

Newsletter

Royalties to include in customs' value

June 22, 2021

Dear Ladies and Gentlemen,

Matter in question

Inclusion of royalties in the customs' value of imported goods, which is one of the most disputable matters of recent years, is receiving new and rapid development in Russia.

The Accounts Chamber of the Russian Federation¹ conducted an audit of the efficiency of the customs authorities' work and revealed a number of cases where royalties were not included in the structure of the customs value unreasonably, without application of any sanctions to the importers.

According to the Accounts Chamber, non-inclusion of royalties in the customs' value led to the underpayment of customs' duties and taxes, to the state budget, of approximately RUB 98,5 billion² (approx. USD 1,35 billion).

Considering these figures, the Accounts Chamber recommended that the customs authorities pay special attention to this issue during the customs' audits and initiate customs' control measures against importers, which have license agreements with the foreign IP holders and licensors.

As this issue is of such great importance, it was subject to discussion at the meeting with the President of the Russian Federation, where the Head of the Accounts Chamber reported about first substantial amounts of additional charges made, after the recent customs' audits.

In the light of such focused approach, we expect further increases of the customs audits, as the customs authorities were advised to double their efforts and work closely with the tax authorities and the Federal Service for Intellectual Property, when registering such license agreements.

Structures to consider

As value of the IP rights generally increases the commercial value of such imported goods, royalties meeting certain legislative criteria shall be included in the customs' value of goods.

However, we see that only a small number of importers, historically, included royalties in the customs' value of imported goods, as not all requirements (and especially the criterion of relevance) were met in practice.

Considering recommendations of the Accounts Chamber, we may suggest that customs authorities may apply a formal approach, leading to adjustment of the customs value without any conformance review of links between the imported goods and IP rights, used by the importers.

In this case, Russian subsidiaries of an international group of companies importing goods to Russia, and participating in other foreign economic activities, can be the first choice to go after for the customs authorities.

In particular, the customs authorities can audit the supply chains for the imported goods, labelled with trademarks, thoroughly when:

- a) royalties are paid for the trademarks, on the basis of license agreements, concluded separately from the supply contracts; or
- b) royalties are included in the price of goods supplied, without concluding any additional license agreements.

Other structures implying assignment of IP rights, payment of royalties for the know-how, etc. used in Russia can also be affected.

¹ The parliamentary control body that promotes efficiency in the management of budget funds, greater accountability of government bodies and orientation of their activities towards the public interest.

² <https://ach.gov.ru/checks/schetnaya-palata-vyyavila-priznaki-zanizheniya-tamozhennykh-platezhey-na-98-5-mlrd-rub->

Recommendations

A possible approach of the customs authorities raises a number of questions, especially in cases when the lump sums of royalties are paid with respect to the imported goods and in relation to other activities, which are not connected with the imported goods (e.g., labelling goods produced in Russia, using trademarks in marketing materials, advertising, etc.).

Considering the above-mentioned, it might be reasonable to check the contractual structures of supplies in Russia, including:

- a) existence of any links in the license and supply contracts between royalties to be paid and goods to be imported (e.g., possibility to terminate the supply contract, in case of non-payment of royalties to the IP holder);
- b) actual circumstances of importation of goods and usage of IP rights in Russia, including communication with the customs' broker to check, whether the broker understands the importer's case clearly;
- c) application of the accurate methodology of inclusion of royalties in the customs' value of imported goods (if any);

- d) assessment whether you can confirm inclusion and share of royalties in the price of goods under the supply contracts;
- e) assessment of the customs and tax risks (related to the customs VAT) of the previous periods, when royalties were not included in the customs' value of imported goods.

Such analysis should help to identify the risks (if any) and provide an understanding whether you need to include royalties in the customs' value or not, prepare the defense position for the previous periods and/or change the contracts and supply chain, if this solution logically and justifiably follows from the results of such analysis.

These steps are important as, in case the unreasonable decrease of the customs' value is identified during the customs' audit, in addition to the collection of arrears, the customs authorities can charge (a) late payment interest and (b) an administrative fine (up to the double amount of unpaid customs' duties and taxes).

In the worst-case scenario, the risk of bringing Russian management to criminal liability may arise. (Such a criminal case has already been initiated against officials of the Russian unit of a multinational clothing-retail company.³

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If you have any questions, please, do not hesitate to contact ALRUD Partner



**Maxim
Alekseyev**

Senior Partner

Tax

E: malekseyev@alrud.com



**Sergey
Artemiev**

Senior Associate

Tax

E: sartemiev@alrud.com

Sincerely,
ALRUD Law Firm

³ <https://www.bloomberg.com/news/articles/2021-02-09/h-m-faces-russian-criminal-investigation-over-customs-duties>