

## European Court of Justice rules payments made for exclusive distribution right are to be added to customs value

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### Executive summary

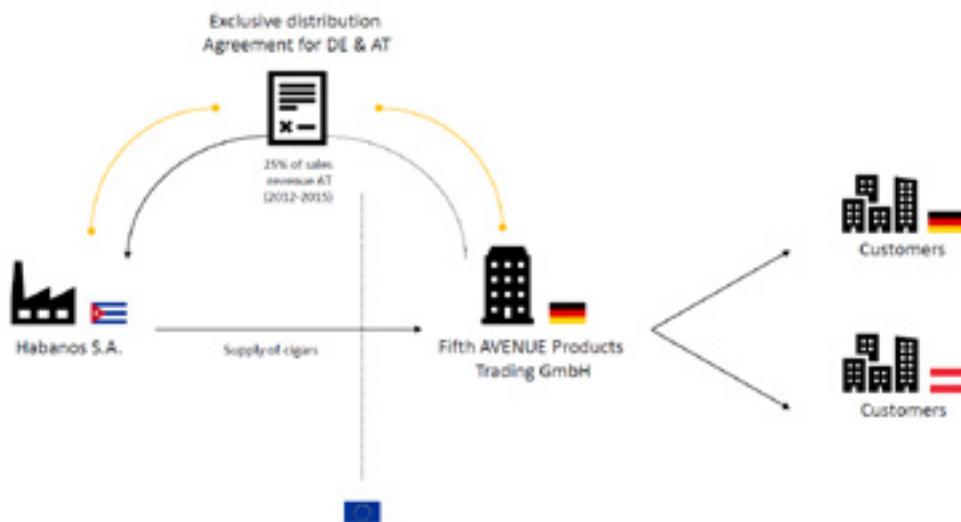
On 19 November 2020, the European Court of Justice (ECJ) published its decision in the court case named "*5th AVENUE Products Trading GmbH*."<sup>1</sup> The ECJ ruled that payments which grant the exclusive distribution rights on a product are not to be classified as royalties or license fees. However these type of payments still need to be added to the customs value of the imported goods if they constitute a condition of sale. For the condition of sale test, it is not relevant that these payments are only made over a certain period of time and are imposed in a framework agreement instead of each individual contract for the subsequent sale of the goods concerned.

### Detailed discussion

#### Background

5th AVENUE Products Trading GmbH (5th Avenue) is a German wholesaler of, among other items, Cuban Havana cigars. 5th Avenue purchases these cigars from Habanos S.A. (Habanos). In 2012, 5th Avenue and Habanos entered into an Exclusive Distribution Agreement (EDA), which gave 5th Avenue the exclusive rights for distributing Cuban Havana cigars in both Germany and Austria.

In exchange for the exclusive distribution right in Austria, 5th Avenue had to pay Habanos 25% of the sales revenue in Austria, for a period of four years. As agreed, after these four years the payments stopped. No compensation was paid regarding the exclusive distribution rights in Germany. These facts and circumstances are illustrated in the graphic below.



The (batches of) cigars were not ordered via a purchasing agreement, but rather in individual batch orders. 5th Avenue would receive a price list, on the basis of which it subsequently placed orders. After the placement of the order, Habanos would file an invoice and deliver the cigars to 5th Avenue. The import of the cigars was handled through the type D customs warehouse in Germany, for which 5th Avenue had a license. The customs value which 5th Avenue declared consisted of the purchase price without taking the compensation payments into account. The reason for this was that, at the moment of the placement under the customs regime, it was not yet known in which country the cigars would be sold. During an inspection, the German customs authorities were of the opinion that the value of the compensation should be taken into account when determining the customs value of the cigars. In the appeals, the Finanzgericht Baden-Württemberg, asked for a preliminary ruling and brought two questions before the ECJ about the customs valuation treatment of the compensation payments. In essence, the question is whether the compensation payments constitute royalties or license fees which are to be added to the customs value.

## Decision of the ECJ

On the basis of article 29 of the Community Customs Code (CCC),<sup>2</sup> the customs value is the transaction value, being the price actually paid or payable for the goods on the moment of import, adjusted where necessary. According to article 32(1)(c) of the CCC, royalties and license fees related to the goods being valued that the buyer must pay, as a condition of sale of the goods being valued, must be added to that price to the extent that those royalties and license fees have not been included in the price actually paid or payable yet. The ECJ noted, however, that, on the basis of article 157(2) of the Implementing Regulation, the royalties and license fees relate solely to payments made by the buyer to the seller for the usage of intellectual property rights. Thus, the payments made in the main proceedings do not qualify as royalties or license fees.

To provide the referring court with all elements of interpretation of European Union (EU) law that may be of assistance, the ECJ restated the preliminary questions to be interpreted as whether the payments in question are to be added to the customs value. In this regard, the ECJ held that under article 29(3)(a) of the CCC, the price actually paid or payable should include all payments made as "condition of sale" of the goods. Moreover, article 32(5)(b) states that payments made in return for the right to distribute or resell the imported goods are not to be added to the customs value if they are not a condition of sale of the goods. According to the ECJ, a condition of sale should be interpreted as payments so important to the seller, that without such payments, the sale would not have been concluded. From the information that is available, the ECJ concluded that the

seller would not have supplied the goods for exclusive distribution in Austria without the payments, thus that the payments in the main proceedings are a condition of sale. In this regard it is irrelevant that the payments are imposed in the framework agreement of exclusive distribution rather than in each individual contract for the subsequent sale of the goods concerned. Furthermore, it is immaterial that the payments are only made for a limited period, being in this case four years.

### Impact on businesses

The Union Customs Code (UCC)<sup>3</sup> replaced the CCC on 1 May 2016. Nevertheless, this court case is also relevant under the UCC as the provisions under the UCC are to a large extent similar to the provisions under the CCC. As explained above, (exclusive) distribution rights should not be included in the customs value unless the payments were paid as a condition of sale. The ECJ seems to indicate that this test is satisfied relatively easily, seemingly making it difficult in practice to keep the value of distribution rights outside the customs value when importing into the EU.

Accordingly, companies should:

- ▶ Review their existing (exclusive) distributions agreements and EU supply chain to determine the impact of this court case.
- ▶ Assess whether the payments for (exclusive) distribution rights are currently included in the customs values of goods imported into the EU and whether they should (retroactively) be included based on this court case.
- ▶ Take this court case into account while drafting (exclusive) distribution agreements.

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### Endnotes

1. ECJ 19 November 2020, C-775/19 (5th AVENUE Products Trading GmbH), ECLI:EU:C:2020:948.
2. Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code, *OJ L 302*, 19.10.1992, p. 1-50.
3. Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code, *OJ L 269*, 10.10.2013, p. 1-101.

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