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LITIGATION ALERT

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Inclusion of royalty and license fee for customs
duty payment under contract manufacturing
arrangement

Inclusion of royalty and license fee for customs duty payment under contract manufacturing arrangement

M/s Xiaomi Technology India Private Limited v. Principal Commissioner of Customs¹

In a significant ruling on customs valuation and beneficial ownership ('BO'), the CESTAT Chennai dismissed appeals filed by Xiaomi Technology India Private Limited ('Xiaomi India'/'Assessee'). Doing so, the CESTAT upheld the customs duty demand for non-inclusion of royalty and license fees paid by Xiaomi India to IPR holders in assessable value ('AV') of mobile phone components imported by contract manufacturers ('CMs').

The CESTAT held that CMs did not enjoy unfettered rights of possession of the imported goods and the DRI investigation rightly pierced the veil to demonstrate that Xiaomi India exercises effective control over the goods and is the BO.

Background and Facts

- Xiaomi India is a subsidiary of Xiaomi Singapore Pte. Ltd., engaged in manufacturing and selling mobile phones in India.
- Xiaomi India paid royalty and license fees to Qualcomm Inc. and Beijing Xiaomi Mobile Software Co. Ltd. (IPR holders) on account of bundled licensed software technologies and licensed hardware technologies, embedded in the parts and components imported by CMs.
- CMs have been given non-exclusive license to use the patent and manufacture Xiaomi-branded mobile phones.

- CMs imported mobile phone components under manufacturing agreements with Zhuhai Xiaomi Communications Technology Company Ltd. (Xiaomi China) and subsequently manufactured finished mobile phones exclusively for sale to Xiaomi India.
- Show Cause Notices were issued to the Assessee demanding differential customs duty on royalty and license fees paid to IPR holders.
- Revenue alleged that the constructive possession, ownership and control of the imported goods remained with Xiaomi China, primarily through Xiaomi India.
- An appeal has been filed by Assessee making the following submissions:
 - Parts and components were not imported on their behalf but the third-party CMs imported goods on their own account
 - Xiaomi India cannot be treated as BO as it does not have any control over the imported components.
 - Xiaomi cannot be treated as importer after clearance of goods when CM was accepted as the importer between importation and clearance.

¹ TS-733-CESTAT-2025-CHNY-CUST

Discussion and Findings

True Purport of Contract

- The nomenclature of a contract or document is not decisive of its true nature.
- The contract, which constitutes a private legal document, must be read as a whole to understand the intention of parties.
- The recitals in the document, the surrounding circumstances, the intention of the executant and acknowledgement by the parties are conclusive.

CMs are not the real buyer of goods

- The CM is a customer, and Xiaomi China is the 'seller' in the 'Product Purchase Agreement' (PPA) while in 'Goods Sales Agreement' (GSA), the CMs are 'sellers' and Xiaomi India is the 'buyer'.
- Xiaomi China exercised complete and dominant control over manner of use, disposal and sale of parts and components imported by CMs, in as much as:
 - Manufacturing process itself was subject to pilot production phases (200-1,000 units) before confirmation of mass production capability.
 - Purchase prices were based on cost construction and the CMs were not free to fix their own price for the sale of the finished mobile phones.
 - Any material breach of the restrictive conditions could lead to unilateral termination of the rights and licences, depriving the CMs of further supply of goods.
 - CMs could only sell the products to Xiaomi India and could only resell the products (parts and components), in India with prior written consent of Xiaomi China.

- CMs acted merely as electronic contract manufacturer (ECM)/job-workers, with severe restrictions on the use of the imported goods.

Xiaomi India is the BO

- The concept of BO has emerged over a period of time through its coverage under various laws² which recognise the BO concept as not being same as legal ownership.
- The 'Group of Companies Doctrine'³ establish that group companies are created for various purposes including limiting liability, facilitating trade, and avoiding tax liability.
- Customs duty demands can be raised from the BO in special circumstances and Xiaomi India's plea that BO concept is inapplicable to the present scenario is incorrect.
- The amendment to the definition of 'importer' under Customs Act is designed to prevent tax evasion and tax base erosion and cannot be used in restricted sense.
- The meaning of BO has three limbs: (i) any person (ii) on whose behalf the goods are being imported or exported or (iii) who exercises effective control over the goods.
- On an application of 'Use and Title' test, specific property rights in equity belonged to Xiaomi India even though legal title belonged to CMs.
- The prompt payment of license fee by Xiaomi India is a sine quo non for the supply of parts and components to the CMs.
- Legislative intent in the case of fraud is clear that duty can be demanded from the person chargeable with duty and not necessarily from the importer.
- The significant 'role plays' by the term 'BO' in tax transparency, integrity of the financial sector and law enforcement efforts and the ring-fencing clause, point to the deceptive nature of a 'service contract' treated as a 'contract for sale'.

²Companies Act, 1956, Benami Transactions (Prohibition) Act, 1988, of the Prevention of Money Laundering Act, 2002 (PMLA), The Income Tax Act, 1961 and the Customs Act

³ Cox and Kings Ltd. vs. SAP India Pvt. Ltd. [2023 INSC 1051]

Addition of royalty payment to transaction value

- Royalty paid for a whole-portfolio/ whole-device license is paid on a price which includes the cost of imported parts and components.
- The point of payment of royalty (sale of the finished mobile phone in India) is not determinative of the payment being a post import payment.
- Such royalty paid is relatable to the imported goods and is a condition of sale directly or indirectly.

Judgment

- The wholistic circumstances and piercing of the corporate veil including restricted CM rights, price fixation, liability allocation, cost reimbursement mechanism, ring-fencing clause demonstrates that Xiaomi India exercised effective control.
- Xiaomi India is the BO of the parts and components imported by the CM, hence, liable to differential duty on royalties and license fees paid to IPR holders.

DHRUVA INSIGHT

This ruling could have wide implications for contract-manufacturing structures, as the Tribunal has effectively broadened the scope of “beneficial ownership” in customs matters. The decision looks beyond the contractual language and focuses on who actually controls the goods and bears the economic burden. In doing so, it signals that corporate layering or inter-company arrangements will not insulate the real beneficiary from customs duty exposure.

At the same time, applying concepts like the “Group of Companies” doctrine, generally seen in other branches of law, to customs valuation appears somewhat overstretched. This aspect of the ruling is likely to be debated further.

The matter will almost certainly be challenged before the Supreme Court. Until there is greater clarity, companies following a contract-manufacturing model should revisit their agreements, control mechanisms, royalty structures and overall disclosures to manage potential litigation risk.

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