Beneficial Ownership of Royalties in Bilateral Tax Treaties

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CHAPTER 2

INTELLECTUAL PROPERTY

According to the OECD, Article 12 of the OECD Model has been designed primarily for income from intangibles with a substantial intellectual content (see 3.3.3.2.2.). Although it may not be essential to the issue of beneficial ownership of royalties to have a full understanding of the meaning of "intellectual property" and "intangibles", some insight into the meaning and special features of the terms may be valuable background.

The aim of this chapter is not to find the exact meaning of the terms. As is seen in the discussion below, the exact boundaries of these terms may be hard to determine and, *inter alia*, be determined by the question of whether it is considered from the point of view of protecting, regulating, managing or marketing it. Any organization or authority who wishes to use the terms for purposes of a statute or otherwise is best advised to specifically define the terms for its purposes. In addition, there may be a difference in the meaning of the terms in the domestic law of different states. The terms intellectual property and intangibles are therefore used in this chapter in their widest possible international sense.

The purpose of the investigation is rather to investigate the way in which the different objects referred to in the definition of royalties in Article 12(2) of the OECD Model relate to the terms "intellectual property" and "intangibles". Article 12(2) refers to the following:
- any copyright of literary, artistic or scientific work including cinematograph films;
- any patent;
- any trade mark;
- any design or model;
- any plan;
- any secret formula or process; and
- information concerning industrial, commercial or scientific experience.

This focus on intellectual property and intangibles is more than just academic. As can be seen from the following comment by
Nimmer, there are important differences between rights in respect of tangibles and those in respect of intangibles:

Property rights in information differ from property rights in tangible property. This is because the subject matter is different as are the rights to be created. The difference in subject matter affects what one is protecting and why. Intangibles are different from things that can be touched or walked on. Intangibles cannot be possessed, but copies can be. Unlike goods, intangibles can be “held” (known) by many people at the same time in exactly the same form.\(^\text{13}\)

The fact that more than one person can be a beneficial owner in respect of rights relating to the same intellectual property is an important factor to be kept in mind in the determination of the beneficial owner of a royalty (see also 6.3.2.10.).

It is worthwhile next to investigate the relationship between intellectual property and intangibles, two terms that often appear to be used indiscriminately. As is evident from the following definitions provided by PricewaterhouseCoopers, intangible assets is the broader term, encompassing, amongst others, intellectual property:

- **intellectual capital**: knowledge with potential for value (i.e. ideas embodied in people, processes, and customers);
- **intellectual asset**: knowledge providing value “working” (i.e. licensed patents, implemented know-how);
- **intellectual property**: knowledge articulated with legal ownership (i.e. patents, trademarks, copyrights, trade secrets); and
- **intangible assets**: all of the above.\(^\text{14}\)

Turning now to the meaning of intellectual property, according to WIPO, it means, very broadly, the legal rights that result from intellectual activity in the industrial, scientific, literary and artistic fields. Creations of the mind, such as an idea for an invention, a


\(^{14}\) PricewaterhouseCoopers Intellectual Asset Management Services, London. Various other organizations have provided different definitions of intangible assets. See, for example, Interbrand, *supra* note 2, at 176; OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, chapter VI; IRC Section 482, for purposes of transfer pricing. For an elaborate analysis, identifying 62 types of intangibles, see Trademark & Licensing Associates, quoted by Weston Anson, “Ways to put a value on a trademark”, *Corporate Finance* 1996/11, at 38.
piece of music or a trademark, cannot, like physical objects, be protected against other persons' use of them by mere possession of the object. Once the intellectual creation is made available for the public, its creator can no longer exercise control over the use made of the creation. This basic fact, that is, the inability to protect something by mere possession of an object, underlies the whole concept of intellectual property law.\footnote{WIPO, \textit{Introduction to Intellectual Property Theory and Practice}, 1997, at 3. (WIPO is an intergovernmental organization with a membership of 157 states as of 1 July 1996.)}

The convention establishing WIPO provides that intellectual property includes rights relating to:

1. literary, artistic and scientific works;
2. performances of performing artists, phonograms, and broadcasts;
3. inventions in all fields of human endeavour;
4. scientific discoveries;
5. industrial designs;
6. trademarks, service marks, and commercial names and designations;
7. protection against unfair competition; and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields.

WIPO explains that intellectual property is traditionally divided into two branches, industrial property and copyright. Area (1) belongs to the copyright branch whilst area (2) are usually called neighbouring rights, that is, rights neighbouring on copyright. Areas (3), (5), (6) and (7) constitute the industrial property branch. Area (4) – scientific discoveries – belongs to neither of the two branches and there is even a dispute as to whether it should be regarded as intellectual property at all.\footnote{Id. at 3 and 4. For a United Kingdom view, see David I. Bainbridge, \textit{Intellectual Property}, 1996, at 3. For the Dutch view, see P.A.C.E. van der Kooij and S.J.A. Mulder, \textit{Hoofdzaken mededingingsrecht}, 1996, at 13.}

The first conclusion from the above discussion is that none of the objects mentioned in Article 12(2) of the OECD Model are tangible.
For purposes of domestic law, the question of whether something can be classified as (intellectual) property is normally closely related to whether it is legally protected, and the relevance of the question concerns issues such as whether it can be the subject matter of rights, whether it can be owned and transferred and whether rights in respect of it can be asserted against the whole world.\(^\text{17}\)

There is little difficulty in concluding that the first few objects in the Article 12(2) definition, that is copyrights, patents, trade marks and designs or models, are intellectual property under the WIPO definition. The exact categorization of the next item, that is “plan”, is less clear, although it probably also falls within the wide WIPO definition.\(^\text{18}\) Vogel refers to the next item, “any secret formula or process”, as know-how in the narrower sense, all business secrets of a commercial or industrial nature which enjoy at least relative protection or are capable of being protected in most countries.\(^\text{19}\) The fact that it is protected provides an argument for including it under a wide definition of intellectual property.

Whether the last object in the Article 12(2) definition, that is “information concerning industrial, commercial or scientific experience”, can be classified as intellectual property, is no easy question. Paragraph 11 of the MC Commentary on Article 12 states that this information alludes to the concept of know-how. Vogel refers to this as know-how in the wider sense of the term which covers unprotected, non-secret knowledge derived from experience. In contrast to general specialist knowledge, experience is, by definition, person-related.\(^\text{20}\)

Closer examination reveals that at least two factors are important when considering the property status of know-how. First, know-

\(^{17}\) For the position in England, for example, see 4.2.

\(^{18}\) See, for example, Graeme I. Halperin, “Taxing the Mind: Is Know-How an Asset for Capital Gains Tax Purposes?”, *Australian Tax Forum* 1989/2, at 240, stating that drawings and plans are presumably afforded property status as literary or artistic works protected under copyright.


\(^{20}\) Vogel, *supra* note 19, at 794. For arguments that knowledge must be secret in order to be know-how, see P.J. Idenburg, *Kennis van zaken*, 1979, at 215.
how can have several meanings and it is therefore necessary to
determine exactly what is understood by the term in the case under
consideration (for example, whether it is used in Vogel’s narrow or
wide sense) and second, the purpose for which the investigation is
made. The following are some of the different views on know-
how:21 Halperin, in an in-depth article, concludes that know-how is
not property in the legal sense and therefore not an asset for capital
gains tax in Australia.22 The position appears to be the same in
Canada.23 The courts in the United Kingdom, however, have been
prepared to classify know-how as property in the tax area.24 In
England in Oxford v. Moss,25 however, it was held that information
is not property for the purposes of theft. As far as the United States
is concerned, Roose states that know-how in the form of secret for-
mulas, secret processes and trade secrets is recognized as property
for tax purposes, whereas know-how is treated as property for cap-
ital gain purposes without regard to the status of the know-how as a
trade secret, where the know-how is related to, and transferred inci-
dent to the transfer of patents.26 Dolan, also dealing with United
States tax, observes that know-how should not be considered to be
intellectual property if it is not “proprietary”, that is if it is merely
knowledge possessed generally by experts in a recognized profes-
sion.27 Nimmer states that in most countries, it is already possible to
own information,28 a statement which suggests that it is property
(see 4.2.3. and 4.3.).

It therefore appears that it is not possible to generalize on the
property status of know-how internationally. In fact, the observation
is also true for some of the other items in the royalties definition,
which, depending on the domestic law, may not be regarded as intel-
lectual property. In the Netherlands, for example, only tangible

21. For further discussion, see Idenburg, supra note 20, at 215-219.
22. Halperin, supra note 18, at 262. See also Australian Taxation Office, Income
23. Halperin, supra note 18, at 242-245.
24. Halperin, supra note 18, at 235.
26. Eric N. Roose, “Tax Considerations in International Licensing of Intellectual
objects can be owned, which means that it is not correct to talk of *intellectuele eigendom* in Dutch Law.²⁹

Importantly, though, for purposes of Article 12(2), is the fact that the structure of that article suggests that information concerning industrial, commercial or scientific experience (know-how in the wider sense) is different from the other objects mentioned. The article begins by referring to consideration “for the use of, or the right to use”, and then lists copyright, patent, trade mark, design or model, plan and any secret formula or process. The words “use of, or the right to use” do not refer to the second part of the article, which simply reads: “consideration for information concerning industrial, commercial or scientific experience.”

The words “use of, or the right to use” suggest the existence of certain rights, the use of which can be granted to others. It further suggests the existence of protection and the existence of property.³⁰

Based on this distinction, it can be concluded that, in a broad international sense and for purposes of Article 12(2), the first group of objects can be considered as intellectual property. As far as information concerning industrial, commercial or scientific experience (know-how in the wider sense) is concerned, however, it does not involve the granting of any rights and can therefore not be regarded as property. It simply represents the provision of information.³¹

In summary: One way of referring to Article 12(2) is that it deals with royalties in respect of the use of, or the right to use intellectual property, and the provision of know-how. Another way, which is probably more safe in an international sense because the wording is more neutral, is to say that it deals with royalties in respect of intangibles.

²⁹. Some of the objects mentioned in the royalties definition in Article 12(2), however, may qualify as property rights (*vermogensrechten*). See 4.4.2. for further discussion.

³⁰. In terms of English law, for example, (see 4.2.3.) something is property if someone is entitled to enforce rights in it.

³¹. See also the finding in *Federal Commissioner of Taxation v. Sherrit Gordon Mines Ltd*, infra note 46.