

**TECHNICAL**

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**Indirect Taxation**

**TAX CASE UPDATE**

**Whether royalty should be added back to the transaction value of imported goods in accordance to Regulation 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999**

**Citation**

[Colgate-Palmolive Marketing Sdn Bhd v Ketua Pengarah Kastam \(2011\) \(HC, KL\)](#) (Originating Motion No: R2-25-259-2008)  
Date of Judgment: 10 May 2011

**Facts**

As a result of a post importation inspection conducted, the Royal Malaysian Customs, Federal Territory, Kuala Lumpur contended that the royalty paid by Colgate-Palmolive Marketing Sdn Bhd (the Applicant) to Colgate-Palmolive Co. USA (CP Co.) should be added back to the transaction value of goods imported and be treated as part of the valuation for the purpose of assessment of sales tax and customs duties.

The issue was referred to the Valuation Branch, Technical Services Division of the Royal Malaysian Customs Headquarters (the RMC) which decided that royalties paid by the Applicant to CP Co. was an adjustment element that had to be added back to the transaction value i.e. the price paid or payable because it fulfilled the conditions of Regulation 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999. The relevant gazette Order is appended at the end of this e-CTIM.

The Applicant appealed to the Customs Appeal Tribunal (CAT) which decided in favour of the RMC.

The Applicant then filed an Originating Motion at the High Court of Kuala Lumpur (hereafter referred to as "the Court") to seek (amongst others) the following orders:

- a) that the application be deemed to be a Notice of Appeal against the decision of the CAT;
- b) that the decision of the CAT for payment of RM756,742.28, being customs duties and sales tax payable on goods imported by the Applicant, be set aside;
- c) that the said sum paid by the Applicant as payment of customs duties and sales tax, be refunded to the Applicant.

**Issue**

Whether the Royalty payment constitutes a condition of sale of goods for export to Malaysia and is liable to be added back to the transaction value of imported goods in accordance to Regulation 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999.

**Decision**

Application allowed with costs.

Summary of grounds of decision:

1. The Court considered the submissions of both the Applicant and the Respondent which are summarised below:

Applicant's submission

- The Royalty adjustment shall be made only if it fulfills all the conditions of Regulation 5(1)(a)(iv) which are fulfilled, i.e. the royalty payment –
  - has been included in the purchase price of goods;
  - is related to the goods that are being imported, paid either directly or indirectly and
  - is a condition of sale of the goods for export to Malaysia
- The payment of Royalty should not constitute a condition of sale of the goods for export to Malaysia because:
  - The relationship between the Applicant and most suppliers reflected the normal practice adopted by the general business community. It did not influence the sales or purchase price and the Applicant was free to buy goods from any supplier according to its needs and determination.
  - Royalty payment to CP Co was for the right to sell in the territory they represented. It was not a condition of sales for export to Malaysia.
  - The goods were sold to the Applicant without the imposition of any condition that the Applicant had to pay Royalty to CP Co. This was proven when the importation of goods was still allowed even though Royalty was not paid and will only be paid after the goods have been sold.

RMC's submission

The RMC's submission was based on its application of the law, and this was set out in the written grounds of decision by the Chairman of the CAT. The following are some salient points:

- There is no dispute that what is imported were licensed products as defined in the Royalty Agreement (i.e. they bear the trademark, patent or design owned by CP Co.). The obligation to pay royalty was clearly spelt out in the Royalty Agreement [Clause 8(a)]
  - The rights granted to the Applicant was the right to use COLGATE (US) trademarks, patents and designs. This right "to use" was defined in clause 18 as "the right to sell" the Licensed Products within Malaysia.
  - Reading the Royalty Agreement as a whole, it is clear that the Applicant could not import the product without incurring a liability to pay royalty on the product when it was sold. In view of the fact that the underlying purpose of purchasing the product was to sell it, the economic reality is that the ability of the Applicant to purchase the goods was of no benefit to it unless it was able to market and sell the products. Hence it can be reasonably concluded that the royalty payments were "as a condition of the sale for export to Malaysia."
2. Before coming to a decision, the Court reviewed the relevant statutory provisions, as well as the principles of interpreting a Taxing Statute.

Provisions of the law

The following statutory provisions were referred to:

- i. S142 (35B) of the Customs Act 1967 empowers the Minister of Finance to make regulations to determine the customs value of imported goods.
- ii. Regulations 4(1) and (3) of the Customs (Rules of Valuation) Regulations 1999 provides for the transaction value as the primary basis of valuation.
- iii. Regulation 5 of the Customs (Rules of Valuation) Regulations 1999 stipulates the conditions for adjustment of price paid or payable. Regulation 5(1)(a)(iv) allows the transaction value to be adjusted by adding the royalties paid in respect of the goods, inter alia, if it forms a condition that the sale of the goods are for export to Malaysia.

Principles of interpreting a Taxing Statute.

The Court reviewed the principles established in precedent cases and quoted (with emphasis) the judgment by Gopal Sri Ram in the case of **Palm Oil Research and Development Board & Anor v Premium Vegetable Oils Sdn Bhd [2004] 2 CLJ 265**, as follows:

*"Hence, the governing principle is this. When construing a taxing or other statute, the sole function of the court is to discover true intention of Parliament. In that process, the court is under a duty to adopt an approach that produces neither injustice nor absurdity; in other words, an approach that promotes the purpose or object underlying the particular statute albeit that such purpose or object is not expressly set out therein."*

3. The Court was of the view that the RMC's contention that the Royalty was a condition of the sale of the goods for export to Malaysia because Royalty was paid to CP Co by the Applicant *"(did) not hold water."* There was no provision in the licence agreement requiring the Applicant to source for products from any related parties. It imposed no condition in relation to the purchase of the products by the Applicant, who had the option to determine how it intended to source its products. *"The decision to choose the source was for pure commercial reasons (sic) such as to achieve better costing..."*
4. In the mind of the learned Judge, *"what seems to be clear is that the Royalty and the purchase price of the products purchased by the Applicant are separate and independent transactions."*
5. In the case of [Nike Sales Malaysia Sdn Bhd v Jabatan Kastam DiRaja Malaysia & 2 Ors R3\(1\)-25-03-2004](#), the Court concluded that *"if the Parliament had intended that Royalty paid in relation to an export of goods be regarded as an adjustment item for the purposes of calculating customs value, there will be no need to further provide for the conditions in Regulations 5(1)(a)(iv)..."*. The Court found no reason to differ from that decision.
6. The Court was of the considered view that the Nike case is relevant as the issues there are more or less similar to the present case.

Members may read the full [Grounds of Judgment](#) from the Kuala Lumpur Law Courts Official website.

Appendix

**Customs (Rules of Valuation) Regulations 1999 [P.U.(A) 507/1999]**

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***Transaction value as primary basis of valuation***

- 4.(1) *The customs value of imported goods shall be their transaction value, that is, the price paid or payable for the goods when sold for export to Malaysia, adjusted in accordance with regulation 5, provided that-*
- (a) *there are no restrictions in respect of the disposition or use of the goods by the buyer, other than restrictions that:*
    - (i) *are imposed by law;*
    - (ii) *limit the geographical area in which the goods may be resold; or*
    - (iii) *do not substantially affect the value of the goods;*
  - (b) *the sale of the goods or the price paid or payable for the goods is not subject to some condition or consideration where its value cannot be determined;*
  - (c) *no part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer is to accrue, directly or indirectly, to the seller; or*
  - (d) *the buyer and seller of the goods are not related at the time the goods are sold for export or where the buyer and seller are related at that time but the proper officer of customs is satisfied that their relationship did not influence the price paid or payable for the goods.*
- (2) *In a sale between related persons, for the purpose of showing that the relationship did not influence the transaction value, the buyer shall produce evidence that the transaction value of the goods being valued, taking into consideration any relevant factors including such factors and differences as enumerated in subregulation (4), closely approximates to one of the following values of other goods exported at the time or substantially at the same time as the goods being valued, being-*
- (a) *the transaction value of identical goods or similar goods in respect of a sale of those goods for export to Malaysia between a seller and buyer who are not related at the time of the sale;*
  - (b) *the deductive value of identical goods or similar goods; or*
  - (c) *the computed value of identical goods or similar goods.*
- (3) *In any case where the proper officer of customs is of the opinion that the relationship between the buyer and seller of any goods influenced the price paid or payable for the goods, the proper officer of customs shall inform the buyer, in writing if so requested, of the grounds on which the proper officer of customs formed that opinion, and shall give the buyer a reasonable opportunity to satisfy the proper officer of customs that the relationship did not influence the price.*

- (4) Where subregulation (2) applies, the buyer shall, without limiting the generality of subregulation (2), provide the following information-
- (a) the nature of the goods being valued;
  - (b) the nature of the industry that produces the goods being valued;
  - (c) the season in which the goods being valued are imported;
  - (d) whether a difference in values is commercially significant;
  - (e) the trade levels at which the sales take place;
  - (f) the quantity levels of the sales;
  - (g) any of the amounts referred to in regulation 5; and
  - (h) the costs, charges or expenses incurred by a seller when the seller sells to a buyer to whom the seller is not related that are not incurred when the seller sells to a buyer to whom the seller is related.

#### **Adjustment of price paid or payable**

- 5.(1) In determining the transaction value of imported goods under regulation 4, the price paid or payable for the goods shall be adjusted-
- (a) by adding thereto amounts, where such amount is not already included in the price paid or payable for the goods, determined on the basis of sufficient information, equal to:
    - (i) commissions and brokerage in respect of the goods incurred by the buyer, other than fees paid or payable by the buyer to the buyer's agent for the service of representing the buyer overseas in respect of the purchase of the goods;
    - (ii) the packing costs and charges incurred by the buyer in respect of the goods, including the cost of cartons, cases, and other containers and coverings that are treated for customs purposes as being part of the goods and all expenses of packing incidental to placing the goods in the condition in which they are transported to Malaysia;
    - (iii) the value of any of the following goods and services:
      - (A) materials, component, parts and other items incorporated in the goods;
      - (B) tools, dies, moulds, and other items utilised in the production of the goods;
      - (C) materials consumed in the production of the goods; and
      - (D) engineering, development work, artwork, design work, plans and sketches undertaken elsewhere than in Malaysia and necessary for the production of the goods,determined under subregulation (2) that are supplied, directly or indirectly, by the buyer free of charge or at a reduced cost for use in connection with the production and sale for export of the goods, apportioned to the goods in a reasonable manner, and in accordance with generally accepted accounting principles;
    - (iv) royalties and licence fees, including payments for patents, trademarks and copyrights in respect of the goods that the buyer must pay, directly or indirectly,

*as a condition of the sale of the goods for export to Malaysia, exclusive of charges for the rights to reproduce the goods in Malaysia;*

- (v) the value of any part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer that accrues or is to accrue, directly or indirectly, to the seller;*
  - (vi) the value of any materials, component, parts and other items incorporated in the goods for the purpose of repair to, or refurbishment of, those goods prior to importation of the goods to Malaysia, and the price paid for the service or repair or refurbishment, as the case may be; or*
  - (vii) the costs of transportation and insurance of, and the loading, unloading and handling charges and other charges and expenses associated with the transportation of, the goods until the goods have arrived in the country of importation;*
- (b) by deducting therefrom amounts, where such amount is already included in the price paid or payable for the goods, equal to any of the following costs, charges or expenses:*
- (i) any reasonable cost, charge or expense that is incurred for the construction, erection, assembly or maintenance of, or technical assistance provided in respect of the goods after the goods are imported;*
  - (ii) any reasonable cost, charge, or expense that is incurred in respect of the transportation or insurance of the goods within Malaysia and any reasonable cost, charge, or expense associated therewith; and*
  - (iii) any customs duties or other taxes payable in Malaysia by reason of importation or sale of the goods,*
- if the cost, charge, expense, duties or other taxes is identified separately from the balance of the price paid or payable for the goods;*
- (c) in respect of carrier media bearing data or instructions, by deducting the value of the data or instructions from the price paid or payable for the goods if:*
- (i) the value of the data or instructions is distinguished from the cost or value of the carrier media; and*
  - (ii) the data or instructions are not incorporated in data processing equipment.*

*(2) The value of the goods and services described in subparagraph (1)(a)(iii) shall be determined-*

- (a) in the case of materials, component, parts and other items incorporated in the goods being valued or any materials consumed in the production of the goods being valued:*
  - (i) by ascertaining-*
    - (A) their cost of acquisition where they were acquired by the buyer from a person who was not related to the buyer at the time of their acquisition;*



- (B) *their cost of acquisition incurred by the person related to the buyer, where the goods were acquired by the buyer from a person who was related to the buyer at the time of their acquisition but who did not produce them; or*
      - (C) *their cost of production where they were produced by the buyer or a person related to the buyer at the time of their production;*
    - (ii) *by adding thereto-*
      - (A) *the cost of their transportation to the place of production of the goods being valued; and*
      - (B) *the value added to them by any repairs or modifications made to them after they were so acquired or produced;*
  - (b) *in the case of tools, dies, moulds, and other items, utilised in the production of the goods being valued in accordance with subparagraphs (2)(a)(i) and (ii) and by deducting therefrom an amount to account for any previous use of the goods made after the goods were so acquired or produced; and*
  - (c) *in the case of engineering, development work, artwork, design work, plans and sketches undertaken elsewhere than in Malaysia and necessary for the production of the goods being valued by ascertaining-*
    - (i) *their cost of acquisition or of the lease thereof, where they were acquired or leased by the buyer from a person who was not related to the buyer at the time they were so acquired or leased and are not generally available to the public;*
    - (ii) *their cost of acquisition or of the lease thereof incurred by the person related to the buyer, where they were acquired or leased by the buyer from a person related to the buyer at the time they were so acquired or leased, but who did not produce them and are not generally available to the public;*
    - (iii) *the cost to the public of obtaining them where they are available generally to the public; and*
    - (iv) *the cost of production where they were produced by the buyer or a person related to the buyer at the time of their production.*

(3) *For the purposes of paragraph (1)(c) – i*

*"carrier media" does not include integrated circuits, semi conductors and similar devices, or articles incorporating such circuits or devices;*

*"data or instructions" does not include sound, cinematic or video recordings.*

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