International Commercial Transactions

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International Commercial Transactions, Franchising, & Distribution Committee

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This article discusses the significant international legal development in 2015 in international commercial transactions, franchising, and distribution.

I. Determining Duties and Taxes: The Changing Status of International Marketing Fees as Dutiable Royalties in Korea

Typically, a Korean distributor, franchisee, or licensee “is often obligated not only to pay royalties to the foreign party but also to contribute funds toward the international marketing efforts” in a cross-border distribution.1 The Korean Customs Service has taken the position that such marketing fees are dutiable royalties and, moreover, the National Tax Service has stated that the marketing fees should be subject to withholding tax.2 The Seoul High Court, however, disagreed. On August 27, 2015, the Seoul High Court held that marketing fees paid by a Korean licensee to its foreign licensor as payment for international marketing are not dutiable royalties for customs purposes.3

The origin of this potentially impactful Seoul High Court decision was a challenge by a Korean subsidiary of a famous international sports apparel company to duties and fines imposed by the Seoul Customs Office. Between 2003 and 2008, the Korean subsidiary paid 8.5 to 10 percent of its net sales as “composite charge” to its parent company for the right to use the trademark and know-how, the right to exclusive distribution in Korea, and as contribution to the parent company’s international marketing fund. During this period, the Korean subsidiary declared the “composite charge” as additional dutiable value of the imported goods.

In 2009, the Korean subsidiary and its parent company entered into a new arrangement for payment of royalties and contribution to the international marketing fund that relied on different base figures, namely, sales revenue and net sales. Under this new

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2. Id.
3. Id.; see Seoul High Court [Seoul High Ct.], 2014Nu65495, Aug. 27, 2015 (S. Kor.).
arrangement, the Korean subsidiary was obligated to pay 10 percent of its sales revenue as royalties. Meanwhile, the Korean subsidiary’s contribution to the international marketing fund was calculated at 4 percent of its net sales. Once the two types of payments were distinguished, the Korean subsidiary began to declare only the royalties, which were based on the sales revenue, as the additional dutiable value of the imported goods. In 2012, the Seoul Customs Office imposed duties and fines on the Korean subsidiary for failing to declare and include the international marketing fees paid to the parent company as dutiable royalties. The Korean subsidiary appealed the decision to the Seoul Administrative Court.

The administrative court of first instance, the Seoul Administrative Court, affirmed the Customs Office’s decision to impose duties on international marketing fees. The court held that “the duties were proper because international marketing fees were payments in consideration for the enhanced value of the trademarks that accrues as a result of the foreign licensor’s international marketing efforts.” In effect, the Seoul Administrative Court deemed the international marketing fees as royalties on the license to use the trademarks, and accordingly, upheld the decision by the Seoul Customs Office.

The Seoul High Court, the court of second instance, disagreed and opined that international marketing fees should be interpreted as costs and expenses that a foreign licensor allocates to each of its licensees. In reaching this conclusion, the Seoul High Court explained that objective and quantifiable information must be used in calculating the dutiable value of any imported goods. Because international marketing fees do not have a direct nexus to a specific imported good, it will be impossible to determine the incremental increase in the dutiable value of the imported goods that is attributable to the international market fees in an objective and quantifiable way. Therefore, the Seoul High Court held the Korean subsidiary was correct in not adding the amount of the international marketing fees to the dutiable value of the imported goods.

Further, the Seoul High Court explained that the primary purpose of collecting international marketing fees is to increase future sales of the products and services. Any value-enhancing effects of international marketing efforts by the foreign licensor are tangential. Consequently, the Seoul High Court reversed the lower court’s decision, and thereby, rejected the interpretation of the Seoul Administrative Court that international marketing fees are royalties on the license to use the trademarks. This Seoul High Court decision may also impact taxpayers with similar facts, who are contesting the withholding tax under the Corporate Income Tax law.

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5. Id.
6. Id., Chang, & Park, supra note 1.
7. Id.
8. Id.
9. Id; see Seoul High Ct., 2014Nu65495.
10. Id., 2014Nu65495.
11. Id.
12. Id.
13. Id.
14. Seoul High Court [Seoul High Ct.], 2014Nu65495, Aug. 27, 2015 (S. Kor.).

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The Seoul Customs Office appealed the Seoul High Court decision and the matter is currently before the Supreme Court for review. In the meantime, it would be advisable to keep a close watch on the dutiable status of international marketing fees and, if appropriate, seek professional assistance in finding ways to structure the payments to minimize payable duties.

II. Agency Agreements Under The New Argentine Civil and Commercial Code

The new Argentine Civil and Commercial Code (CCC) has become applicable as of August 1, 2015.15 This new legislation supersedes the former civil and commercial codes, originally enacted in the 1860s. The CCC regulates more than thirty different kinds of contracts, some of them for the first time in Argentina. Within these new regulations, the CCC establishes the rules applicable to agency agreements.

According to Article 1479 of the CCC, the agent is an independent intermediary who undertakes to promote business on a regular basis on account of another person defined as entrepreneur.16 The CCC sets forth a right to exclusivity in favor of the agent. This exclusivity can be applied to certain kind of transactions, geographical regions, or groups of persons to be defined in the agreement.17 Conversely, the agent can be contracted by several entrepreneurs. But the former cannot agree to be appointed as agent in the same business or by competitors, unless expressly authorized.18

The qualification of the agent as “independent intermediary” is intended to differentiate the agent from the salesman, who is merely an employee of the entrepreneur. This has been one of the most serious contingencies regarding agency agreements when the agent is a natural person. The main risk associated with agency agreements that are executed with individuals is that such relationships may be deemed employment relationships. In such cases, the provisions of the labor laws will become applicable and take precedence over the terms of any existing agency agreement the parties may have executed. The difference between the agency agreement and the employment agreement is the “independent attribute” of the person that renders the service. On this regard, if the agent works on an exclusive basis and under subordination and instructions of the entrepreneur from a legal, technical, and economic standpoint, the relation between them will be considered for all legal purposes as an employer-employee relation, regardless of any existing agreement that the parties may have executed specifying an agency relationship. Accordingly, legal advice becomes very relevant in properly differentiating both figures in practice.

An agent does not represent an entrepreneur for the execution of the agreements related to his or her activity. Moreover, an agent must have a special power of attorney for collection purposes.19 Additionally, the agent is entitled to a fee for the transaction.
concluded as a result of the agent’s participation whenever the entrepreneur has obtained the correspondent price. Unless otherwise provided in the agreement, fees are variable according to the volume or value of the transactions, or the agreements promoted by the agent. The agent has no claim to be reimbursed for expenses, according to the agent’s nature as independent intermediary, although parties could agree on that reimbursement.\(^\text{20}\)

Except as otherwise provided by the parties, it is presumed that the agreement is executed for an undetermined period.\(^\text{21}\) If the parties provide a specific term for the agreement, then the continuation of the agency relationship after the conclusion of the term agreed to by the parties converts the agreement into a non-fixed term agreement.\(^\text{22}\)

Either party is entitled to end a non-fixed term agency agreement, provided prior notice is given to the other party. The CCC establishes that the term of the prior notice must be of one month for every year of duration of the agency agreement.\(^\text{23}\) The parties may agree on a longer term for the prior notice.\(^\text{24}\) If the notice is not provided, the non-finishing party is entitled to compensation equivalent to the profit not received during the period.\(^\text{25}\)

Other causes for termination of the agreement specifically established in the CCC are: (i) the death or disability of the agent; (ii) dissolution or bankruptcy of any of the parties; (iii) expiration of the term of the agreement; (iv) material or repeated breach of the obligations by any of the parties which seriously put into question the capacity or intention of the defaulter to comply with the subsequent obligations; and (v) material decrease in the volume of business of the agent.\(^\text{26}\)

Once the agency agreement is terminated, the agent is entitled to compensation if (i) the activity has significantly increased the business of the entrepreneur, and (ii) its activity will continue producing substantial advantages to the latter.\(^\text{27}\) That compensation cannot exceed the amount equivalent to one year of fees, net of expenses, taking the average of the fees received by the agent during the last five years.\(^\text{28}\) But the agent does not have a right to compensation in the following cases: a) when the entrepreneur has terminated the agreement due to the default of the agent, b) when the agent has terminated the agreement except that the termination is due to a default of the entrepreneur, and c) because of illness, age, or disability which reasonably would not allow the agent to continue its activity.\(^\text{29}\)

Non-compete clauses are valid provided they do not exceed one year and apply to a reasonable territory or group of persons.\(^\text{30}\) The agent cannot appoint sub-agents unless expressly authorized by the entrepreneur.\(^\text{31}\)

\(^\text{20}\) Id. art. 1490.
\(^\text{21}\) Cod. Civ. y Com., art. 1491.
\(^\text{22}\) Id.
\(^\text{23}\) Id. art. 1492.
\(^\text{24}\) Id.
\(^\text{25}\) Id. art. 1493.
\(^\text{26}\) Id. art. 1494.
\(^\text{27}\) Cod. Civ. y Com, art. 1497.
\(^\text{28}\) Id. art. 1497.
\(^\text{29}\) Id.
\(^\text{30}\) Id. art. 1498.
\(^\text{31}\) Id. art. 1499.
Generally, the new regulation clarifies some situations that had previously been uncertain. But some solutions could be questionable such as the absence of a cap on the term of prior notice in terminating non-fixed term agreements.