, where there are two or more qualifying sales for export, US courts have determined that the lowest transaction value shall apply for valuation purposes.[12]

As to the royalty payments, counsel for the appellant noted that the valuation provisions of the Act are based on the price of goods when sold for export to Canada. In contrast to the valuation regime in place until the end of 1984, which was based on the intrinsic value of goods, including costs associated with intellectual properties, the present regime is based on the price received by the vendor in the sale for export, subject to certain adjustments. Those adjustments, found at subsection 48(5) of the Act, represent an anti-avoidance scheme to ensure that, where certain charges are not included in the price paid or payable to the vendor for the goods, but are paid separately, such charges will be included in the price for valuation purposes.

Counsel for the appellant argued that all royalties and licence fees are not dutiable. Rather, such fees are dutiable when payment is made in respect of the goods, either directly or indirectly, as a condition of their sale for export to Canada. Payment of a fee is a condition of sale when imposed by the vendor for its benefit. If the vendor cannot require that payment be made before a sale occurs, then payment of the fee is not a condition of the sale and not, therefore, part of the price of the goods. Furthermore, there is no evidence of agreements between the licensors and the manufacturers giving the licensors control over to whom goods are sold.

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7. In support of this proposition, counsel for the appellant referred to subsections 49(5) and 50(2) of the Act, which dictate choosing the lowest transaction value of identical goods or similar goods when there are two or more transaction values of such goods that meet certain requirements set out in the Act.

8. Appeal No. AP-93-322, November 4, 1994; leave to appeal denied by the Federal Court - Trial Division, Action No. 95-T-5, February 2, 1995.

9. Subsequent to the Tribunal's decision in *Harbour Sales*, subsection 48(1) of the Act was to be amended, by introducing a Canadian residency requirement, by *An Act to amend the Customs Act and the Customs Tariff and to make related and consequential amendments to other Acts*, S.C. 1995, c. 41, s. 18. As of the date of hearing of this appeal, the amendment had not been proclaimed in force.

10. In support of this proposition, and for a general review of the rules governing the interpretation of taxing statutes, counsel for the appellant referred to *Québec (Communauté urbaine)* v. *Corp. Notre-Dame de Bon-Secours*, [1994] 3 S.C.R. 3.

11. *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade*, signed in Geneva on April 12, 1979.

12. See, for example, *E.C. McAfee Co. and St. Paul Fire and Marine Insurance Co.* v. *United States, U.S. Customs Service and Commissioner of Customs*, 842 F.2d, 314, 6 Fed. Cir. (T) 92 (Fed. Cir. 1988); *Nissho Iwai American Corp.* v. *United States*, Appeal No. 92-1239, *Slip Op.* at 16 (Fed. Cir. Dec. 28, 1992); and *Synergy Sport International, Ltd.* v. *United States*, 17 CIT 18 (1993) (USITC).

Counsel for the appellant submitted that, because of the context within which the term "condition" is found, it must be interpreted with reference to the law respecting the sale of goods. Under this interpretation, if a condition of sale is not met, the vendor need not make the sale. However, in this case, sales by the manufacturers were not dependent on the payment of royalties under the licence agreements at issue. Sales occurred well before the payments were due, and the manufacturers could not rescind the contract if the payments were not made.

As the royalty payments were made for marketing and distribution rights in Canada to goods bearing a copyright, trademark or patent, they are not the type of royalty or licence fee that is dutiable under the Act. In support, counsel for the appellant argued that marketing expenses in the form of royalty payments are not included in the deductive or computed value for duty.[13] As the value for duty appraised under these methods should be similar to that appraised under the transaction value method, the royalty payments should not be included in the value for duty under the transaction value method.

Furthermore, counsel for the appellant contended that the royalty payments were not made in respect of the goods. Where payments are made for exclusive distribution rights, and not for use of a right provided under trademark, copyright or patent law, such payments are not in respect of the goods.

With regard to the reimbursements paid by the appellant, counsel for the appellant submitted that they were not payments of subsequent proceeds, as described in subparagraph 48(5)(*a*)(v) of the Act. Counsel opined that this provision of the Act ensures that a vendor's price in a sale for export to Canada is not split into dutiable and non-dutiable components. It was submitted that there is no evidence of price splitting or that the payments were made in respect of the price paid or payable for the goods. Rather, the payments by the appellant merely flowed through Mattel to the master licensors. They were not payments of an obligation by Mattel to the master licensors.

The payments by the appellant to Mattel were characterized as royalties by counsel for the appellant. Counsel argued that, as royalties, if they are not dutiable under subparagraph 48(5)(*a*)(iv), which deals expressly with royalties, then they cannot be dutiable under subparagraph 48(5)(*a*)(v) of the Act.[14] Furthermore, if the Tribunal finds that Mattel was not the vendor of the goods, then the payments could not have accrued to the vendor, as required by subparagraph 48(5)(*a*)(v) of the Act.

Counsel for the respondent argued that there was only one sale for export, being between Mattel and the appellant. In support of this position, counsel referred to much of the confidential evidence tendered during the hearing.[15] In particular, counsel noted that the appellant was offered products through an established process, at a price established by Mattel. If the appellant chose to purchase a particular product, it was at that price, and the appellant was invoiced at that price. Counsel submitted that this price should be used for valuation purposes.

As to the US court decisions, counsel for the respondent submitted that they are based on legislation with slightly different wording, that they do not involve transactions between related companies and that they are not binding on the Tribunal.

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13. Sections 51 and 52 of the Act respectively.
14. In support of this proposition, counsel for the appellant referred to S.L. Sherman and H. Glashoff, *Customs Valuation: Commentary on the GATT Customs Valuation Code* (Norwell, Ma.: Kluwer Law and Taxation, 1988) at 155.
15. *Transcript of In Camera Argument*, September 25, 1996, at 25-30.

With regard to the royalty payments, counsel for the respondent submitted that inclusion of "directly or indirectly" in subparagraph 48(5)(*a*)(iv) of the Act results in the provision having broad effect. It was argued that this conclusion was recognized by the Tribunal in *Reebok Canada Inc., A Division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise.*[16] In *Reebok*, after noting that the phrase "as a condition of the sale" is preceded by the words "directly or indirectly," the Tribunal concluded that, "although a fee may not be required pursuant to the terms of the purchase itself, it may still be considered to be a condition of the sale, as long as there is some connection between it and the goods purchased.[17]"

Counsel for the respondent submitted that the evidence establishes a clear link between the royalty payments made by the appellant and the imported goods. Furthermore, the licence agreements provide significant protection and control to the licensor, which were enforceable against the appellant. Based on the evidence,[18] the principle enunciated in *Reebok* is determinative of this aspect of the appeal.

With regard to the reimbursements paid by the appellant, counsel for the respondent noted that they are made to "cover off" licence payments which Mattel is obliged to make to the master licensors. Counsel argued that they represent indirect royalty payments. As such, they are dutiable under subparagraph 48(5)(*a*)(iv) of the Act. In the alternative, counsel argued that they represent payments of subsequent proceeds and are dutiable under subparagraph 48(5)(*a*)(v) of the Act. In this regard, it was submitted that an obligation to pay Mattel, which is the vendor of the goods, occurs when the appellant subsequently sells the goods.

With regard to the first issue, the Tribunal is of the view that there was a single sale for export, being between Mattel as vendor and the appellant as purchaser. The manufacturers and Mattel Trading did not manifest the necessary degree of independence from Mattel to support a finding that true sales occurred between them. As a whole, the evidence supports the finding that Mattel was the principal as regards the supply of goods to the appellant.

It is Mattel that designs and develops new products. To display its wares, Mattel participates in toy fairs and uses catalogues. Though Mattel may seek consultation, it has the final say on prices for its products at the various transaction levels. A single price list is established for all products, regardless of the actual manufacturer that may make them. If the appellant orders a particular product, it is at the price payable to Mattel and no other. Thus, it is Mattel that issues annual product offerings and establishes prices to the appellant. It is the appellant that initiates the sale for export by ordering goods.

To acquire product, the appellant must use an ordering system established and controlled by Mattel; it may not order goods through different means directly from the manufacturers or any other party. For this reason and others, Mattel has the final say as to which products are available for sale to the appellant. Total demand for the various products from all Mattel subsidiaries is assigned through the system to the various manufacturers. The appellant is advised to whom a purchase order must be issued. Furthermore, the manufacturing source of a particular product may be switched without consultation with the appellant.

The evidence as a whole presents a picture of a single, multi-stage transaction involving one sale for export. The Tribunal is of the view that the manufacturers, Vendor Operations and Mattel Trading are

16. Appeal No. AP-92-224, September 1, 1993.
17. *Ibid*. at 6.
18. *Transcript of In Camera Argument,* September 25, 1996, at 30-42.

providing services and more[19] to Mattel. In effect, the arrangement results in a division of the sale price amongst the various parties according to the "value added" that they bring to the goods sold to the appellant.

As to the contention by counsel for the appellant that subsections 49(5) and 50(2) of the Act indicate a legislative intent to apply the lower of two or more prices as the transaction value, the Tribunal notes that these provisions apply to two or more sales of identical or similar goods and not to two or more stages in a single, multi-stage transaction involving one sale for export. Thus, these provisions are not relevant to the specific facts of this case. Accordingly, the Tribunal dismisses the appeals on this issue.

With respect to the royalty payments by the appellant to the licensor, the Tribunal starts with the proposition, articulated in *Polygram Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise*,[20] that three key criteria must be met for the payments to be dutiable: (1) the payments were a royalty or licence fee; (2) the payments were in respect of the goods; and (3) they were paid, directly or indirectly, as a condition of the sale of the goods for export to Canada.[21] As the Tribunal finds that the payments were not made as a condition of the sale of the goods for export to Canada, it allows the appeals on this issue.

In forming this view, the Tribunal is not persuaded that a sufficient nexus existed between the payments and the sales for export to say that they were made as a condition of those sales. Rather, the payments were more closely related to rights, in respect of the goods, exercised in Canada and quantified with reference to resales in Canada and other factors[22] that bore little or no connection to the sales for export. Furthermore, the evidence was to the effect that some goods were purchased and imported into Canada without the appellant ever making a royalty payment in respect of the goods.[23]

Unlike the circumstances in *Polygram*, the appellant was making payments to a third-party licensor, which was unrelated to the vendor of the goods. The evidence did not support a finding that the licensor actually exerted control or influence over the sales for export through ownership, contract or otherwise to the extent that sales were made conditional on the royalty payments.

As to the reimbursements, the Tribunal is in agreement with counsel for the respondent that they may be characterized as indirect royalty payments. A review of the salient agreements indicates that Mattel could assign the agreements or rights thereunder to subsidiaries or affiliates. Although there was no direct evidence that such assignments occurred, the evidence is clear that, at a minimum, the burden of the royalty payments incurred under the agreements in respect of sales in Canada had been passed on to the appellant. The appellant was making the payments in consideration of rights granted under the agreements. Subparagraph 48(5)(*a*)(iv) of the Act recognizes royalties and licence fees paid directly and indirectly. As the burden of the royalty payments in respect of sales in Canada was passed on to the appellant, the Tribunal considers such payments by the appellant to be indirect royalty payments. These payments were passed through Mattel to the master licensors. If the agreements or rights and obligations thereunder were assigned

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19. See, for example, *Transcript of In Camera Hearing*, September 24, 1996, at 112.
20. (1992), 5 T.C.T. 1216, Canadian International Trade Tribunal, Appeal Nos. AP-89-151 and AP-89-165, May 7, 1992.
21. *Ibid*. at 1218.
22. For instance, under subparagraph 1.(j) of Exhibit A-1 (protected), the appellant must guarantee a certain payment regardless of whether the goods are imported into or manufactured in Canada, and which bears no relation to the sale of the goods, in partial consideration for the rights being granted to it.
23. For instance, goods subsequently exported (*Transcript of In Camera Hearing*, September 24, 1996, at 26 and 56) or returns/defects (*Transcript of In Camera Hearing*, September 24, 1996, at 22).

to the appellant, as claimed by counsel for the appellant, the Tribunal would consider them to be direct royalty payments passed through Mattel to the master licensors.

The Tribunal is of the view that the indirect royalty payments were not made as a condition of the sale of the goods for export to Canada. As the payments were more closely related to rights exercised in Canada, quantified with reference to resales in Canada and ultimately accrued to third parties unrelated to the vendor of the goods, and for other reasons similar to those found determinative of the second issue, the Tribunal finds that the conditions of subparagraph 48(5)(*a*)(iv) of the Act have not been met with respect to the indirect royalty payments to the master licensors.

With regard to subparagraph 48(5)(*a*)(v) of the Act, the Tribunal is of the view that the economic benefit or value of the indirect royalty payments passed through Mattel and accrued to the master licensors. Though the indirect royalty payments were made from the proceeds of sales in Canada, the value of such payments did not accrue to Mattel, the vendor of the goods. As the conditions of both subparagraphs 48(5)(*a*)(iv) and (v) of the Act have not been met, the Tribunal allows the appeals on this issue.

Accordingly, the appeals are allowed in part.

Charles A. Gracey
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