THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Reportable

Case no: 509/2019

In the matter between:

THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE **APPELLANT**

and

LEVI STRAUSS SOUTH AFRICA (PTY) LTD **RESPONDENT**

Neutral citation: *Commissioner: SARS v Levi Strauss SA (Pty) Ltd* (509/2019) [2021] ZASCA 32 (7 April 2021)

Coram: WALLIS, MBHA and SCHIPPERS JJA and EKSTEEN and ROGERS AJJA

Heard: 4 March 2021

Delivered: This judgment was handed down electronically by circulation to the parties' representatives by email, publication on the Supreme Court of Appeal website and release to SAFLII. The date and time for hand-down is deemed to be 09h45 on 7 April 2021

Summary: Customs and Excise Act 91 of 1964 – section 49(7) – appeal against origin determination – importation of goods from SADC countries – certificates of origin in terms of Annex I to Rules of Origin to the Protocol on Trade in the Southern African Development Community (SADC)

Region – validity – goods produced in a member state and sold to purchaser in non-member state – purchaser on-selling goods to an end user in a member state – goods dispatched by producer directly to end user – whether goods consigned directly from one member state to another member state – whether qualifying for favourable rate of duty in terms of Protocol.

Valuation of goods for purpose of calculating customs duty – determination of transaction value in terms of ss 65, 66 and 67, read with s 74A(1), of the Act – inclusion of commissions other than buyer's commission under s 67(1)(*a*)(i) of the Act – what constitutes buyer's commission – international procurement process – manufacturing process under agent's control – scope of purchaser's control of agent – whether commission on purchases through a related company constituted buyer's commission.

Transaction value – inclusion of royalties in terms of s 67(1)(*c*) of the Act – whether royalties due directly or indirectly as a condition of sale of the goods for export to South Africa.

ORDER

On appeal from: Gauteng Division of the High Court, Pretoria (Satchwell J, sitting as court of first instance):

1 The appeal is upheld with costs, such costs to include those consequent upon the employment of two counsel.

2 The order of the high court is set aside and replaced by the following order:

'(a) The appeal in terms of s 49(6) of the Customs and Excise Act 91 of 1964 succeeds in relation to the Commissioner's determination dated 25 March 2014 that the Certificates of Origin accompanying the bills of entry for goods imported by Levi SA and consigned from countries within the SADC area during the period from 1 July 2010 to 5 February 2014 were invalid.

(b) The determination and demand for payment of the sums of R52 466 124.19 and R87 240 129.71 in consequence thereof are set aside.

(c) The application and appeal in terms of s 65(6) is otherwise dismissed.

(d) The respondent is to pay the applicant's costs, such costs to include those consequent upon the employment of two counsel.'

JUDGMENT

Wallis JA (Mbha and Schippers JJA and Eksteen and Rogers AJJA concurring)

[1] The respondent, Levi Strauss South Africa (Pty) Ltd (Levi SA), is locked in a dispute with the appellant, the Commissioner for the South

African Revenue Services (the Commissioner or SARS, as appropriate), over the import duties and value-added tax (VAT) payable by it in respect of clothing imports that at the relevant time made up some sixty percent of its sales. After a protracted audit lasting over two years, SARS issued a determination on 25 March 2014 in which it determined that the place of origin certificates issued in respect of imports from countries in the South African Development Community (SADC) and used to clear imports emanating from such countries were invalid, and therefore disentitled Levi SA from entering these goods at a favourable rate of zero percent duty under the Protocol on Trade in the Southern African Development Community (SADC) Region (the Protocol). This involved by far the largest amount in dispute. The other disputes related to the determination of the transaction value of the imported goods on which duty was payable. SARS determined that certain commissions and royalties paid by Levi SA to other companies in the Levi Strauss group fell to be included in determining the transaction value.

[2] Levi SA launched the present application proceedings by way of an appeal under s 49(7)(*b*) of the Customs and Excise Act 91 of 1964 (the Act) against the origin determination and an appeal under s 65(6) of the Act against the transaction value determinations. In pursuing those appeals the determinations were presumed to be correct so that the onus rested on Levi SA to show that they were incorrect.[1] After a disputed reference to oral evidence – Levi SA having contended that there was no dispute of fact warranting such a reference – some evidence was led and the appeals were argued before Satchwell J. She upheld them in their entirety, set aside the

[1] Sections 49(7)*(b)*(i) in the case of the origin determination. Although there is no similar provision in respect of the transaction value determination, on ordinary principles the onus rested on Levi SA to satisfy the trial court that SARS' determination was wrong. In terms of s 65(4)*(a)*(ii)*(bb)* a transaction value determination is operative from the date of the determination unless it is set aside by a court.

determinations and substituted them in terms proposed by Levi SA. This appeal is with her leave.

Background and the issues

[3] Levi Strauss & Co (LS & Co) is the ultimate holding company of an international group of companies. It is one of the world's largest brand-name apparel marketers operating in more than 110 countries through three divisions, the Americas, Europe and Asia Pacific. Clothing bearing its well-known trademarks is sold in over 55 000 retail outlets, including a number that are either company-owned or franchised and dedicated solely to its brands. Levi SA is the wholly-owned subsidiary responsible for its trading operations in Southern Africa. Apart from its manufacturing activities, which do not feature directly in this appeal, its role is best described as that of a wholesale distributor of clothing on behalf of LS & Co.[2]

[4] During the period from 2010 to 2014, with which this appeal is concerned, Levi SA manufactured approximately forty percent of the clothing that it sold. It imported the rest, much of it from Mauritius and Madagascar, both members of the SADC. Until about 2011 this clothing was purchased directly from the producers in the SADC. The arrangements with these producers to manufacture, or assemble,[3] this clothing, in accordance with the stringent requirements of LS & Co, were made by Levi Strauss Asia Pacific Division Pte Ltd (Levi APD), a company incorporated

[2] The description is that ascribed to subsidiaries performing the same role in the group in Transfer Pricing Reports prepared by PricewaterhouseCoopers LLP on behalf of LS & Co for submission to the US authorities under its Transfer Pricing Regulations. The same reports recorded that LS & Co conducted its operations as a worldwide marketer of apparel through foreign subsidiaries owned directly or indirectly by it. Counsel for Levi SA accepted the accuracy of these descriptions

[3] It is not clear from the papers whether the producers in Mauritius and Madagascar produced clothing from scratch, using designs and fabrics determined by LS & Co, or whether theirs was a CMT (cut, make and trim) operation. It makes no difference so far as the issues in this appeal are concerned.

in Singapore. On 1 December 2005, Levi APD and Levi SA concluded an agreement entitled 'Buying Agent Agreement' (the BAA) to regulate their relationship. It was amended on 1 December 2010. The BAA initially provided that Levi APD was to be paid an amount of seven percent of the purchase price of the goods for its services. This was described as a buying commission. Under the amendment in 2010 this increased to twelve percent. I will refer to these arrangements as the Levi APD regime.

[5] From 2011 this system was altered. The aim was that instead of purchasing directly from these producers, Levi SA would purchase them from Levi Strauss Global Trading Company Limited (Levi GTC) incorporated in Hong Kong. A Master Sales Agreement (the MSA), dated 1 January 2011, but only signed by Levi SA on 18 March 2011, provided for Levi SA to purchase clothing from Levi GTC. In turn Levi GTC would purchase the clothing from the same contracted suppliers in SADC countries as before, and sell them to Levi SA at a mark-up of twelve percent. The suppliers dispatched the garments directly to Levi SA. I will refer to this as the Levi GTC regime. The manner in which I have described it suggests a seamless transition from the one regime to the other, but this did not necessarily occur in all instances.[4] Some established producers were unable to operate under the new system and accommodations were made to deal with this. Nevertheless for the purpose of considering the issues of principle in this case it is convenient to distinguish between the two regimes in the manner I have done.

[4] There was a dispute on the papers whether the transition from the one regime to the other was as smooth as suggested in the founding affidavit, but at the end of the day nothing turns on this. If any producer continued to supply Levi SA directly, the customs entries in relation to such supplies should have been treated as if Levi GTC was fulfilling the functions previously performed by Levi APD.

[6] The transition to the Levi GTC regime gave rise to what was conveniently described in argument as the origin issue. Article 2 of the Protocol provided that 'originating goods' would qualify for favourable treatment in accordance with the provisions of Annex I to the Protocol. Levi SA contended that all the clothing it imported from producers in Mauritius and Madagascar was consigned directly from Member States of the SADC to it, as the consignee in another Member State, and were accordingly originating goods that qualified for the favourable duty, which at all times relevant to these proceedings was set at zero percent. SARS contended that the position was not that simple. It argued that the purpose of the Protocol was to promote trade between countries in the SADC region. Under the Levi APD regime Levi SA had purchased clothing directly from producers in Mauritius and Madagascar and that clothing had been consigned directly to it in South Africa, thereby satisfying the origin criteria in Rule 2.1. However, under the Levi GTC regime the producers in Mauritius and Madagascar were selling the clothes to Levi GTC, which was on-selling them to Levi SA from Hong Kong, but causing them to be sent directly from the producers to Levi SA. SARS contended that this undermined the purpose of the Protocol and that it should be construed as requiring that the commercial relationship giving rise to the goods being imported to South Africa needed to be between parties, both of whom were based in SADC countries.

[7] The other two issues arose because s 65(1) of the Act, provides that the value at which goods must be entered for customs duty purposes shall be the transaction value thereof within the meaning of s 66. Section 66(1) provides that:

'Subject to the provisions of this Act, the transaction value of any imported goods shall be the price actually paid or payable for the goods when sold for export to the Republic, adjusted in terms of section 67 . . .'

The adjustments with which this appeal is concerned are dealt with in ss 67(1)(*a*)(i) and 67(1)(*c*) respectively.

[8] Section 67(1)*(a)*(i) provides that 'any commission other than a buying commission' is to be added to the price actually paid or payable for the goods to the extent that it was incurred by the buyer and not included in that price. Levi SA said that the commission it paid to Levi APD under the BAA – initially seven percent and, after the amendment, twelve percent – was a buying commission. SARS disputed this and determined that Levi APD was not a buying agent, so that the commission paid to it was not a buying commission and fell to be included in determining the transaction value of these goods.

[9] Section 67(1)(*c*) of the Act provides that in determining the transaction value of goods there shall be added to the price actually paid or payable for the goods:

'royalties and licence fees in respect of the imported goods, including payments for patents, trademarks and copyright and for the right to distribute or resell the goods, due by the buyer, directly or indirectly, as a condition of sale of the goods for export to the Republic, to the extent that such royalties and fees are not included in the price actually paid or payable, but excluding charges for the right to reproduce the imported goods in the Republic . . .'

Levi SA pays a royalty to LS & Co at varying rates on every sale of garments it makes, whether manufactured by it or imported. These are paid in terms of a Trademark License Agreement (the TLA) dated 1 December 2010. The issue is whether the royalties payable by Levi SA were 'in respect of the imported goods' and were due 'directly or indirectly, as a

condition of sale of the goods for export to the Republic'. SARS determined that they were and accordingly that the transaction value of the clothing should be adjusted to take account of the royalty.

[10] If SARS is unsuccessful in its appeal on the origin issue, but successful on the issues relating to the adjustment of the transaction value of the clothing, this would have no effect as far as the payment of import duty is concerned because the zero percent rate under the Protocol would still apply. It would however affect the amount of VAT payable and to that extent a decision on those questions would have a practical effect. It would also provide guidance to SARS and other importers as to the correct approach to the relevant provisions.

The origin issue

[11] Rule 2.1 in Annex I to the Protocol is the applicable rule for the purpose of identifying originating goods. It provides that:

'For the purpose of implementing this Protocol, goods shall be accepted as originating in a Member State if they are consigned directly from a Member State to a consignee in another Member State.'[5]

Levi SA's approach was simple. It said that the goods were produced in SADC countries and were sent – consigned – directly to it in South Africa, also an SADC country, and were therefore originating goods. SARS accepted that this construction was one that Rule 2.1 bore linguistically. It argued that there was a further requirement that the commercial relationship giving rise to the consignment had to be between parties in two SADC countries. Levi SA submitted that there was no construction of the

[5] Rule 2.1 also requires that the goods must have been wholly produced or sufficiently worked in a Member State, but compliance with these local-production rules was not in dispute.

language used that could impose the qualification for which SARS contended.

[12] Starting with the language of Rule 2.1 it says that goods shall be accepted as originating in a Member State if they are consigned directly from that state to another Member State. In ordinary parlance that is what occurred with the goods in this case. They were produced or sufficiently worked in Mauritius and Madagascar and were sent either by air or sea directly from there to South Africa. Both the air waybills and the bills of lading identify Levi SA as the consignee and the producer in either Mauritius or Madagascar as the consignor. Each shipment constituted a consignment as defined in Rule 1 of the Annex as having been sent 'from one exporter to one consignee'. Each was accompanied by a declaration of origin given under Rule 9.1 in the form of Appendix II to Annex I. The two examples in the record, which I assume were typical, reflect the producer of the clothing as the exporter.

[13] This is consistent with the structure of the Act, which is concerned with the movement of goods in and out of South Africa, rather than the commercial transactions underlying such movements. Indeed, in the case of both there may be no commercial transaction, yet the movement of the goods may attract duty. Customs duty is defined as a duty leviable on goods imported into the Republic. The duty is leviable irrespective of the commercial basis, if any, upon which the goods came into the country. An importer, such as Levi SA, is simply a person who brings goods into the Republic. Goods are deemed to be imported in the circumstances set out in s 10 of the Act, but nothing in that section requires consideration to be given to anything other than the physical movement of the goods. It is unconcerned with any commercial relationship behind that movement. Section 38 requires that the importer must make due entry of the goods

within seven days of their deemed entry into the Republic. The Protocol is likewise concerned with the physical origin of the goods in a Member State of the SADC, not with their commercial origins.

[14] This approach accords with the definitions of 'exportation' and 'importation' in the Glossary of International Customs Terms published by the World Customs Organisation, of which South Africa and all other SADC countries, with the exception of the Democratic Republic of Congo, are members. It defines 'exportation' as 'the act of taking out or causing to be taken out of any goods from the Customs territory'. Conversely 'importation' is 'the act of bringing or causing any goods to be brought into a Customs territory'. A 'declaration of origin' is:

'An appropriate statement as to the origin of the goods made, in connection with their exportation, by the manufacturer, producer, supplier, exporter or other competent person on the commercial invoice or any other document relating to the goods.'

The focus is on the physical situation and transport of goods, not the commercial dealings giving rise to them.

[15] In its determination SARS took the view that Levi GTC was the exporter because it placed the orders with the producers, paid for the goods, bore the risk in them and sold them to Levi SA. SARS relied first upon the definition of 'exporter' in s 1 of the Act. That definition reads as follows:

'**exporter**' includes any person who, at the time of exportation-

(a) owns any goods exported;

(b) carries the risk of any goods exported;

(c) represents that or acts as if he is the exporter or owner of any goods exported;

(d) actually takes or attempts to take any goods from the Republic;

(e) is beneficially interested in any way whatever in any goods exported;

(f) acts on behalf of any person referred to in paragraph (*a*) (*b*), (*c*), (*d*) or (*e*),

and, in relation to imported goods, includes the manufacturer, supplier or shipper of such goods or any person inside or outside the Republic representing or acting on behalf of such manufacturer, supplier or shipper'.

[16] SARS did not identify the portion of the definition on which it relied. Before its amendment by s 1(1) of Act 112 of 1977, the definition consisted only of the words appearing after 'in relation to imported goods'. It was accordingly only concerned with identifying the exporter in relation to imported goods. Presumably, in relation to exported goods, the ordinary meaning of exporter, namely the person responsible for sending the goods out of the country applied. The purpose of the amendment appears to have been to clarify, and possibly broaden, the scope of the concept of an exporter in relation to goods being exported from South Africa. There is no indication of a need to alter the existing definition in relation to imported goods. The new sub-sections correspond *mutatis mutandis* with the sub-sections of the definition of an importer. They are couched in language apt to apply to the removal of goods from South Africa and, in the case of sub-sec (*d*), can only apply in that situation. They are not applicable to the identification of the exporter in relation to imported goods.

[17] The exporter in relation to imported goods includes any person who would naturally be regarded as the exporter, as well as the manufacturer, supplier or shipper of the goods. There is nothing unusual in this. The Act is deliberately cast in broad terms in order to ensure that duty is paid. There may be several people to whom SARS may look to recover duty or perform functions in terms of the Act. Whether Levi GTC would fall within the general understanding of an exporter, as the party securing the exportation of the goods to South Africa, is irrelevant. The producers in Mauritius and Madagascar were the manufacturers, suppliers and shippers of the goods.

In accordance with the definition, they were the exporters of those goods. The statement in para 6.7.4 of the determination that they were not regarded as the exporters to South Africa was incorrect. As exporters they were permitted to provide certificates of origin under Rule 9 of the Origin Criteria. It was no doubt convenient for them to do so as that obviated the need to provide a separate certificate from them as producers of the goods in terms of Appendix III to Annex I to the Protocol.

[18] SARS also relied in its determination on certain provisions of Rule 49B.10(9) of the Rules promulgated under the Act,[6] but this was misconceived. Where the rule deals with exporters, it is concerned with South African persons and entities that export goods to other SADC Member States. It requires them to be registered as exporters (Rule 49B.01(*f*)). The issue of certificates of origin under Rule 49B.10(9)1(*h*) referred to by SARS concerns the issue of certificates by South African exporters. The rule requires Box 1 of the certificate (identifying the exporter) to refer to a natural person ordinarily resident in the Republic, or a person whose business or the place of business of which is in the Republic. That has nothing to do with such certificates in the context of the importation of goods into South Africa.

[19] SARS is correct to say that the Protocol's purpose is to encourage trade within the SADC and it aims to do this by removing tariffs and other barriers to trade. In dealing with barriers to trade caused by tariffs its aim is to reduce the number of situations where someone in Member State A could procure goods from Member State B, but tariffs make it economically more sensible to procure them domestically, or from a non-

[6] Rules published in GNR 1874 of 8 December 1995 (GG 16860), as amended.

Member State. Removing tariffs and encouraging trade is aimed at stimulating productive activity in State B by enhancing competitiveness, and providing the economic benefit of cheaper prices to businesses and consumers in State A.

[20] SARS' argument focussed on the twelve percent mark-up paid by Levi SA to Levi GTC. It contended that the economic benefits flowing from the purchase of imported apparel from Levi GTC did not accrue to the countries from which the goods were shipped to South Africa. This was incorrect as is apparent from comparing the purchasing of goods under the Levi APD regime, with the purchase of the same goods under the Levi GTC regime. In each case the goods were procured from the same producers in the same countries and shipped to Levi SA in South Africa. Under the former regime, Levi SA paid twelve percent of the producer's price to Levi APD and, in the latter, it paid Levi GTC a mark-up of twelve percent on that price. The overall cost was the same and the cash flows identical, save that the additional twelve percent accrued to a different Levi Strauss group company outside the SADC. Commercially, the situations were indistinguishable. The economic benefits to the producing countries were unchanged, as were the economic benefits to Levi SA and South African consumers. Yet SARS conceded – clearly correctly – that in the case of the Levi APD regime the Origin Rules were satisfied, while contending that under the Levi GTC regime they were not. There is nothing in the evidence to show that any portion of the economic benefit which the SADC manufacturers could commercially have expected to receive for their input was diverted. The twelve percent ‘buying commission’ in the Levi APD regime and the twelve percent mark-up in the Levi GTC regime was compensation for services unrelated to anything done by the SADC manufacturers.

[21] The basic flaw in SARS's contention is illustrated by the following scenario. Instead of Levi GTC purchasing the clothes from the producer, another Levi Strauss group subsidiary in, say Mauritius,[7] did so at the same price and sold the clothes to Levi SA. SARS accepted that this would satisfy the Origin Rules, but was unable to point to the economic advantage accruing to Mauritius in that situation. Twelve percent accruing to the Mauritian entity would, after deducting any local expenses, still be remitted to Levi GTC to cover the latter's costs.

[22] SARS argument misconceived both trade and the effect of the relevant commercial relationships. Nothing illustrates this better than the following passage from the answering affidavit:

'By structuring the trade transaction in this manner, Levi ensures that the goods meet the requirements of the rules of origin whereas a significant portion of the economic benefits of the trade transaction are diverted to Hong Kong or Singapore at the expense of the member states. The economic benefits of the trade transaction that accrue to the manufacturing member state are limited to the amount of the invoice issued by the contract-manufacturer to … Levi GTC. Similarly, the value for customs in the importing member state (South Africa) is also limited to the same amount which attracts customs duty at preferential rate (as opposed to the full rate).

Although the actual amount that is paid by the Applicant in South Africa is 12% more than the amount that flows to the contract-manufacturer, the additional 12% is diverted to … Levi GTC duty-free.'

The deponent recognised that the transactions satisfied the Origin Rules, but then misunderstood their effect, leading to the erroneous conclusion that the twelve percent was 'diverted … duty-free' to Levi GTC.

[7] The example is not far-fetched. There is a wholly-owned subsidiary in Mauritius called Levi Strauss Mauritius Ltd.

[23] For all those reasons there was no merit in the origin argument on behalf of SARS. The words 'consigned directly from a Member State to a consignee in another Member State' refer to the physical transport of the goods from one Member State to another and not to the underlying commercial transactions giving rise to that. The conclusion in the determination that the certificates of origin presented by Levi SA in support of its entry of goods from Mauritius and Madagascar were invalid was incorrect and that determination was correctly set aside by the high court.

The alternative origin argument

[24] A subsidiary issue concerning the validity of the SADC certificates of origin was raised by SARS in argument. In the course of the audit, it transpired that notwithstanding the change from the Levi APD regime to the Levi GTC regime, some producers had continued to send invoices to Levi SA as well as to Levi GTC and, in some instances, these had been used when entering the goods, instead of the invoices rendered by Levi GTC. The auditors provided Levi SA with a schedule reflecting 47 instances where this was discovered. Vouchers of correction were prepared and lodged with SARS and any additional amounts due were paid. One instance referred to in the answering affidavit was not reflected on the schedule, but according to the evidence was dealt with subsequently.

[25] SARS submitted that the 47 cases in the schedule, plus the one referred to in its affidavit, showed that the SADC certificates of origin were 'issued on the basis of declarations tainted by misrepresentation using fictitious invoices' and were invalid. For this reason, it submitted that the relevant imported goods did not qualify for SADC preferential rates. It extrapolated these cases to the general body of such imports by claiming

that Levi SA did not establish, the onus being on it, that there were no other cases and that none of the other invoices suffered from the same taint.

[26] I do not think this argument is open to SARS on these papers. An appeal under s 49(7)*(b)* of the Act is an appeal against the determination. While it is an appeal in the wide sense, involving a complete re-hearing and determination of the merits,[8] it remains an appeal against what was determined in the determination and nothing more. It is open to SARS to defend its determination on any legitimate ground, but it is not an opportunity for it to make a wholly different determination, albeit one with similar effect.

[27] The determination in issue in this appeal was that the SADC certificates of origin used to enter goods were invalid, because GTC was not an exporter to South Africa from within SADC, but an exporter from outside the SADC. The foundation for this was embodied in the following paragraphs of the answering affidavit, which encapsulated the origin argument:

'The economic benefits flowing from the purchases of imported apparel by the Applicant from Levi GTC … did not accrue to the countries from which the goods were shipped to South Africa. Accordingly, the main objective of the SADC Trade Protocol is not achieved when the Applicant purchases the goods from sellers in Hong Kong or Singapore but shipped from an SADC Treaty member state. Consequently, the goods do not qualify for the preferential tariff treatment in terms of the SADC Protocol.

The purpose of the preferential rules of origin is to achieve genuine trade between businesses of the member states where the economic benefits of that trade accrue to the relevant member states. The interposition of non-member state entities between the manufacturer and the importer is a stratagem aimed at defeating the very objective of

[8] *Pahad Shipping CC v Commissioner South African Revenue Service* [2009] ZASCA 172; [2010] 2 All SA 246 (SCA) para 14.

the SADC Treaty Protocol by diverting the economic benefits of the transaction from the member states to a non-member state to the prejudice of the member states. The state of export derives significantly less economic benefits from the transactions, higher profits are diverted and the state of import suffers a loss on import duties.'

[28] Contentions that the certificates of origin emanating from the producers in Mauritius and Madagascar were tainted by misrepresentation and based on fictitious invoices, appear nowhere in the determination, or indeed in the answering affidavit. Had they been the subject of the determination the proceedings in the high court would have taken a very different course. Levi SA would have been required to demonstrate not only that it had properly and adequately responded to the 48 cases identified by SARS, where an incorrect invoice had been used to enter the goods and determine their transaction value, but that there were no other cases where that had happened.

[29] In any event there are three reasons why there is no merit in the argument. First, under the Protocol, the certificates of origin are validated by the country of origin of the goods. Such a certificate, once given, may only be queried in exceptional circumstances in terms of Rule 9.3 in Annex I to the Protocol. These certificates have never been queried by SARS and it has accepted vouchers of correction and the payment of duties and VAT in accordance with those vouchers. It is not open to it in those circumstances to challenge them at this late stage.

[30] Second, where the customs authority of a Member State asks that a certificate of origin be verified, the verification consists of nothing more than advising that the certificate was issued by the relevant Customs Office or designated authority and that the information therein is accurate. There

is nothing to indicate that an inadvertently incorrect reference to the invoice number invalidates the certificate, or that a reference to the invoice to Levi GTC, would result in a certificate being withheld. On Levi SA's version, supported by affidavits from the SADC manufacturers, certificates of origin were in the vast majority of cases issued on the strength of the correct invoices issued by the SADC manufacturer to Levi GTC, indicating that the use of an incorrect invoice in 47 or 48 instances did not mislead the competent authorities in Mauritius and Madagascar into authenticating certificates of origin for which they would otherwise have withheld authentication.[9] The essential facts to which the certificates attest are that the goods emanated and were consigned from the state issuing the certificate, after being produced or undergoing sufficient working or processing there, and were consigned to the state seeking verification. These certificates did that and there is no challenge to their correctness in that regard.

[31] Third, SARS wanted us to extrapolate from the cases in the schedule and the extra one referred to in the answering affidavit, to a conclusion that all the certificates suffered from the same defect. It is impossible to do that, not least because it is not apparent from the schedule that all the cases listed involved imports from SADC countries. There are only four where the preferential rate of duty of zero percent was charged. Save in one case where the rate was 30 percent, the balance attracted duty at rates of 45 percent. The determination referred to both SADC and EUR1 certificates, as had the original letter containing the prima facie audit findings. An online search reveals that EUR1 certificates are issued by certain European

[9] The exception was Aquarelle, where Aquarelle Madagascar (by whom the goods were produced) invoiced Aquarelle International Ltd in Mauritius. Certificates of origin were obtained by Aquarelle Madagascar on the strength of its invoices to Aquarelle International.

countries under a variety of pan-European trade entities, such as the European Union or the European Free Trade Association. Levi SA's Global Shipping Manual for imports to South Africa required that EUR1 certificates be provided for all shipments produced and loaded from European Union member countries. It seems possible that the cases where a duty other than zero percent was levied may not even have emanated from an SADC member state. Given this confusion it is impossible to draw the inference that SARS asked us to draw. It reinforces the point that the determination had nothing to do with this issue and, as a result, the appeal was not pursued by SARS on this basis. The argument falls to be rejected.

The buying commission issue

[32] Was the amount Levi SA paid to Levi APD under the BAA a buying commission that fell to be excluded under s 67(1)*(a)*(i) of the Act in determining the transaction value of the imported goods?[10] A buying commission is defined in s 65(9) of the Act, in accordance with para 1(a)(i) of the Explanatory Notes to Article 8 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (the Implementation Agreement), as:

'. . . any fee paid by an importer to the importer's agent for the service of representing the importer abroad in the purchase of goods being valued'.

Levi SA contended that Levi APD was appointed under the BAA as its agent in order to represent it abroad in the purchase of the imported apparel and the fee paid to it for these services was therefore a buying commission. SARS contended that properly construed in the light of a complete

[10] Because of the confusion during the transition between the Levi APD regime and the Levi GTC regime it was suggested that some shipments involving Levi GTC were dealt with under the BAA. That is irrelevant to whether the commission paid to Levi APD was a buying commission. Insofar as some transactions involving Levi GTC may have been undertaken under the BAA and on the same basis as those with Levi APD, the decision in relation to Levi APD will apply equally to that situation and any issue concerning such cases must be resolved at a later stage in the light of the judgment.

understanding of the procurement process adopted by the Levi Strauss group at the time, Levi APD was not the agent of Levi SA and accordingly the commission was not a buying commission.

[33] Broadly speaking the principal functions of a buying agent are to: find suppliers for the goods the importer wants; express the importer's needs to the seller; obtain samples of the goods for the importer's inspection and approval; assist the importer in negotiating prices; assist in arranging the transportation of the goods from seller to importer; and perform administrative functions. The functions may vary from case to case and be more or less extensive. The range of functions undertaken by the intermediary is not decisive of whether they are acting as a buying agent and earning a buying commission. Of more fundamental importance is the nature of the relationship between them and the importer. This is clear by reference to the international approach to the issue of buying agents and buying commission.

[34] The position under the Implementation Agreement is that buying commissions should be excluded when determining the value of goods on which duty is levied varies. It appears to have been a basic principle of customs valuations in the United States of America for many years.[11] Prior to the conclusion of the Implementation Agreement in its current form the position was unclear.[12] Some countries contended that the value for customs purposes should include all costs incurred in procuring the imported goods, whether incurred by the seller or the buyer, and whether or not included in the price. Others took the view that only costs that the

[11] *United States v Nelson Bead Co* 42 C.C.P.A. 175 (1955); *JC Penney Purchasing Corp. v United States* 451 F. Supp. 973 (Cust. Ct. 1978) 983.
[12] *Sussan (Wholesalers) Pty Ltd v Collector of Customs* [1978] AATA 92

seller would have to incur in order to complete the transaction by delivering the goods to the importer should be included. On that basis a buying commission incurred in the procurement of the goods, that is, their identification, the negotiations for their acquisition and administrative measures related thereto, would be excluded.[13]

[35] The reason for excluding buying commissions in determining the transaction value of imported goods seems to be that in terms of Article 1.1 of the Implementation Agreement the starting point for determining the transaction value is the price actually paid or payable for the goods when sold for export to the country of importation. The inclusions under Article 8 seek to capture the total payment made by the buyer to, or for the benefit of, the seller, whether in money or otherwise.[14] In setting its price, the seller is generally not concerned with the costs the importer incurs in order to procure the goods. Nor is it concerned with whether the importer undertakes the procurement itself or through a third party, or what costs the importer incurs in doing so. It is only concerned with the price that those goods would secure in a sale on commercial terms to another party. Although payment of a buying commission may form part of the importer's cost of sales the underlying assumption is that these are costs that would otherwise have to be incurred by the importer and do not enure for the benefit of the seller. The position is otherwise, however, where the intermediary is acting for its own advantage or for the seller. The assumption then is that were the intermediary not involved the seller would demand a higher price for the goods if selling them on commercial terms, so that the real commercial price should include the commission paid to the intermediary.

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[13] Ibid.
[14] Note to Article 1 of the Implementation Agreement.

[36] There is little guidance as to the meaning of the different terms in the definition of a buying commission. The commission is described as a fee paid by the importer to the importer's agent. It is not necessarily expressed as a percentage of the price of the goods. It may be determined on some other basis. While an importer is clearly identified in the Act, there is no definition of 'importer's agent'. When dealing with an international agreement, one must always be cautious not to import domestic legal concepts into its construction that may not be internationally recognised. It is desirable that there should, so far as possible, be uniformity among nations.[15] This is consistent with the requirements of Articles 31(1) and (4) of the Vienna Convention,[16] which apply to the interpretation of the Implementation Agreement. Accordingly, I do not think that we should determine whether Levi APD would be regarded as an 'agent' in the technical sense of our law of agency. In my opinion an agent is a representative chosen by the importer to act on its behalf and in accordance with its wishes in return for payment of a fee or commission.

[37] The notion of representation necessarily implies that the agent acts at the behest of the importer. While the agent may bring its own expertise to bear in the recommendations it makes to the importer, the important decisions must be those of the importer. Where the importer has little or no freedom of action in regard to the actions of the intermediary the

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[15] *Pan American World Airways Incorporated v SA Fire and Accident insurance Co Ltd* 1965 (3) SA 150 (A) at 167H-168A. This is the approach in other jurisdictions. See, for example, *Riverstone Meat Co Pty Ltd v Lancashire Shipping Co Ltd (the Muncaster Castle)* [1961] 1 All ER 495 (HL) at 513 (per Lord Merriman) and 524-5 (per Lord Hodson); *Integrity Cars (Wholesale) Ltd v Chief Executive of New Zealand and Another* [2001] NZCA 113 para 19 and the authorities there cited; and *De Danske Bilimportører v Skatteministeriet* (Case C-98/05); [2010] BVC 132 para 40.

[16] Vienna Convention on the Law of Treaties, 1969. The Treaty is applicable in South Africa as part of our customary international law. *Law Society of South Africa and Others v President of the Republic of South Africa and Others* [2018] ZACC 51; 2019 (3) SA 30 (CC) paras 35 and 36. While that judgment concerned article 18 its terms extend to the Convention as a whole.

intermediary is not an agent in any realistic sense. It is for that reason that the nature of the relationship between importer and 'agent' is of fundamental importance. Commentary 17.1 issued by the Technical Committee on Customs Valuation of the World Customs Organisation, discusses buying commissions and says:

'Despite the existence of an agency contract, the Customs is entitled to examine the totality of the circumstances to determine whether the so-called agent is, in fact, acting on behalf of the buyer and not on the account of the seller, or even on his own account.'

Section 74A directs that our interpretation of the relevant provision of the Act is subject to both the Implementation Agreement and the explanatory notes and commentaries issued under it. The terms of the sections under consideration are derived from the Implementation Agreement and corresponding statutes internationally are broadly similar. It is therefore helpful to examine the approach adopted in other countries to the identification of a buying agent and buying commission.

[38] The United States cases consistently hold that the relationship between the importer and the intermediary is central, and the extent to which the importer can control the actions of the intermediary in procuring the goods is fundamental.[17] A compliance document on buying and selling commissions published by the United State Customs and Border Protection,[18] expands upon this in the following terms:

'Whether a person is a *bona fide* buying agent depends upon all the relevant facts of each case and the totality of the evidence. The fact that a person is called a buying agent does not mean that he/she is in fact a *bona fide* buying agent. Also, the fact [that] a person enters into a buying agency agreement with the buyer does not mean that such

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[17] *B W Wholesale Co v United States* 436 F. 2d. 1399 (C.C.P.A. 1971).

[18] *Buying and Selling Commissions* issued after revision in October 2006 by the US Customs and Border Protection as a compliance publication, sv 'When is the intermediary a *bona fide* buying agent?' So far as I can ascertain this remains applicable in the USA. It was treated as authoritative in New Zealand in *Integrity Cars (Wholesale) Ltd v Chief Executive of New Zealand and Another* [2001] NZCA 113 op cit, fn 15.

person is a *bona fide* buying agent. Having authority to act as a *bona fide* buying agent is not the same as actually performing as one. What needs to be considered is whether the services actually performed by the agent is what the parties agreed to and whether such actions are consistent with a *bona fide* buying agency.

In order to be considered a *bona fide* buying agent, the purported agent must be acting on behalf of and primarily for the benefit of the buyer, rather than for the seller or himself/herself. The main factor which determines whether a party is a bona fide buying agent is the right of the buyer to control the agent's conduct with respect to those matters entrusted to the agent. The buyer should control the purchasing process and the buying agent should take directions from the buyer and act upon the buyer's instructions. For example, a buying agent usually does not control who the manufacturer is or what is to be purchased. Normally, the buyer makes such decisions and the buying agent carries them out. Also, a buying agent usually does not control the manner of payment and other significant aspects of the purchase. While a buying agent may exercise some discretion, the ultimate purchasing decisions should be made by the buyer and not by the buyer's agent. The more discretion a purported agent has, the less likely it is that such person is a *bona fide* buying agent.'

[39] The approach in the United Kingdom is the same. It asks whether the intermediary acted as an agent on behalf of the importer when the relationship is examined as a whole. The description of the intermediary as an agent is not decisive, as it is capable of describing someone who acts as a true agent in a representative capacity as well as someone acting on their own behalf.[19] The test is one of the substance of the relationship, not the form.[20]

[40] In my opinion neither the nature, nor the extent, of the services provided by the intermediary are decisive. The primary question is whether

[19] *Potter and Another v Customs and Excise Commissioners* [1985] STC 45 at 48.
[20] *Umbro International Ltd v Revenue and Customs* [2009] EWHC 438; [2009] STC 1345 para 27. Here the existence of a written agency agreement was held not to override the other indications that the intermediary was acting as seller of the goods for its own account.

the intermediary is not only acting on behalf of the importer, but also in accordance with the wishes and directions of the latter. If the intermediary is the one making the decisions and acting of its own accord, or under directions from a third party, it is not an agent in any realistic sense of the word. The applicable principle is that: [21]

'The essence of an agency relationship is the exercise of control by the principal over the conduct of the agent as to those matters entrusted to the agent's care.'

This accords with the views expressed by commercial sources. One commentator wrote:[22]

'The overriding characteristic marking a buying agent status is that the intermediate party is acting under the direction and control of the buyer/principal essentially on behalf of the latter.'

To similar effect, in another commercial publication,[23] it was said:

'Although no single factor is determinative, the primary consideration is the right of the principal to control the transactions vis a vis the agent's conduct with respect to those matters entrusted to the agent. That is, the agent cannot act independently or without the express authorization of the principal with respect to those matters.'

Approaching the issue in this way in the present case requires a close examination of both the BAA and the totality of the circumstances, including the manner in which the Levi Strauss group dealt with procurement and the role of Levi APD in relation to purchases of imported apparel by Levi SA.

[41] Levi SA's evidence and argument were based on the BAA. Other than saying that Levi APD was based in Singapore, the founding affidavit contained no information about it or its role in the Levi Strauss group. Nor

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[21] *JC Penney Purchasing Corp. v United States* op cit, fn 11; *New Trends Inc v United States* 645 F. Supp. 957 (Ct. Int'l Trade 1966)

[22] Mark K Neville Jr *Buying Agency (Part 1)* available at http://www.itctradelaw.com/articles/buying-agency-part1.html, the website of a firm of trade lawyers.

[23] *'Buying Commission explanation'* posted on 4 March 2016 on https://www.doing-business-international.com/2016/03/buying-commission-explanation/.

did it explain how or why it came about that the BAA was concluded between two wholly-owned subsidiaries of LS & Co. A more complete picture emerged in response to the answering affidavit's description of the global sourcing and supply system adopted by the Levi Strauss group. Furthermore, when oral evidence was led before Satchwell J, three transfer pricing reports, for the years ended 30 November 2010, 2011 and 2012, prepared for submission to the appropriate US authorities under certain Treasury Regulations by PricewaterhouseCoopers LLP on behalf of LS & Co, were included in the bundle.[24] I have resorted to all these sources in what follows.

[42] LS & Co is an international marketer of apparel. It conducts its operations outside the US through foreign subsidiaries, referred to as affiliates, that it owns either directly or indirectly through other subsidiaries. These are managed through its three divisions. LS & Co plays the leading role in designing and developing products and is responsible for the global marketing strategy of the products. It takes advantage of its global infrastructure to implement new designs and developments by licencing trademarks and trade names to its affiliates. It regards its trademarks as its most critical and valuable assets. LS & Co licences its trademarks and trade names to various subsidiaries, on terms that typically grant them a licence to use the marks and names within certain regions. In addition to specifying the scope of the uses to which the licensee may put the marks and names, the agreements cover the consideration payable for the use of the rights, payments, reporting, quality control, intellectual property rights, confidentiality, length of licence and other general

[24] These reports were introduced by Levi SA's counsel at an early stage in Mr Ettlin's evidence and relevant passages from the 2011 report were put to and confirmed by him. Counsel for SARS cross-examined Mr Ettlin on this without objection.

provisions. The licences may also regulate manufacturing activities. The overall picture is one of extremely strict central control by LS & Co of the use to which the marks and names are put.

[43] Consistent with this picture, the procurement process of the Levi Strauss group was and is centrally controlled. Without challenge, SARS summarised it in the following terms in its answering affidavit:

'The global sourcing and supply of Levi's® branded apparel and accessories is carefully and systematically managed, globally planned and co-ordinated by Levi San Francisco[25] through an organised system called 'Global Sourcing Organisation (GSO). Levi San Francisco closely controls and monitors the use of the Levi's trademarks on the branded apparel, the design and development of apparel, sourcing and supply of fabric and other materials used to manufacture the apparel, as well as the manufacturing of branded apparel.'

SARS went on to say that each division managed the sourcing and supply of goods in its region. In the case of the Asia Pacific division, in which Levi SA fell at all material times, Levi APD was the company responsible for the management of the division.

[44] The GSO is described in considerable detail in the transfer pricing reports. It commenced in 2006. Prior to that there had been three regional sourcing zones. The GSO replaced them and sourcing for all divisions was then done centrally. Its headquarters were established in Singapore and, by 2011 at least, Levi APD was performing the GSO function for the entire group. This changed in the second half of 2011 when Levi GTC assumed the GSO function, coinciding with the change from what Mr Ettlin, the Vice President, Global Supply of LS & Co, referred to as the change from a BAA model to a 'buy/sell' model. The latter is not relevant to the buying

[25] This is a reference to Levi Strauss International, California, one of the intermediate subsidiaries between LS & Co and Levi SA.

commission issue as nothing was paid to Levi GTC as a 'commission', but its role in the procurement of apparel under the GTC regime may, in due course, have a bearing on the royalty issue.

[45] The function of the GSO was dealt with in detail in the 2010 transfer pricing report and was largely repeated in the two subsequent reports, save for a minor adaptation in 2012 to allow for the advent of Levi GTC in place of Levi APD. It is helpful to set it out in full:

'The GSO serves as the merchandise sourcing arm for the LCAs.[26] The GSO provides the LS & CO Group with a set of procurement capabilities designed to deliver the right product at the right time and at the right cost and quality. The LSAs[27] assist the GSO in executing the sourcing strategy devised by the GSO leadership team and work under the GSO's direction and general overview to undertake the gamut of sourcing support functions. The LSAs are located throughout the world and provide sourcing support to the GSO in the nature of production monitoring, logistics, quality control and other support staff.'

[46] The report went on to describe the functions performed by the GSO in much greater detail. It said that they:

'… broadly include the following categories of functions:

- Sourcing strategy and planning.
- Pre-production sourcing functions, such as development of samples and prototypes; identification of manufacturers for production; negotiation of pricing and volume terms with manufacturers; product costing; consolidation and placement of product orders, including purchase orders ("PO") issuance; identification of fabrics and selection of raw material suppliers.
- Production and post-production sourcing functions, such as production supervision and monitoring; demand and supply planning including inventory management and production scheduling; quality and technical services

[26] Local country affiliates such as Levi SA.
[27] Local sourcing affiliates, that is, subsidiaries engaged in the sourcing of fabric and garments.

including product integrity ("PI"), quality assurance ("QA") technical development and technical services; arrangements for logistics including documentation, shipping, insurance and customs clearance and payment of invoices to vendors.

- Other sourcing functions including social and environmental responsibility/Terms of Engagement ("TOE") management; and BPI[28].'

[47] A distinction was drawn between the Product Management (PM) side of these activities and the Manufacturing Operations (MO).

'1 … The key PM functions … include:

i. Development of product prototypes and samples;

ii. Identification of fabrics and sundries – fabric and finish developers (PM personnel) work with designers to identify ideal fabrics and with MO personnel to locate the right mills;

iii. Product costing using the global costing tool;

iv. Negotiation of volumes and pricing with manufacturers, through collaboration with MO personnel;

v. Final selection of manufacturers;

vi. Demand and supply planning including inventory management and production scheduling; and

vii. Consolidation and placement of product orders – PO Issuance.

2 … The key GSO MO functions include;

i. Identification of third party manufacturers;

ii. Negotiation of volumes and pricing with manufacturers, through collaboration with PM personnel;

iii. Assistance related to procurement of raw materials and negotiations with mills;

iv. Production monitoring and supervision;

v. Quality and technical services including PI, QA, technical development, and technical services;

vi. Arrangement for logistics …

vii Social and environmental responsibility …'

[28] Business process improvement.

[48] It is important to note that this allocation of functions within the Levi Strauss group arose from decisions by LS & Co (or Levi San Francisco) concerning the management of its business operations as a marketer of apparel under its trademarks and name brands. Levi SA had no responsibility for the decision to establish the GSO and the allocation of functions to it. Nor is there any basis for thinking that as a subsidiary (a local country affiliate), described in the transfer pricing reports as being best categorised as a 'wholesale distributor', it had any ability to conduct its own sourcing activities independently outside the ambit of the GSO. The design and manufacture of apparel for the group was controlled by LS & Co and Levi SA was constrained to act in accordance with the system it ordained.

[49] This is reflected in the services to which the BAA related as described in Exhibit B to the BAA. They were set out as follows:

'**SERVICES**

1. advise Principal regarding prices and sources of Merchandise available for export to South Africa from the Territory;

2. advise Principal of supply and manufacturing aspects of Principal's proposed purchases of Merchandise;

3. identify to Principal[29] only manufacturers that can meet Principal's requirements (including, without limitation, LS & CO's Global Sourcing and Operating Guidelines and manufacturing standards) and have sufficient financial, production, labor and administrative resources;

4. solicit offers from manufacturers to sell Merchandise to Principal, procure samples of Merchandise and develop estimates of the manufacturer's selling price to Principal;

5. assist Principal when Principal's representatives visit suppliers to negotiate contracts or review production;

[29] This may be an error in that in the amended schedule this is replaced by 'contract'.

6. assist and advise Principal in the preparation and negotiation of purchase contracts which shall remain subject to Principal's final approval;

7. in strict conformity with instruction issued by Principal, place orders with and/or purchase for the account of Principal Merchandise from suppliers and ensure that the invoices prepared in connection with such orders and purchases conform to the provisions of Section 4;

8. inform in writing all suppliers that Principal is the entity for whom Agent is acting;

9. notify Principal of the name of each supplier and the total cost in both foreign market currency and United States dollars of each item and obtain confirmation from Principal;

10. monitor and advise Principal of the status of all orders placed for Merchandise until such Merchandise has been delivered to Principal under Principal’s purchase order;

11. inspect finished goods to ensure that such Merchandise (i) conforms to Principal’s specifications as set forth in the applicable purchase order and is not defective in any respect, (ii) meets the requirements of all United States and South Africa laws and regulations as specified in the purchase order, (iii) is packaged, labeled, priced and invoiced in accordance with the instructions set forth in the applicable purchase order, and (iv) is packaged in a manner which will ensure its safe transportation to Principal’s stores or warehouses, and Agent will advise Principal immediately of any discrepancies;

12. at Principal's request, where appropriate, arrange for and supervise the consolidation of shipments in order to reduce shipping costs;

13. at Principal’s request, arrange on behalf of Principal for the shipment of Merchandise from the delivery point specified in Principal’s purchase order to each South African port of entry Principal shall designate;

14. represent Principal in any claims against [it/Principal] including claims or requests for refunds or allowances from suppliers in the event that defective or non-conforming Merchandise is received in South Africa;

15. use its best efforts, consistent with its appointment as Agent, to ensure that Merchandise which is eligible for duty-free treatment under South Africa law shall qualify for such duty-free treatment;

16. procure and provide to Principal, in conformance with applicable South Africa custom regulations, prior to exportation, all documentation, certificates, forms, statements and information appropriate and/or necessary for exportation to and importation into South Africa including, without limitation, all appropriate

documentation, certificates, forms, statements or information for the release and liquidation of entries of Merchandise at the lowest tax and customs duty rates applicable to the Merchandise or for exemption from such tax or customs duty assessments;
17. manage any general and administrative service contracts related to the above Services as may be necessary, including services provided by Agent's contractors through separate arrangements and agreements;
18. at Principal's request, and provided Agent in his sole discretion deems appropriate or acceptable, advance payment for any Merchandise on behalf of Principal for orders placed in connection with approved purchase order;
19. provide such other related Services as Principal may reasonably request from time to time.' (The insertion in items 14 is in line with changes in the amended schedule to correct obvious errors.)

[50] The amendment of the BAA in 2010 contained an even more extensive list of 33 services. The following were added to the existing list:
'1. advise Principal of development, sourcing, manufacturing, and supply aspects of Principal's proposed purchases of Merchandise;
2. advise Principal regarding prices and sources of Merchandise available for export to the Principal's Territory from Agent's Territory;
3. provide Merchandise planning, including the identification of burgeoning fashion trends, and developing Merchandise that are expected to be locally relevant and popular, and priced within the contemplated budget of consumers;
4. provide development and implementation of fabric choices; review and edit initial prototypes to ensure that Merchandise can be mass-produced on-budget & within a given time period; work with Global Sourcing Organisation ('GSO') teams to re-develop Merchandise when pricing or production-related challenges arise;
5. provide development of Merchandise prototypes & samples (eg, working with designers and third party contract manufacturers to create and review initial Merchandise samples, etc.);
6. oversee the quality testing procedures for Merchandise and acting as a liaison between the product development team and the quality testing lab;
7. manage and provide costing estimates for Merchandise and related analysis;

8. oversee and develop global sourcing strategies (eg from which countries and suppliers to obtain needed fabrics, etc), including the development of regional seasonal, annual, and multi-year sourcing strategies;
9. prepare detailed manufacturing specifications which provide contract manufacturers with specific blue prints to properly and efficiently manufacture Merchandise;
10. publish and distribute a detailed 'Restricted Substance List', which represents a comprehensive study of all potential dangerous chemicals commonly used in the manufacturing process;
11. publish and distribute a 'Master Supply Agreement' ('MSA'), which sets the terms of engagement that a suppliers and manufacturers must adhere to in order to produce Merchandise for the Principal;
12. enter directly into a MSA on behalf of Principal relating to the manufacture and supply of products as set forth in the applicable MSA;
13. provide supply chain planning associated with the mass-production of Merchandise orders (eg how best to create economies of scale in the manufacturing process; when to aggregate which orders and with which manufacturers, etc);
14-18 …
19. select the third party suppliers and manufacturers (eg evaluation and selection of contract manufacturers to ensure production processes are of a sufficiently high quality and that production methods and working conditions are consistent with extremely strict internal sourcing guidelines and terms of engagement, etc);
20-23 …
24. ensure that manufacturers with whom orders were placed produces Merchandise that properly adheres to the Agents global sourcing and operating guidelines, the "Restricted Substance List", the MSA terms of engagement, and all other manufacturing standards;'

[51] The extended list of services was accompanied by a fee increase from seven to twelve percent. The 2011 transfer pricing report explained the fee change on the basis of an alteration in the manner in which Levi APD's 'pooled costs' were determined. Until November 2010 they included the MO costs, but not the PM costs. With effect from the 2011 year, both

MO and PM[30] costs were included in the GSO's pooled costs and this resulted in the GSO charging the Local Country Affiliates a 'sourcing commission' of twelve percent of the FOB price of merchandise. The extended list of services reflected this change in the functions performed by Levi APD.

[52] A comparison of the schedules to the BAA with the functions of the GSO demonstrates that the BAA reflects the functions of the GSO as services to be provided to Levi SA. Realistically those services would have been provided to Levi SA in any event, because the GSO was established by LS & Co to operate in that manner. Against that background the role and purpose of the BAA is unclear. I turn to examine its terms.

[53] Stripped of unnecessary detail, the key terms of the BAA, in which Levi SA is described as 'Principal' and Levi APD as 'Agent', were the following:

'1 Appointment of Agent

Principal appoints Agent to act as Principal's non-exclusive agent for the procurement of the … "Merchandise" to be imported into South Africa from … [all countries in which the Agent operates] during … the "Term". During or after the Term, Principal may procure Merchandise directly and may appoint other agents for Merchandise and the territory or otherwise, and Agent may act as representative or agent for other purchasers for similar goods in the Territory or otherwise.

2 Services by Agent

Agent accepts the appointment described in Section 1 and shall perform the services identified on Exhibit B with due care and in accordance with this Agreement and applicable law.

3 Ordering and Payment

[30] Sometimes referred to as PD&S – production, distribution and supply.

Principal shall be free to accept or reject proposals made by Agent. If Principal decides to use a manufacturer proposed by Agent, Principal shall directly enter into supply agreements with, and place orders with, the manufacturer, and shall be responsible for paying the manufacturer for the Merchandise.'
(The interpolation in square brackets incorporates the definition of Territory from Exhibit A.)

[54] A few points need to be made about these terms. While the 'Merchandise' is elsewhere defined as the merchandise determined by Levi SA, there is no suggestion that this could be any merchandise other than Levi Strauss merchandise sold under its various trademarks and brand names. Given the structure of the Levi Strauss group and the operation of the GSO, the appointment 'made' in clause 1 and 'accepted' in clause 2 can hardly have been a voluntary arrangement freely entered into by the two parties. The power reserved in clause 1 to procure merchandise directly and to appoint other agents to undertake the procurement process on its behalf, was entirely inconsistent with the operation of the GSO. The power in clause 3 to accept or reject proposals by Levi APD in regard to the design, source, price and identity of the manufacturers of apparel was likewise inconsistent with the GSO. The notion, in the same clause, that Levi SA had 'complete authority' over all the terms and conditions of purchases, cannot be reconciled with item 11 of the amended schedule under which Levi APD was to publish and distribute a Master Sales Agreement setting the terms of engagement that suppliers and manufacturers had to adhere to. Levi GTC's subsequent imposition of the Master Sales Agreement on Levi SA makes it apparent where the power of decision lay.

[55] Some of the clauses introduce an air of unreality into the agreement. Thus, for example, clause 8.4 provided for Levi SA to provide Levi APD with 'manufacturing standards, specifications, know-how and

other Principal Confidential Information.' This ignored the fact that Levi APD through the GSO established the manufacturing standards and specifications and was vested with all the know-how relevant to the production of the apparel. Similarly, given its status as the head company in the Asia Pacific division, the provisions of clause 9.1 providing that Levi SA *may* make available to Levi APD manufacturing standards, designs, specifications, know-how and other proprietary information, including production volumes, production techniques, forecasts, sourcing strategies (that is to source via the GSO) and financial information, are meaningless. This was information that Levi SA was obliged to provide to Levi APD as a matter of course.

[56] It would be otiose to trawl through each and every anomaly in the BAA and identify each and every inconsistency with the operations of the GSO. The reality is that Levi SA was in a subordinate position with little scope for independent action. That is illustrated by the provisions of clause 12 dealing with the termination of the BAA. The proposition in clause 12.1 that either party could terminate it at any time flies in the face of reality. Any termination could only occur at the instance of Levi APD or LS & Co. This is contrary to the basic principle that the authority of the agent is always revocable at the instance of the principal.[31]

[57] Applying the test discussed earlier in this judgment, one asks whether Levi SA exercised control over Levi APD in regard to the matters entrusted to Levi APD under the BAA? Expressed differently, is the overriding characteristic of the BAA that Levi APD is acting under the direction and control of Levi SA in exercising its functions under the BAA?

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[31] LAWSA Vol 1 (3 ed, 2013) para 149; *Bailey and Another v Angove's Pty Ltd* [2016] UKSC 47 para 6.

Could Levi SA purchase from the manufacturers without using the services of Levi APD? The answer to these questions is 'No'. It follows that Levi APD was not acting as a buying agent on behalf of Levi SA. Levi SA did not discharge the onus of showing that these payments were buying commissions that fell to be excluded from the determination of transaction value.

[58] During argument a member of the court asked counsel for SARS whether, if that was the case, the payment to Levi APD was a commission at all within the meaning of s 67(1)*(a)*(i), since if it were not a 'commission' it might not have had to be added to the price of the imported goods to arrive at the transaction value. The postulate was that it might simply be an amount to reimburse Levi APD for undertaking tasks that Levi SA would otherwise have undertaken itself. Interesting though the question was, it is unnecessary to explore this possibility. In entering the goods, Levi SA said the payments to Levi APD were buying commissions. SARS issued its determination on the footing that they were not. The only basis advanced in support of the appeal was that they were buying commissions. The high court agreed and this judgment concludes that the high court erred. There is no basis for considering whether the determination could have been attacked on a different basis. To this may be added that counsel for Levi SA did not, after the question was raised, seek to justify the trial court's order on this alternative basis, and we did not receive the assistance from counsel on both sides which would have been needed to resolve it.

The royalty issue

[59] Levi SA pays royalties to LS & Co in terms of the TLA concluded on 1 August 2011. Before that, according to the recitals in the preamble to

the TLA, they operated 'under mutual agreement of both parties'. I assume that involved some kind of informal licence. The schedule to the TLA reveals that LS & Co had registered, or was in the course of registering, its trademarks under the Trade Marks Act 194 of 1993. The case was conducted on the basis that the answer to the royalty issue would be the same in the period prior to the conclusion of the TLA as it was thereafter.

[60] The dispute is about the ascertainment of the transaction value of the imported goods under both the Levi APD and the Levi GTC regime and whether an amount in respect of royalties is to be included in the transaction value. The answer depends upon whether, in terms of s 67(1)*(c)* of the Act they became due by Levi SA, directly or indirectly, as a condition of sale of the goods for export to South Africa. There was no dispute that royalties were paid under the TLA on the sale, and in respect, of the imported goods.

[61] The expression 'as a condition of sale of the goods for export to South Africa' is not easy to construe. The Glossary of International Customs Terms published by the World Customs Organisation defines 'exportation' as 'the act of taking out or causing to be taken out of any goods from the Customs territory'. The sale for export requirement is satisfied by sales of goods for consignment to South Africa from outside South Africa. The liability for duty must arise as a condition of those sales.[32] However, this does not resolve the question of what is meant by a 'condition of sale' or the effect of the qualification 'directly or indirectly'.

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[32] *The Commissioner for the South African Revenue Service v Delta Motor Corporation (Pty) Ltd* 2003 (1) JTLR 15 (SCA); [2002] JOL 10207 para 23 (*Delta*). See also Note 2 to the Notes relating to paragraph 1*(c)* of Article 8 the Interpretation Agreement.

[62] The Supreme Court of Canada[33] held that the words 'condition of sale' had a settled legal meaning in the law of sale. It adopted the narrow construction that:

'in its usual meaning a condition is a term which, without being the fundamental obligation imposed by the contract, is still of such vital importance that it goes to the root of the transaction'.

Based on that approach it said that unless the vendor was entitled to refuse to sell licenced goods to the purchaser, or could repudiate the contract of sale where the purchaser failed to pay the royalties, the corresponding section of the Canadian legislation was not engaged. Levi SA argued that this court in *Delta*[34] adopted the same approach and submitted that, in any event, it should be followed. I do not agree with either contention. As to the first, there was no discussion in *Delta* about the interpretation of s 67(1)*(c)*, beyond the statement that all the requirements of the section had to be satisfied for it to be applied. That cryptic, and trite, observation did not address the questions arising in this case of the meaning of 'condition of sale' and the implications of the words 'directly and indirectly'. Nor is it possible to infer any definite conclusion in regard to these issues from the discussion and resolution of the factual issues in that case.

[63] As to the second, the *Mattel SCC* judgment has been followed in Malaysia,[35] but the New Zealand courts[36] and the European Court of Justice (ECJ)[37] have adopted a broader view, as had the Federal Court of Appeal

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[33] *Canada (Deputy Minister of National Revenue) v Mattel Canada Inc* 2001 SCC 36; [2001] S.C.R 100 p 125 (*Mattel SCC*).
[34] Op cit, fn 32.
[35] *Nike Sales Malaysia Sdn Bhd v Jabatan Kastam Diraja Malaysia and two others* [2013] MLJ 21 (FC-PJY). A similar conclusion was reached by the Supreme Court, Contentious - Administrative Chamber in Spain in the matter of *Adidas España S A* Case No 7460/2005.
[36] *Adidas New Zealand Ltd v Collector of Customs (Northern Region)* [1999] 1 NZLR 558 (CA) (*Adidas*); *The Collector of Customs v Avon Cosmetics Ltd* [1999] NZCA 256 (*Avon Cosmetics)*; *Chief Executive of the New Zealand Customs Service v Nike New Zealand Ltd* [2003] NZCA 218; [2004] 1 NZLR 238 (*Nike*).
[37] *GE Healthcare* [2017] EUECJ C-173/15 (*GE Healthcare*).

in Canada in *Mattel FCA*.[38] The New Zealand decision in *Nike* dealt expressly with *Mattel SCC*. The majority held[39] that its approach was inappropriately narrow in the context of the interpretation of an international agreement. I agree with this criticism for the reasons discussed in para 36 of this judgment. The point is particularly significant in the context of South African law, where a condition is not the same as a term of the contract. This illustrates the danger of construing an international instrument in accordance with the narrow requirements of any one legal system.

[64] With respect, it seems to me that the Canadian approach suffers from three further weaknesses. Firstly, the requirement that there be a condition, in the sense of a term, attaching to the sale of the goods for export, renders the words 'directly or indirectly' redundant, because the obligation to pay royalties would arise directly or not at all.[40] Secondly, as Richardson P pointed out in *Avon Cosmetics*,[41] a 'condition of sale of the goods' is neither the same, nor as narrow, as a 'condition of the contract of sale of the goods'. Thirdly, it is inconsistent with the acceptance in Commentary 26.1 on Article 8 of the Implementation Agreement that the obligation to pay the royalties may arise under an agreement between the licensor and the importer, rather than the importer and the vendor, and that the licensor and the vendor may be unrelated parties.

[65] As to the first of these, while the words 'directly or indirectly' are adverbial and grammatically linked to the royalty becoming 'due' by the

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[38] *Canada (Minister of National Revenue) v Mattel Canada Inc* 1999 CanLii 7405 (FCA) (*Mattel FCA*).
[39] Ibid, paras 57-59.
[40] See, for example, *Reebok Canada v The Deputy Minister of National Revenue for Customs and Excise* 2002 FCA 133 para 12.
[41] *Avon Cosmetics Ltd* op cit, fn 36. See also *Mattel FCA* op cit, fn 38, para 26.

importer, they cannot in my view be severed from the condition of sale that renders them due. Royalties may be due directly as a condition of sale, or due indirectly as a condition of sale. Royalties are due when they become owing and payable under the agreement with the licensor. They will be due directly if the fact of the sale to the importer is what gives rise to the obligation to pay the royalty, as where the contract of sale stipulates for the payment of the royalty, or a separate contract between the licensor and the importer provides that the purchase of the goods gives rise to an obligation to pay the royalty. They will be due indirectly where the fact of the sale is a necessary condition for the obligation to pay the royalty to arise and the sale would not take place in the absence of an obligation to pay the royalty.[42]

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[66] I am not persuaded by the view expressed in *Mattel FCA*[43] that the purpose of the words 'directly or indirectly' is merely to extend the application of the section to cover indirect payments, such as a price reduction by way of set-off of a debt owed by the vendor to the importer, or the settlement of a debt owed by the vendor to a third party.[44] Those are unusual situations that will only rarely arise in practice in implementing agreements for the payment of royalties in return for the right to use or exploit the intellectual property of another. In my view the more plausible construction is that the words 'directly or indirectly' operate to extend the situations in which the obligation to pay the royalty becomes due.

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[42] Factually, the sale to Mattel Canada by its United States parent company would have taken place irrespective of whether Mattel Canada paid the royalty under its agreement with the independent third party licensor.
[43] *Mattel FCA* op cit, fn 38, para 28.
[44] The *adjectus solutionis gratia* of our law. *Stupel & Berman Incorporated v Rodel Financial Services (Pty) Ltd* [2015] ZASCA 1; [2015 (3) SA 36 (SCA) para 13.

[67] The second and third matters referred to in para 64 can be dealt with together. Section 67(1)*(c)* refers to a condition of sale, not a condition of the contract of sale. Consistently with the judgment in *Mattel SCC* the latter would require that there be an express or tacit term for the payment of royalties in the contract under which the goods were imported. Accepting that this is not what is required and avoiding any technical meaning of the words, I prefer the formulation by Létourneau JA in *Mattel FCA*[45] that the royalties must become due as a prerequisite or requirement of the export of the goods, although that may arise under a contract other than the export contract. A convenient practical test is to ask whether the goods would have been exported in the absence of the obligation to pay the royalty.[46]

[68] This approach is consistent with Commentary 25.1 to the Implementation Agreement on 'Third Party Royalties and Licence Fees – General Commentary'. Paragraph 7 provides that a key consideration in determining whether the buyer must pay the royalty as a condition of sale is whether the buyer is unable to purchase the imported goods without paying the royalty. This calls for an analysis of the contractual documents and all the facts surrounding the sale and importation of the goods. The Commentary recognises that the royalty may be payable to a third party unrelated to the seller, as in the case of the purchases made by Levi SA from independent suppliers under the Levi APD regime.[47] Where the licensor is unable to interfere with a sale for export to the importer and prevent it from taking place it is difficult to conclude that payment of the

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[45] *Mattel FCA* op cit, fn 38, para 26.

[46] This is the approach of the US Customs and Border Service under General Notice, Dutiability of Royalty Payments, Vol. 27, No. 6 Cust. B. & Dec. at 1 (February 10, 1993) ("Hasbro II ruling"), wherein, Customs asks the following questions:
Was the imported merchandise manufactured under patent?
Was the royalty involved in the production or sale of the imported merchandise?
Could the importer buy the product without paying the fee?

[47] Once the Levi APD regime was replaced by the Levi ATC regime all the parties were connected.

royalty is a condition of the sale. Factually, that was the situation in *Mattel*, where the licensor was unrelated to the Mattel group of companies. However, where the licensor is in a position vis a vis the importer to exercise control over the process at every stage, the position is different. As Blanchard J said in *Nike*:[48]

'… [W]here royalties are payable to a licensor which is a member of the same corporate group as the licensee – and particularly where the buying is in practice conducted through another member of the corporate group – the situation is throughout under the parent company's control exercisable on behalf of the licensor.'

[69] The factual situation in *GE Healthcare* was similar to that under the Levi GTC regime in the present case. The licensor, buyer and seller of the imported goods were all members of the wider GE group of companies and all were controlled by the parent company of the group. The court accepted that the legal position was correctly summarised by the Advocate General in his opinion as being that:[49]

'the payment of a royalty or a licence fee is a 'condition of sale' of the goods being valued where, in the course of the contractual relations between the buyer, or a person related to him, and the seller, the payment of royalty or of the licence fee is so important to the seller that, without such payment the seller would not have concluded the sales contract …'

The question posed to the ECJ was whether the payment of the royalties to the licensor could be a condition of sale of the goods for export, where they were payable to an undertaking related to both the buyer and the seller. It said that it was necessary for the national court to determine whether the licensor had any control over the buyer and seller such as to enable it to ensure that royalties would be paid on the export of the goods.[50]

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[48] *Nike* op cit, fn 36, para 67. This is so in every case where courts have concluded that the royalty is to be included in the transaction value of the goods. In *Mattel FCA* the court concluded on the facts that it was not to be included.
[49] *GE Healthcare* op cit, fn 37, para 60.
[50] *GE Healthcare* ibid, para 68.

[70] The ECJ went on to cite the following commentary on customs valuation issued by the European Commission: '[51]

'[W]hen goods are purchased from one person and a royalty or licence fee is paid to another person, the payment may nevertheless be regarded as a condition of sale of the goods … when, for example, in a multinational group goods are bought from one member of the group and the royalty is required to be paid to another member of the same group. Likewise, the same would apply where the seller is a licensee of the recipient of the royalty and the latter controls the conditions of the sale.

The final conclusion in *GE Healthcare* was that royalties are a 'condition of sale' of the goods being valued where, within a single group of undertakings, those royalties are required to be paid to an undertaking related to both the seller and the buyer and were paid to that same undertaking. [52] This broader view of the position was also espoused in Advisory Opinion 4.15 issued by the Technical Committee on Customs Valuation[53] and is reflected in the outcome of several decisions of the Peruvian Tax Court, dealing with arrangements similar to those in this case and the others to which I have referred.[54]

[71] I conclude that properly interpreted s 67(1)*(c)* is concerned with the contract in terms of which the goods are imported into South Africa. It is

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[51] Compendium of Customs Valuation Texts of the Customs Code Committee: Customs Valuation Section TAXUD/800/2002-EN issued by the European Commission para 13 of Commentary No 3 (September 2008). The same commentary appears in the current (2018) edition of the Compendium in para 9 of Commentary 3.

[52] *GE Healthcare* op cit, fn 37 para 71.

[53] In the matter under consideration, the licensor and importer were related to each other but not to the manufacturer. Payment of royalties by the importer to the licensor was not a term of the sales from the manufacturer to the importer. However, the licensor had a supply agreement with the manufacturer to manufacture goods bearing its trademarks and to sell those goods to the importer. The manufacturer had to comply with the licensor's specifications and could sell the branded goods only to persons approved by the licensor. The Technical Committee advised that payment of royalties was a condition of sale of the goods for export to the importer because the latter would not be able to buy the goods if it failed to pay royalties to the licensor. Non-payment of royalties would bring about a termination of the license agreement and the withdrawal of the authority given by the licensor to the manufacturer to sell the goods to the importer.

[54] The decisions are referred to in summary form in Lux, Cannistra and Rodriguez Cuadros 'The Customs Treatment of Royalties and License Fees with Regard to Imported Goods' *Global Trade and Customs Journal* Vol 7, Issue 4, 2012, pp 120-142 at 139-141.

not a requirement of the section that the obligation to pay royalties should be embodied, either expressly or tacitly, in that contract by way of a contractual term. The royalty may be payable to a third party other than the seller. It may become due directly, because the terms of the contract, either expressly or tacitly, impose that obligation or where the terms of the royalty contract inextricably link the payment of the royalty to sales for export to the licensee. It may become due indirectly where the nature of the relationships between exporter, importer and licensor when viewed as a whole is such that the sale would not have occurred without an obligation to pay a royalty becoming due.

[72] Turning then to the TLA, Article 2 granted to Levi SA exclusive, non-transferable rights in the Trademarks and Trade Names[55] identified in schedules to the agreement. They were granted solely for use in the Territory, in connection with the manufacture, advertising, promotion, display of advertising commercials, distribution, sale and retailing of Products; the operation of Levi's® and Dockers® stores; and in connection with sales of Products to authorised Licensees and Sublicensees of LS & Co. The Products were defined as meaning items of apparel and accessories identified in a schedule and bearing one or more of the trademarks. The Territory was defined as the Republic of South Africa and twelve other African states, but excluding Mauritius and Madagascar, from which much of this apparel was being imported. The rights were subject to an express limitation that Levi SA could not, without the consent of LS & Co, authorise any person or entity to affix any of the trademarks to any product or sue them in relation to any product other than the Products or affix any trademarks, trade names or logos other than the defined

[55] These and other capitalised words are defined in the TLA.

Trademarks to any of the Products. Sub-licensing was only permissible with the written approval of LS & Co and on terms approved by it.

[73] Article 3 provided for the payment of royalties. Its material terms read as follows:

'3.1 Royalties: In consideration of the rights granted to Licensee under Article 2.1 of this Agreement, Licensee shall pay royalties to Licensor as follows:

(a) A royalty in an amount equal to nine percent (9%) of the Net Sales Price of all Category "A" Products sold by Licensee;

(b) A royalty in an amount equal to nine percent (9%) of the Net Sales Price of all Category "B" Products sold by Licensee;

(c) A royalty in an amount equal to fifty percent (50%) of the respective royalty rates in Articles 3.1(a) and 3.1(b) for Category "A" Products and Category 'B' Products that are second quality Products.

3.2 . . .

3.3 Time of Accrual of Royalties:

(a) Any and all royalties payable to Licensor under Article 3.1 of this Agreement will accrue on the date on which the relevant Products are billed, invoiced, shipped or delivered by Licensee or paid for by Licensee's customers, whichever event occurs first, and will be deemed to be held in trust for the benefit of Licensor until payment of those royalties is actually received, in accordance with the provisions of Article 3.5 hereof; and

(b) Under no circumstances shall the royalties payable to Licensor under Article 3.1 of this Agreement be considered a condition of (1) purchase of any Product by Licensee or Sublicensee; (2) import of any Product by Licensee or Sublicensee; or (3) sale of any product to Licensee or Sublicensee. Products may be procured by Licensee or Sublicensee without regard to the royalty payments under Article 3.1 of the Agreement.'

[74] The Net Sales Price referred to in this provision was defined as meaning the invoice price at which Products were sold by the Licensee to customers, other than LS & Co, its affiliates and specified Licensees and

Sublicensees, less deductions. The latter referred to customary discounts and allowances granted by Levi SA in accordance with its standard commercial practices; certain taxes; and credits on returns. In regard to the sourcing and manufacture of products article 4.1 provided that:

'Licensee shall manufacture Products at its own facilities or may obtain Products as follows: i) by placing orders via the Licensor global sourcing organisation; or (ii) by purchasing directly from Licensor, an Affiliate; or an Authorised LS & CO licensee. The royalty payment requirements set out in Article 3 shall govern all sales of Products regardless of how Licensee procures them.'

[75] Under Article 3 the royalty was payable in consideration of the rights conferred under Article 2.1 Those rights were principally the advertising, promotion, distribution and sale of clothing and accessories bearing the trademarks and trade names. These items were imported by Levi SA in order to be sold in terms of this licence. The sale of the goods for export to South Africa for the purposes of sale therefore involved the exercise of the rights under Article 2.1(b)(i). The imported goods included the Trademarks and Trade Names and used the intellectual property covered by the TLA. While no royalty payment would accrue under Article 3.3(a) of the TLA until the goods were sold, the obligation to pay a royalty when that occurred already existed in terms of Article 3.1 The amount of the royalty and the date for payment still fell to be determined, but that does not detract from the fact that the obligation to pay the royalty had already arisen under the TLA. *Adidas*, *Nike* and *GE Healthcare* held that the fact that the royalty would only become due after the goods had been sold – a customary feature of royalty agreements, as pointed out by Blanchard J in *Adidas* – did not mean that the obligation to pay the royalty was not a condition of the sale for export.

[76] This conclusion is reinforced when examining these provisions in the light of the buying arrangements under which Levi SA procured the imported goods. Although Article 4.1 postulated two procurement options, Levi SA was constrained by the manner in which the GSO functioned to use only the first and place orders via the GSO. Under the earlier regime it was compelled to purchase from manufacturers appointed by Levi APD on the terms negotiated by Levi APD. After the change of regime, it was constrained to order directly from Levi GTC. Under both regimes the process of production and sale between Levi SA and the supplier was entirely managed and controlled by the licensor, LS & Co. That is close to the situation described in para 9(e) of Commentary 25.1 to the Implementation Agreement as being an indication that the royalty is a condition of sale, namely where:

'The royalty or licence agreement contains terms that permit the licensor to manage the production or sale between the manufacturer and importer (sale for export to the country of importation) that go beyond quality control.'

In this case there was no need for there to be a provision in the TLA because of the complete control that LS & Co exercised over the entire production and procurement process through the GSO.

[77] In each of the New Zealand cases cited earlier the court dealt with a situation where the importer was the New Zealand subsidiary of an international group of companies, and the importer's function was the importation, sale and distribution of the group's products in New Zealand and some nearby territories. In each case the royalties payable to another company in the group were calculated on the value of domestic sales. In *Adidas*[56] the importer could only import goods supplied by manufacturers approved by its holding company. The sole purpose of the imports was

[56] Op cit, fn 36, p 563.

domestic sales, which would crystallise the obligation to pay royalties. In those circumstances Henry J concluded that it could not import the products without incurring the liability to pay royalty. That made the payment of royalties a condition of the sale to it of the products in accordance with the approach discussed earlier in this judgment. Blanchard J pointed out in his concurring judgment, that it was inconceivable, had the importer been an independent company under separate ownership, that orders would have been placed on its behalf without ensuring that the royalty was and would be paid.'

[78] In *Nike*,[57] after recognising that the two views expressed in *Adidas* might differ, the majority approach was formulated in the following terms:

'It seems to us that … there must be a combination of two features. First, the royalty must be payable to the manufacturer or to another person as a consequence of the export of the goods to New Zealand and, secondly, the party to whom the royalty is payable must have a control of the situation going beyond the ordinary rights of a licensor of intellectual property and giving it the ability to determine whether the export to New Zealand can or cannot occur.'

The majority accordingly held that because the goods in question were only exported to New Zealand because of the existence of the licence agreement requiring the payment of the royalty and because of the control that the holding company could exercise over the parties to the sale for export to ensure payment of the royalty, the royalties were payable 'as a condition of the sale of the goods for export to New Zealand'.

[79] There is nothing in the TLA to distinguish those cases and *GE Healthcare* from the present one. If anything, Article 3 is clearer in linking the export of goods to South Africa directly with the payment of

[57] Op cit, fn 36 para 67.

the royalty. In my opinion, therefore, SARS was correct in saying that the royalty needed to be included in determining the transaction value of the imported goods.

[80] I have considered whether the fact that the exact royalty cannot be quantified until the goods have been sold affects the matter. I think not. All that s 67(1)*(c)* requires is that the royalty be 'in respect of the imported goods'. I agree with Blanchard J in *Adidas*[58] that:

'It is unrealistic to contend that royalties are not payable 'in respect of the imported goods' merely because they are fixed in relation to the price at which the importer sells them and because nothing is payable [to the licensee] unless they are resold. In practice, royalty payments are almost invariably calculated on sales by the licensee.'

The ECJ came to the same conclusion in *GE Healthcare*[59] as did the Federal Court of Australia in another case involving the Mattel group.[60] All recognised that the consequence of this was that adjustments to duty already paid might have to be made either by way of further payments or by way of refunds. Section 67(1)*(d)* of the Act indicates that the transaction value of goods may be affected by later events.[61] Section 65(5) empowers the Commissioner to amend a value determination, and this would represent at least one way in which an over- or under-estimate of royalties at the time of importation could be adjusted.[62]

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[58] Op cit, fn 36, at 566.
[59] Op cit, fn 37 para 54.
[60] *Mattel FCA*, op cit, fn 38.
[61] Section 67(1)*(d)* requires the inclusion in the transaction value of 'the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller'.
[62] The issue is discussed in greater detail along the lines suggested here in the article by Lux, Cannistra and Rodriguez Cuadros op cit, fn 54, at 136-137. In an article for clients Bell Gully noted that the practical position in New Zealand is that:

' One practical difficulty that importers face when calculating duty is that typically royalties are calculated by reference to "net sales" and therefore the amount of the royalty for a particular good is not known at the time of importation.

Customs' practice has been to require the importer to use the previous year's figures to estimate the amount of royalty that is expected to be payable in relation to imports for the current year. This estimate is expressed as a percentage of the import price which is added to the dutiable value of product imported

[81] Levi SA relied heavily on the provisions of Article 3.3(b) and the express statement that the royalties payable should not be considered a condition of purchase or import of any product by Levi SA or the sale of any product to it. I would not go so far as to say that this provision carries no weight as conveying the intention of the parties in concluding the TLA. Clearly the aim was to avoid royalties being included in calculating the transaction values of imported goods in terms of Article 8 of the Implementation Agreement and legislation giving effect to that provision. On the approach set out in this judgment, the obligations under the TLA, seen in the light of the procurement policies of the Levi Strauss group under the GSO, led to the conclusion that payment of the royalty was a condition of the sale for export of the goods. Article 3.3(b) cannot then assist Levi SA.

Result

[82] In the result the appeal must fail in respect of the origin issue, but succeed in respect of the buying commission and the royalty issues. That requires some amendment to the order of the high court. It read as follows:

'1 The applicant's appeal against the Respondent's determinations made on 25 March 2014 are upheld.

2. The aforesaid determinations made by Respondent on 25 May 2014 are set aside:

2.1 That Levi Strauss Asia Pacific Division (Pty) Limited ('Levi APD') is not a buying agent of the applicant and that consequently the buying commissions paid by the applicant on goods sourced by Levi APD should have been included in the value of those goods for duty purposes upon their importation.

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for the current year. The uplift figure is then usually treated as an interim payment and at the end of each year the position is reviewed to see whether additional duty is payable (or refundable).'
See https://www.lexology.com/library/detail.aspx?g=3d20d017-17e5-4c08-b045-89d6f1b39065 accessed 29 March 2021.

2.2 That the royalties/licence fees paid by the applicant to LS & Co are to be included in the value for duty purposes of the goods imported by the Applicant upon their importation.
2.3 That South African Development Community Certificates of Origin were invalidly used in respect of goods imported by the Applicant from SADC manufacturers/suppliers contracted by Levi APD or Levi Strauss Global Trading Company Limited ("Levi GTC") resulting in the applicant incorrectly claiming preferential duty rates.
3. That the said determinations be substituted by determinations to the following effect:
3.1 That Levi APD is a buying agent of the Applicant and that the buying commission paid by the Applicant on goods sourced by Levi APD is not to be included in the value of those goods for duty purposes upon their importation;
3.2 That the royalties/licence fees paid by the Applicant to LS & Co are to be excluded from the value for duty purposes of the goods imported by the Applicant; and
3.3 That Southern African Development Community Certificates of Origin were validly used in respect of goods imported by the Applicant based in South Africa from SADC manufacturers/suppliers contracted by Levi APD or Levi GTC and that preferential duty rates are applicable to the importation of such goods.
4. That the demand accompanying the above determinations be withdrawn.
5. That the respondent shall pay the costs of this application, including the costs of two counsel, such costs to include those attendant upon the interlocutory application heard before Murphy J which resulted in the judgment of Murphy J of 2 May 2017.'

[83] I do not doubt that it is permissible for a court seized with an appeal under either s 49(6) or s 65(7) in appropriate circumstances to substitute the determination by the Commissioner with a fresh determination in accordance with its judgment. That is appropriate where the determination was that a sum of money was due and the court determines that a different sum was due by the importer. However, where the determination of the appeal involves a challenge to the principle upon which the determination was made it may be inappropriate for the court to substitute the determination with another. It is then preferable simply to set aside the

determination, or to refer it back to the Commissioner for reconsideration in the light of the judgment. In my view it was inappropriate in the circumstances of this case for the court to have been asked to substitute the suggested determinations for those of the Commissioner. All three potentially affected situations that were not before the high court when it dealt with the appeals.

[84] In my view the appropriate order would be to set aside the determination in regard to the invalidity of the Certificates of Origin to the extent consistent with this judgment and to set aside the corresponding demand for payment of duty and VAT of R52 466 124.19 and R87 240 129.71. There is no need to make a substitute determination and if there are any other issues SARS is free to address them in such manner as may be appropriate. As regards the determination in respect of commissions paid to either Levi APD or Levi GTC in terms of the BAA that these were not buying commissions the determination must stand. Likewise, the determination that royalties due to LS & Co on the goods imported, whether under the Levi APD or the Levi GTC regime must be added to the purchase price of those goods must stand.

[85] There is a lack of clarity in the determination as to the basis upon which the amounts claimed because of the inclusion of the commissions and royalties were calculated. However, neither appeal was directed at those calculations in the event that Levi SA's primary case failed. Accordingly, the determination does not fall to be disturbed in that respect. As regards the costs order in the high court, Murphy J made the costs of the application before him costs in the cause in the application. There was accordingly no need for any special order in regard to those costs.

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[86] I make the following order:

1 The appeal is upheld with costs, such costs to include those consequent upon the employment of two counsel.

2 The order of the high court is set aside and replaced by the following order:

'(a) The appeal in terms of s 49(6) of the Customs and Excise Act 91 of 1964 succeeds in relation to the Commissioner's determination dated 25 March 2014 that the Certificates of Origin accompanying the bills of entry for goods imported by Levi SA and consigned from countries within the SADC area during the period from 1 July 2010 to 5 February 2014 were invalid.

(b) The determination and the demand for payment in consequence thereof of the sums of R52 466 124.19 and R87 240 129.71 are set aside.

(c) The application and appeal in terms of s 65(6) is otherwise dismissed.

(d) The respondent is to pay the applicant's costs, such costs to include those consequent upon the employment of two counsel.'

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M J D WALLIS

JUDGE OF APPEAL

Appearances

For appellant:	C E Puckrin SC (with him N K Nxumalo)
Instructed by:	Macrobert Attorneys, Pretoria
	Lovius Block Inc, Bloemfontein
For respondent:	J P Vorster SC (with him E Muller)
Instructed by:	Shepstone & Wylie, Johannesburg
	Webbers, Bloemfontein.