Inclusion Of Post Import Marketing Expenses

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India Media, Telecoms, IT, Entertainment

THE Delhi bench of the CESTAT in the case of *M/s Reebok India Company* - ***2018-TIOL-561-CESTAT-DEL*** held that advertising expenses incurred by the importer under an obligation emanating out of an agreement with the seller of the imported goods is includible in the transaction value of goods for the purpose of Customs valuation in terms of section 14(1) of the Customs Act, 1962.

While it is understood that the aforesaid order has been challenged in the Supreme Court and the appeal has been admitted by the Hon'ble Court, this article seeks to critically analyse the decision and examine the repercussions thereof.

Backaround

Background

Rule 10(1) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provides for inclusion of certain amounts to the price actually paid or payable for the imported goods (i.e. the transaction value), for the purpose of Customs valuation. In addition to specific instances of additional consideration (such as royalty related to the imported goods paid as a condition of the sale of the goods), there is a residuary sub-clause (e) which provides for inclusion of all other payments actually made or to be made as a condition of sale of the imported goods, or to satisfy an obligation of the seller. The interpretative notes to rule 3 of the Customs Valuation Rules (which *inter alia* provides that the transaction value would be subject to additions under rule 10), mentions the following:

> *"(...) Activities undertaken by the buyer on his own account, other than those for which an adjustment is provided in rule 10,* ***are not considered to be an indirect payment to the seller, even though they might be regarded as of benefit to the seller*** *. The costs of such activities shall not, therefore, be added to the price actually paid or payable in determining the value of imported goods. (...)*
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> *(...) However, conditions or considerations relating to the production or marketing of the imported goods shall not result in rejection of the transaction value. For example, the fact that the buyer furnishes the seller with engineering and plans undertaken in India shall not result in rejection of the transaction value for the purposes of rule 3.* ***Likewise, if the buyer undertakes on his own account, even though by agreement with the seller, activities relating to the marketing of the imported goods, the value of these activities is not part of the value of imported goods nor shall such activities result in rejection of the transaction value.****"*

(Emphasis supplied)

Hence, the value of the marketing expenses incurred by the importer on its own account is explicitly excluded from the transaction value, even where such expenses are incurred in pursuance of an agreement with the seller. Further, the Indian courts have held time and time again that expenses on post-importation activities will not form part of the transaction value for the purpose of Customs valuation.

The facts of the 2018 Reebok judgment were such that there existed a distribution agreement between M/s Reebok International Ltd., England and the importer (*i.e.* M/s Reebok India Company), wherein the importer was obligated to incur certain expenses in India (calculated at 6% of the net sales of imported goods) towards advertisement and promotion of the imported goods. The Tribunal's observations can be summed up by the following excerpt of its ruling:

> *"RIL UK is the owner of the brand name 'Reebok' and it is obvious that such promotion, and advertising is towards promotion of their brand as a whole and not only in respect of goods being imported by the appellant. Therefore, from these agreements it is evident that the appellant is carrying out such brand promotion on behalf of RIL England and such expenses were made on behalf of RIL UK. (...)*
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> *(...)that this appellant has incurred such expanses (sic) on the expression (sic) obligation of RIL England and as a clear condition of the sale of goods for disputing them in India. It cannot be*

concluded, in the facts of the present case, that the expenditure has been incurred by the appellant on their own account."

The Tribunal thereafter proceeded to reject the appeal on the basis of the above, arguably with a narrow and perverse reading of the applicable law.

Genesis of Customs Valuation: The international perspective

The Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 have been framed by India under the obligation emanating out of Article 22 of the WTO Customs Valuation Agreement (formally known as the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994) , which provides for conformity of the national legislation of each member state with the provisions of the WTO Valuation Agreement.

A number of revisions in positions from the erstwhile BDV (Brussels Definition of Value) method vis-à-vis the WTO Customs Valuation Agreement have been made on the basis of practicality. While the older regime was based on a notional approach of customs valuation, the current regime is based on a positive approach of customs valuation. To make practicality a cornerstone, the current regime has sacrificed a host of earlier elements of the older regime. One such element relates to the treatment of advertising and promotion expenses incurred by the importer. Under the older regime, expenses incurred by the importer for *"finding, establishing and maintaining a market for the goods in the country of importation"* were included in the transaction value on the idea that in an open market sale, these would be normally borne by the supplier. During the GATT Tokyo Round Negotiations before the birth of the WTO Customs Valuation Agreement, the European Communities (*"**EC**"*) proposed the exclusion of the aforesaid expenses for the first time. Following was the rationale provided for such exclusion:

"[W]e have excluded the costs of advertising in the country of importation. We have done this partly because in many cases the advertising costs are borne either directly or indirectly by the seller and the transaction can reasonably be viewed as an invisible export, and partly in the interests of simplification."

Although the EC proposal was resisted by some countries (who, in fact, counter-proposed that the agreement specifically include such costs), in the end the exclusion was finally included as part of the interpretative note to Article 1 of the WTO Customs Valuation Agreement, which subsequently found its way to the interpretative notes to rule 3 of the Customs Valuation Rules.

The Technical Committee of the WTO on Customs Valuation has published a commentary (Commentary bearing no. 16.1 in WCO Compendium) on the subject *Activities undertaken by the buyer on his own account after purchase of goods but before importation* , which provides a useful background on the subject . An excerpt from the said commentary is reproduced below:

" (...) 4. (...) In the context of Articles 1 and 8 and their Interpretative Notes, these may include activities undertaken with the aim of promoting the sale and distribution of the goods in the country of importation. The cost of these activities when they are undertaken by the buyer on his

> *own account should not be considered an indirect payment to the seller, even though they might be regarded as for the benefit of the seller. The following example illustrates this principle:*
>
> *Firm A is a dealer in electrical goods in country I. He markets these goods through a network of dealers (retail outlets and service centres) operating under franchise agreements with him. Firm A concludes a long term contract with foreign manufacturer S for the supply of a new type of electrical appliance. Under the terms of the contract, the appliance is to be marketed under S's trademark and A undertakes to bear on his own account the cost of all marketing in the country of importation. Firm A places an order for an initial stock of the appliances and, prior to importation, conducts an advertising campaign.*
>
> *5. In the above example, the cost of the advertising campaign is not a part of the Customs value nor shall it result in rejection of the transaction value, as these activities are those related to marketing the imported goods as stated in the final sentence of paragraph 1 (b) of the Interpretative Note to Article 1."*

Sheri Rose now and Brian J. O'Shea, in their book A *Handbook on the WTO Customs Valuation Agreement* (Published by Cambridge University Press, United Kingdom (2015) ISBN 10: 110700084X) have reiterated the position that advertisement expenses incurred by the importer in the country of importation are not to be included in the transaction value, even though such expenses are regarded to benefit the seller indirectly, or are incurred in pursuance of an agreement with the seller.

It would be relevant to note that in *Collector of Central Excise, Shillong vs. Wood Craft Products Ltd. reported in -* ***2002-TIOL-278-SC-CX-LB*** , it was held by the Supreme Court of India that the internationally accepted nomenclature emerging from the HSN, being the basis of the Central Excise Tariff, was a safe guide for ascertaining the true meaning of any expression used in the Central Excise Act. It can thus be safely assumed that the commentaries and statements relating to WTO Valuation Agreement, which form the basis of the valuation principles of Indian Customs, can be safely relied upon to understand the niceties of the provisions of Customs Valuation Rules. The 2018 Reebok judgment appears to have been pronounced without providing due credence to the background to this exclusion.

Error in interpretation of the phrase 'on its own account' – Indian jurisprudence

The Tribunal in the 2018 Reebok Judgement has interpreted 'activities undertaken under obligation coming out of an agreement' with the supplier to be not undertaken by the importer 'on its own account' in the context of interpretative note to rule 3 of Customs Valuation Rules. Such an interpretation is erroneous in view of two judgments of the Supreme Court of India. In *Radhakrishna Sivadutta Rai and Ors. vs. Tayeballi Dawood bhai* reported in *AIR 1962 SC 538* , the Supreme Court of India has concurred with the UK Court of Appeals' decision in *Gadd vs. Houghton* reported in *(1876) 1 Ex. D. 357,* which had held the following:

> *"(...) when a man says that he is making a contract 'on account of' some one else, it seems to me that he uses the very strongest terms the English language affords to show that he is not binding himself, but is binding his principal"*

Further, above decision of the Supreme Court of India has also been cited by the Hon'ble Court with approval in the case of *American Express Bank Ltd. vs. Calcutta Steel Co. and Ors.* reported in *(1993) 2 SCC 199* .From the above two decisions of the Supreme Court of India it would follow that the significance of the term 'on its own account' is to signify agreements entered on one's own behalf, as opposed to agreements entered as an agent on behalf of a disclosed principal, a view that has unfortunately not been considered by the Tribunal at all in the 2018 Reebok judgement.

Conclusion

It, therefore, appears that the Tribunal has failed to appreciate both the technical aspect (alignment with the international valuation principles) and the judicial aspect (alignment with existing judicial precedents) while arriving at the conclusion in the 2018 Reebok judgement. Hopefully, one expects this judgement to be reversed by the Supreme Court of India.

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