Licensing of Brands in Ukrainian Dealership Practice:

Feasible Solution for Foreign Producers and Importers

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Dealership agreements are widely used in Ukrainian business practice, particularly by foreign producers of branded products *vis-a-vis* their local importers and dealers.

A dealership agreement usually provides for certain possibilities for the dealer to use trademarks of the producer which does not necessarily mean that there is trademark license agreements between the parties. At the same time, there are numerous cases when Ukrainian tax and other controlling authorities request dealers and importers to present trademark license agreements. If there is no license agreement, the tax authorities tend to recognize *de-facto* license relations between the parties based on the fact of the use of the trademarks under dealership schemes.

One may say that because the dealership agreements are not regulated by statutory civil law international dealership practice related to the use of trademarks does not merely fit in the *Civil Code of Ukraine* (the *Civil Code*). Therefore, from this legal standpoint the use of trademarks by dealers can only be qualified as derivative to a license agreement.

Finally, Ukrainian controlling authorities claim that if a dealer uses a trademark, the dealer has to pay a royalty, and this statement is based on the definition of license agreement under Ukrainian law[1].

Ukrainian court practice is rather ambiguous in respect of royalty payments in question. For example, in the LLC Niko-Ukraine *v.* Tax Authorities case the Kiev Circuit Administrative Court confirmed that the use of trademarks under the dealership agreement does not imply *per se* payment of the royalty and the respective taxable income of the licensor. The Kiev Administrative Court of Appeal sustained the position of the tax authorities that the use of trademarks does automatically presume the royalty. Finally, after a year of trials the Higher Administrative Court of Ukraine confirmed that the use of respective trade signs to identify distributed products under the dealership agreement shall not be qualified as the use of intellectual property objects subject to royalty[2] (the latter, would be possible under a license agreement).

Businesses in Ukraine are trying to find feasible solutions to authorize the use of trademarks in connection with dealership agreements avoiding the risk of additional costs and litigations. This article considers several legal options as to the use of trademarks in dealership relations from the perspectives of IP, civil and tax laws of Ukraine.

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[1] Article 1109 of Civil Code; please see below.

Options of trademark licensing under Ukrainian IP rules

Option 1: License as a separate document (Article 1108 of *Civil Code*)

A license as a separate document represents a conventional authorization, i.e., a unilateral commitment of a trademark's holder. To be valid the document does not need to be accepted by the licensee. In Ukrainian legal terms the definition of the license corresponds to the definition of a unilateral legal deed, or "odnostoronniy pravochyn". Ukrainian scholars and judges tend to distinguish licenses from consensual license agreements[3].

Option 2: Licensing under a license agreement (Article 1109 of *Civil Code*)

From the doctrinal position, the difference between trademark license agreements and mere licenses (unilateral deeds) is the royalty payment, which is a mandatory element in license agreements. Under the legal doctrine payment of royalty is indeed the main aim of a license agreement as under the agreement the licensee commits to pay for the granted license: "the license agreement is bilateral, consensual and paid"[4], "the main aim of license agreements is to ensure possibility... to receive remuneration for the granted right to use the invention"[5].

It is possible that, this doctrinal position explains why Ukrainian controlling authorities tend to qualify the use of a trademark in dealership as a *de-facto* license agreement which entails mandatory royalty payments.

Option 3: Royalty-free license agreement

The importance of royalty as an essential element in license agreements was somewhat diminished in Ukrainian case law. In 2007 the High Commercial Court of Ukraine issued the following recommendations to lower courts with respect to the validity of royalty-free licensee agreements: "The Ukrainian laws in force do not require that the authorization to use trademarks should be exclusively for a fee"[6].

More recently royalty-free license agreements were indirectly recognized by the Plenum of High Commercial Court of Ukraine, which stated the following: "If a license agreement provides for a fee for the use of intellectual property, the licensor's payment claims cannot be dismissed based on the fact of alleged non-use of the intellectual property by the licensee..."[7].

Essential difference between the above Options

A license (Option 1) does not need to be accepted by the licensee; one may compare the form of this document with a unilateral power of attorney. The Royalty-free license agreement (Option 3) is similar to a deed of gift and the latter is understood under Ukrainian law as a so-called "unilateral agreement" / "odnostoronniy dogovir"[8]. And finally, Option 2 is a typical bilateral agreement providing for the payment of royalties.

Qualification of options from general civil law perspective

Option 1 is generally compliant with civil law rules and can be applicable to dealership schemes[9].

The dealership agreement under Option 2 may potentially be qualified as *de-facto* commercial concession[10]. Commercial concessions have much more developed statutory regulation in Ukraine and restrictive provisions towards producers as concessionaires. To this extent we do

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[2] Resolution of the High Administrative Court of Ukraine of 31 January 2011 on the case Niko-Ukraine.

[3] Ruling of the Kiev Court of Appeal of 25 September 2012 on the case City-Com; The Civil Law of Ukraine / Ed. by V. Borisova, I.V. Spasibo-Fateeva, V.L. Yarotsky. — Volume 2. — Kiev: Yurinkom Inter, 2007. — p. 413.

[4] Scientific and Practical Commentary to the Civil Code of Ukraine / Ed. by O.V. Dzera. — 3rd Edition. — Kiev: Yurinkom, 2008. — p. 813; The Civil Code of Ukraine: Scientificand Practical Commentary / Ed. by E.O. Kharitonova. — 2nd Ed. — Kiev: Pravova Ednist, 2009. — p. 611.

[5] The Civil Code of Ukraine. Scientific and Practical Commentary / Ed. by E.O. Kharitonov. — 5th Ed. — Kharkiv: Odissey, 2008. — p. 1076.

[6] Overview Letter of the High Commercial Court of Ukraine of 22 January 2007, No.01-8/24.

[7] Section 5.3. of the Resolution of Plenum of the High Commercial Court of Ukraine of 17 October 2012, No.12.

[8] In contrast to Option 1, the trademark Royalty-free license agreement will not be valid until accepted by the licensee, even though the latter has no payment obligations towards the licensor.

[9] We note, however, that it may be rather complicated to perform state registration of the license under Option 1.

[10] In accordance with Article 1115 Civil Code under a contract of commercial concession one party (right-possessor) shall be obliged to grant to the other party (user) for payment the right of use in accordance with the requirements thereof of a complex of rights belonging to this party, including, most importantly, IP rights for the purpose of the manufacture and/or sale of a determined type of good and/or rendering of services.

A TRADEMARK LICENSE becomes TAXABLE to the EXTENT that SUCH a LICENSE is AIMED at GENERATING the LICENSEE'S BUSINESS INCOME

not recommend applying Option 2 in dealership schemes.

Option 3 is not expressly envisaged in statutory civil law. In terms of the Ukrainian legal system this fact leaves room for potential litigation and misinterpretation by Ukrainian controlling authorities.

In our opinion out of the 3 options, Option 1 seems currently to be the most feasible solution for dealership schemes from general civil law perspectives.

Tax law implications

A trademark license becomes taxable to the extent that such a license is aimed at generating the licensee's business income. This may be the case for commercial concessions, which correspond to the above Option 2.

By contrast, the trademark licensing under Option 1 shall not represent a taxable event if the dealer is considered a quasi-agent who merely undertakes to distribute the goods of a principal further to authorizations of the latter and subject to remuneration. We tend to believe that in the above case Niko-Ukraine LLC v. Tax Authorities the Higher Commercial Court has qualified the respective dealership agreement exactly in this way.

Finally, given that Option 3 is not expressly envisaged in the Ukrainian civil law, risk of its confusion by tax authorities with Option 2 cannot be completely excluded. And so we would not recommend using it for the purposes of licensing brands in Ukrainian dealership practice.

Conclusions

When trying to find a balance between the above-mentioned doctrinal and judicial positions, a dealer using the producer's trademark under the Royalty-free Options 1 and 3 may be qualified as a quasi-agent of the producer.

From the general civil law perspective Option 1 currently seems to be the most feasible solution for dealership schemes. At the same time, Option 1 may cause negative tax exposure if the dealer is not considered as a quasi-agent of the producer.

By contrast, the dealer's commitment to pay the royalty under Option 2 may serve as formal grounds to as certain that the dealership agreement is a *de-facto* commercial concession; from this standpoint Option 2 cannot be recommended in the dealership context.

Finally, Option 3 is not expressly regulated by statutory Ukrainian civil law and so leaves room for potential litigations both from the civil and tax law standpoints.

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