

## ARTICLE

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### **Some issues concerning legislation related to licensing agreements in Kazakhstan**



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The issues of using trademarks in particular assignment of rights to intellectual property objects were previously reviewed in the articles “Assignment of trademarks under license agreements in Kazakhstan” and “Assignment of rights under franchising agreements in Kazakhstan”.

These articles among other things dwell upon such issues as what is use of trademarks, clarify the need to register license agreements (hereinafter - LA) and franchise agreements containing registered IP objects, which are patents and trademarks. Continuing the review of these legal relations and on the basis of feedbacks received under these articles, following is the review of the basic requirements to Trademark License Agreements. We will also review issues related to royalties.

Trademarks must be registered and registered in Kazakhstan (or protected in Kazakhstan by virtue of international treaties). In accordance with the legislation of Kazakhstan, the rights to use IP objects can be assigned only on the grounds of the license agreement registered with the Ministry of Justice of the Republic of Kazakhstan. Other types of assignment of rights, for example, within the framework of distribution or dealer agreements are illegal since such agreements are not registered and accordingly assignment of rights under them is not valid.

In essence, by entering into such an agreement, a trademark owner is likely to simply deprive himself of the opportunity to challenge the use of the

trademarks by the distributor or dealer in the event of a conflict, also proper control over the use cannot be effected, nor the right to receive royalties for the use of a trademark.

License agreements like other types of agreements should contain all essential provisions and conditions and should be drafted in accordance with the requirements of the legislation of Kazakhstan. This article deals only with those license agreements related to assignment of rights to trademarks.

The license agreement provides that the licensor, owner of intellectual property rights assigns rights to the trademarks to the licensee.

The essential terms of such agreements are subject to the substance of the assigned rights, which:

- refer to precisely identified objects, in this case, specific trademarks;
- are exclusive;
- territorial, that is, limited to the territory of the Republic of Kazakhstan;
- refer only to those goods and services for which the assigned rights to use trademarks are registered;
- limited to at least the validity of trademark registrations.

The exclusivity of rights is based on the right of a trademark owner to prohibit others from using a designation that is identical or confusingly similar to it. Trademark owner is also entitled to permit

- to one or more entities or individuals
- use all or part of these rights
- in all or part of the territory of operation,
- in relation to all or part of goods and services,
- in all or only certain ways.

By default, that is, if it is not specified in the license agreement, the license is:

- is not exclusive,
- refers to the use of a trademark throughout the territory of the Republic of Kazakhstan,
- issued for all goods and services for which a trademark is registered,
- to use it in all ways,
- should be paid for,

- the licensee is not entitled to assign these rights by sublicense to the third parties; and
- only IP rights owner can protect the violated rights to trademarks (and issue a power of attorney for such actions).

The parties are entitled to amend the above provisions; however it should be clearly indicated in the license agreement. For example, the license can be either exclusive or not, with the right to issue sub-licenses or the licensee may not have such right.

The license agreement must also contain some other mandatory provisions and should be drawn up in accordance with the requirements of the legislation. This includes the following: Mandatory indication in the license agreement that the quality of the licensee's goods/services should not be lower than that of the licensor, as well as that the licensor is entitled to control the quality of the licensee's goods and the quality of services provided.

The license agreement must be prepared in the Kazakh and Russian languages, be prepared in at least four copies, signed by the authorized persons, indicating their positions, and, of course, be registered with the Ministry of Justice of the Republic of Kazakhstan. In addition, the license agreement should be submitted for registration not later than six months from the date of its signing. If the license agreement is submitted for registration by a foreign legal entity, then this should be done only through a registered patent attorney of the Republic of Kazakhstan. Registration of the license agreement takes two to three months and an unregistered license agreement can be recognized (and in practice is considered) as not concluded.

If the license is granted by the Kazakh trademark owner, then in addition to the agreement, the decision of the licensor's management bodies on the issue of concluding an agreement and granting powers to sign the agreement is also provided.

An interesting feature is that, despite the assignment of rights to use trademarks registered in Kazakhstan, the Ministry of Justice does not impose strict requirements on the indication of the law applicable to the license agreements, however, of course, in relation to all peremptory norms and legislation, it will be legislation of Kazakhstan regardless what is indicated in the license agreement.

Other provisions of the license agreement, such as, for example, the procedure for settlement of disputes, the term of agreement and others are determined only through mutual consents of the parties.

It should be noted that when concluding a license agreement in relation to IP objects, the legislation of the Republic of Kazakhstan removes a number of antimonopoly restrictions.

In particular, such restrictions do not apply to:

*Anti-competitive horizontal agreements*

- establishing or maintaining prices (tariffs), discounts, extra charges (surcharges) and (or) any additional charges;
- increasing, decreasing or maintaining prices at bids, distorting the results of bids, auctions and competitions, including by dividing by lots;
- division of the market according to the territorial principle, the volume of sale or purchase of goods, the range of goods offered or the composition of sellers or buyers (customers);
- reduction or termination of the production of goods;
- refusal to conclude agreement with certain sellers or buyers (customers).

*Anti-competitive vertical agreements*

- setting the resale price of the goods, except for the case when a seller sets the maximum resale price of goods for a buyer (customer);
- the obligation of a buyer (customer) not to sell the goods of a market entity that is a competitor of a seller. This prohibition does not apply to agreements on the organization by a buyer of the sale of goods bearing a trademark or other means of individualization of the seller or producer;
- a seller's obligation not to sell the goods to a market entity that is a competitor of a buyer (customer).

The taxation issues should be mentioned separately.

We indicated above that by default, the license agreements are compensated, that means it is assumed that for the use of rights to trademarks, which are intangible assets, a licensee pays a fee to a licensor, for example, in the form of royalties.

Royalties can be established depending on the volume of production of products bearing a trademark, on the volume of sales, in the form of fixed annual payments or on another basis. A license agreement can be free of charge; however this should be clearly indicated in a license agreement.

At the same time, if a license agreement is free of charge, it means that (i) either the cost of a trademark is zero, (ii) or a licensee would have to pay

for the use of someone else's property, but does not pay, thus receives additional income.

In other words, there is an unjustified enrichment of a licensee. And, since this is the case, a licensee must pay tax at the rate of 10% of the value of the royalty not specified in a license agreement, as well as in the case of receiving a gift, purchase of goods or services at a lower value for the difference between the market price and the purchase price. In practice, in order to determine the correct taxation, the determination of the amount of unpaid royalties is very problematic and requires the involvement of IP evaluators, the application and agreement with the licensee of approaches and methods for determining the amount of royalties and, consequently, taxes.

In practice, the question arises about the possibility of retrospective establishment of rights and obligations under a license agreement. It should be noted that the rights to use a trademark (or other subject to state registration of an IP object) are considered assigned from the date of registration of a license agreement. Until that time, the rights are not assigned and royalties cannot be paid for this period prior to registration, even if an obligation for such payment is established in a license agreement.

For unregistered license agreements, royalty payments cannot be made either within Kazakhstan or abroad.

License agreements concluded within the Eurasian Economic Union, **the Protocol on the Protection of Rights to Intellectual Property Objects** (Appendix No. 26 to the Treaty on the Eurasian Economic Union) establishes the regional principle of exhaustion of rights:

*"On the territories of the member states, the principle of exhaustion of the exclusive right to a trademark, a trademark of the Union is applied, according to which it is not a violation of the exclusive right to a trademark, a trademark of the Union, the use of this trademark, a trademark of the Union in relation to goods that were lawfully introduced into business in the territory of any of the member states directly by a trademark owner and (or) a trademark of the Union or by other entities with the consent of a trademark owner".*

It follows that:

- If a licensor is located outside the EAEU, and a licensee is located on the territory of the EAEU, then a license agreement can be concluded

for any type of use of a trademark;

- If both a licensor and a licensee are located on the territory of the EAEU, then a license agreement can be concluded for any use of a trademark, however not in relation to goods introduced into business by a trademark owner or with his consent;
- In the event that a trademark owner is located outside the EAEU and a buyer is located in the EAEU, then, according to the principle of regional exhaustion of rights, the trademark owner's rights to the trademark are not exhausted. Consequently, a trademark owner is entitled to demand the conclusion of a license agreement and payment of royalties. If this does not happen, then a buyer of goods must pay tax on income received from non-payment of royalties, since, as it discussed above, otherwise it will be considered as an unjustified enrichment.

The situation is somewhat different with other registered IP objects - patented inventions, industrial designs, and utility models. They are subject to the national principle of exhaustion of rights, and the conclusions drawn on trademarks are valid for them, but instead of the territory of the EAEU, Kazakhstan must be indicated.

In other words,

- If a licensor is located outside of Kazakhstan and a licensee is located in Kazakhstan, then a license agreement can be concluded for any type of use of a patent;
- if both a licensor and a licensee are located in Kazakhstan, a license agreement can be concluded for any type of use of a patent, however not in relation to goods introduced into business by a patent owner;
- in the event a patent owner is located outside Kazakhstan and a buyer is located in Kazakhstan, then, according to the principle of national exhaustion of rights, a patent owner's rights to use a patent are not exhausted. Consequently, a patent owner is entitled to demand the conclusion of a license agreement and payment of royalties. If this does not happen, then a buyer of goods containing a patent must pay tax on income received from non-payment of royalties, since it is unjustified enrichment.

The above is undoubtedly applicable to both foreign companies and Kazakh companies. However our more than 20 years of experience in the field of IP protection shows; it is foreign companies that come to the Kazakhstan market and very often:

- do not have valid and sufficient trademark registrations for operating in Kazakhstan, or these registrations are insufficient in terms of the number of trademarks, their writing in Cyrillic, the

specified classes or goods. Registration in other countries in most cases does not matter for operation of a foreign company in Kazakhstan;

- draft license agreements and do not register them, or enter into distribution or dealership agreements, believing that they are sufficient, however it is not;
- start paying royalties without establishing proper cooperation with their Kazakh partners and by this violating the tax legislation of Kazakhstan;
- try to use their rights to trademarks that are not available or are essentially insufficient, from which they endanger their own business and the business of those who are associated with them.

We recommend to companies operating in Kazakhstan or those who are just going to start working here:

- conduct appropriate searches for the presence of registered own trademarks or, especially if they are not registered, for the presence of registrations of these (or confusingly similar) trademarks in the name of the third parties, in particular, their dealers or distributors, other counterparties or partners in business;
- finish registration of the necessary intellectual property rights, in particular, trademarks;
- fix all drawbacks of existing registrations;
- prepare, conclude and register licensing agreements;
- calculate and pay royalties, include royalties in the customs value of goods; and
- monitor the market and protect appropriate rights.