# Customs & Trade in Israel

## A Legal Newsletter

### Adv. Gill Nadel, Chair of the Import, Export and International Trade Law Practice, Tax Department

**Customs Duty On Royalties: The Contract Is Not Everything**

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**Background:**

In a District Court ruling from March 2013 [TA (Central District) 18199-06-10, **Marvidex Surfing Products (2004) Ltd. & Others V. The State of Israel - Customs Authority**, ruling given on 10.3.13] the court accepted in principle the companies' arguments and ruled that in order for royalties to become dutiable, it must be proven that the importer has to pay them as a precondition for importing the products to Israel (and not their sale in Israel). The District Court ruled that for the purpose of this question (does the importer have to pay royalties in order to import), the language of the contract between the brand owner and the importer must be examined, as well as the parties actions in practice.

Both parties appealed to the Supreme Court, and in November 2016 the Supreme Court rejected most of the Customs Authority's appeal. The Supreme Court ruled that in order for royalties to become dutiable, they must be connected to the products, and be a requisite of their import to Israel - not their sale in Israel.

The Supreme Court ruled further that examination of the language of the individual contract between an importer and a brand owner is insufficient on its own, and the way both sides conduct themselves in practice must be examined as well. The court ruled that the testimony of a brand owner is an acceptable method to determine whether he supervised the importer, to what extent, etc., as a means to decide whether the royalties are a perquisite of the import transaction.

**Case Facts:**

The Tel Aviv District Court recently published its ruling in the appeal of the Customs Authority on a Magistrate Court ruling. The Magistrate Court ruled that royalties paid by an importer to a trademark owner in the electricity and electronics field are exempt from customs duty, as per the ruling of the District Court in the Marvidex case.

The Customs Authority argued that the Magistrate Court did not consider the Supreme Court's ruling in the Marvidex case, as the Supreme Court's ruling was given only after the Magistrate Court ruled on the case. The Customs Authority therefore appealed the ruling.

The case in question involves an importer - Semicom Lexis Ltd. - which imports and markets electric appliances, electronics, photography and digital imaging, batteries, and magnetic and optical media. The importer paid royalties to the Korean based Hyundai company for the right to use its trademark in the sale of products in Israel. The products were purchased from other Hyundai certified manufacturers in China, not Hyundai itself.

The question the Magistrate Court faced was whether the royalty payments of the importer to the trademark owner of Hyundai, for trademark use, are included in the "transaction value" and dutiable, as per section 133(a)(3) to the Customs Order. The dispute revolved around the second condition set by the section: "that the importer is must pay, either directly or indirectly, as a precondition for the sale of the goods in Israel by the importer".

The Magistrate Court ruled that although the contract between the importer and the trademark owner granted the trademark owner the right to supervise the products manufacturing process, it was proved by testimonies presented to the court that in practice the trademark owner did not conduct any practical and effective supervision of the manufacture process, nor product choice and quality.

**The Appeal:**

The dispute between the parties in the appeal centers around whether the Magistrate Court properly implemented the law which existed at the time of the District Court's ruling on the Marvidex case, and whether the Supreme Court's rulings in the case lead to a change in the results of that implementation. The disputes was whether the proper implementation demands a reversed decision when acting first and foremost according to the contracts, which indicate that withholding royalty payments will lead to breach of contract with Hyundai, resulting in the contract's termination.

The court approved the facts determined by the Magistrate Court, as well as their implementation. Even though the contracts between the trademark owner and the importer allegedly grant the trademark owner the right to supervise the manufacturing process, in practice, the trademark owner did not exercise its right and was barely involved in supervising the products, limiting its supervision to quality control.

Although it was proven in the Magistrate Court that the trademark owner was required to certify each shipment prior to its release from Chinese customs for export to Israel, the court ruled that it was merely a technical approval, proven to be given by the trademark owner in all cases. In practice, the importer received free reign to do as it pleased with the goods manufactured in China, as long as the packaging and logo with the trademark owner's name were satisfactory.

The court therefore ruled that the trademark owner has no control over the manufacturing process, and therefore the royalties paid to it by the importer are not part of the good's value for duty purposes. The court rejected the appeal, charging the Customs Authority with legal fees amounting to 30,000 ILS, to be paid to the importer.

[Appeal: 56505-06-15 **The State of Israel V. Semicom Lexis Ltd.** Ruling given on 27.8.17]

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**The above review is a summary. The information presented is for informative purposes only, and does not constitute legal advice.**

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