Beneficial Ownership of Royalties in Bilateral Tax Treaties

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CHAPTER 4
OWNERSHIP

4.1. INTRODUCTION

This study is about the beneficial ownership of royalties. To be more specific – it is about Article 12(1) of the OECD Model, which states that “[r]oyalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State” [emphasis added].

The meaning of beneficial ownership is investigated in later chapters. It is submitted, however, even at this stage of the study, that beneficial ownership is a form of, or a degree of, ownership. The aforementioned submission is the rationale for including a chapter on ownership in the study. In order to find the meaning of beneficial ownership, it is necessary first to investigate the meaning of ownership.

For the purpose of gaining a general understanding of the meaning thereof, the current chapter investigates the meaning of ownership in England and the United States, as common law states, and the Netherlands, as a civil law state. What does it mean to be the owner? What are the appropriate tests for ownership? What are the rights of ownership? After an investigation as to the meaning of ownership generally, the chapter concludes with a section on the ownership of royalties.

The classification of rights and their relation to property is also investigated. One reason for such investigation is to determine whether the different objects mentioned in the royalties definition in the OECD Model should be regarded as rights or property, or both. The second reason, which is more fully discussed in 6.3.2.8.1., is that the question whether the right of beneficial ownership is a personal right which can be asserted against one person only, or a right which can be asserted against all persons, is an important factor regarding the tax treaty application of beneficial ownership by civil law states.
It should be noted that the investigation of whether, for example, it is (legally speaking) possible to own a royalty in Dutch law is not in order to apply such domestic law to treaty interpretation. The purpose of the investigation is first to obtain some background on the domestic systems of some states which, in the end, make up the international community. Second, should the investigation show that it is not possible to own a royalty in Dutch law, or the law of any other state, it will be another indication that an international approach should be taken to the interpretation of such terms in bilateral tax treaties.

Lastly, various other factors or concepts interrelate with royalties. This chapter therefore also investigates the legal nature of intellectual property, assignment and licence as part of the process of understanding the meaning of royalty ownership.

4.2. ENGLAND

There is ample material on ownership and related issues in England. A study of this material reveals a specific interrelationship between rights, property, things and ownership, which are analysed in the paragraphs below.

4.2.1. Rights and ownership

It is meaningful and necessary to speak of a right of ownership.90 Ownership of copyright, for example, is a legal right to exercise a legal right.91

Bell states that ownership is a property right and goes on to call it the most basic right: all property has its owner. The two central characteristics of property rights are that they are rights “against the world”, that is against persons in general, and that they are assigna-

ble. It must be cautioned, however, that not all property rights necessarily contain both these characteristics and that some contain only one, or even neither, of the characteristics.

As regards the first characteristic, Bell continues that the fact that one has a right that all must respect highlights one of the most powerful features of property rights, the ability to bind third parties. The distinction with a personal right, for example a contractual right, is that a personal right is against a specific person.

On the second characteristic: The primary significance of saying that one owns a debt owed to you, is that you can assign it. Thus, in the early law, which did not permit the assignment of intangibles, choses in action (although recognized as a category of rights) were not considered to be property, and they only came to be regarded as such when the original prohibition was relaxed.

Further, to qualify as a property right, a right must bring its holder into a direct relationship with specific assets. In *National Provincial Bank v. Ainsworth*, Lord Wilberforce said the following on property rights, as distinguished from personal rights:

> Before a right or interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and having some degree of permanence or stability.

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93. Id. at 12.
94. It is also necessary to distinguish between legal rights and equitable rights in English law. This is particularly important as far as beneficial ownership is concerned. According to *Black’s Law Dictionary*, 1990, at 1324, in the case of legal rights the person seeking to enforce the right for his own benefit has the legal title and a remedy at law, whereas equitable rights are enforceable only in equity, as at the suit of the *cestui que trust*. See further discussion in 5.2.6.1.
96. “Chose in action” came to be a general term for intangible property of all kinds, any right that can only protected by legal action rather than by taking possession. See Bell, *supra* note 92, at 22.
To summarize on the relationship between ownership and rights: The right of ownership is a property right, the significance of which is that a right of ownership binds third parties and can be assigned.

4.2.2. Ownership and things

According to Dias, the term “ownership” is used with reference to “things”. “Thing” refers either to physical objects, corporeal things, or certain rights, incorporeal things; in other words, ownership is of corporeal or incorporeal things. The use of the phrase “corporeal ownership” with reference to physical objects is simple. The term “incorporeal ownership”, however, is applied only to some types of claims, etc. in so far as these are things, but it does not apply to others, because they are not things. This complicates matters by introducing an element of arbitrariness into the use of thing and ownership. There is said to be ownership of copyrights and patents, because these are treated as things, but there is no ownership of bodily security or reputation, because these are not things.\(^{100}\)

Honoré agrees that the object of ownership is always spoken of as a “thing” in the legal sense, a res. He further supports the fact that there is an element of arbitrariness in the classification of things. He puts it as follows:

[I]t is clear that to stare at the meaning of the word “thing” will not tell us which protected interests are conceived in terms of ownership. When the legislature or courts think that an interest should be alienable and transmissible they will reify it and say that it can be owned, that it is property. They will not say that it can be owned and is a res because of a prior conviction that it falls within the appropriate definition of “thing”. The investigation of “things” seems to peter out in a false trail.\(^{101}\)

In summary: only things can be owned. But there is no way of logically working out whether or not a certain phenomenon is regarded as a thing. One has to know the details of the legal system concerned to tell whether what you are dealing with is a thing.

\(^{100}\) Dias, supra note 90, at 295-296.

4.2.3. Property

It is next necessary to consider the meaning of property and its relationship with ownership and rights. In literature on royalties, including some bilateral tax treaties, the terms property and rights are often used in conjunction.

Whether or not intellectual property such as copyright is property in a legal sense, is often important for non-tax purposes: such as whether it is possible to commit a criminal theft of a copyright, whether copyright belongs to a partnership when works are created in the course of the partners’ business, or whether the testamentary disposition of one’s property includes the disposition of one’s copyright as well. It may also be important for tax reasons, though, for example, for purposes of capital gains tax or transfer pricing.

For purposes of the current investigation, the importance of the meaning of property relates to the fact that, as is clear from the discussion below, in order to be subject to ownership, the relevant phenomenon must be property.

According to Bell, property can be defined as that which is capable of being the subject matter of property rights. It is only where a certain type of right is allowed to exist in relation to a given phenomenon that we can label that phenomenon as property. In particular, since it is the basic property right, it is a question of the appropriateness of subjecting the phenomenon to ownership.

According to Phillips, over the years a great debate has been conducted as to whether copyright is property or not. The argument that copyright is not property is on the premise that something cannot truly be property unless it is solid and has the attributes of a physical presence. This position reflects a misunderstanding of the use to which lawyers put the word “property”. The word is derived from the Latin word proprius, meaning “one’s own”. Something is therefore property if someone is entitled to enforce rights in it. But, Phillips continues, this issue is quite sterile as far as English law is
concerned, since the nature and extent of copyright is defined almost exclusively by the express provisions of the law which governs it. To put it another way, copyright has no existence outside the four walls of the Copyright, Designs and Patents Act 1988. The aforementioned Act describes copyright as a property right. Although copyright most resembles personal property under the statute and is said to be transmissible as personal or movable property, it is really sui generis since its assignment and inheritance, in fact, follow rules specially laid down for it, and not just the normal laws of personal property.

In terms of the above discussion on copyright, which is valid also for other types of intellectual property such as patents and registered trade marks, something is property if someone is entitled to enforce rights in it. Bell as noted above, is more explicit on the rights to be enforced, referring specifically to property rights.

To summarize on the relationship between property, ownership and rights: A phenomenon is only regarded as property if it can be owned. Not only tangible but also intangible things can be owned. Certain rights are also property. Examples of such rights are copyrights, patent rights and trade mark rights.

4.2.4. Ownership

The discussion so far in this section on England can be summarized as follows: Only things can be owned. In order to be property, the phenomenon must be capable of being the subject matter of property rights. The right of ownership is a property right. The right of ownership binds third parties and it can be assigned.

To put it differently, whether one can go so far as to call the terms ownership, property and things, synonymous, is uncertain. At

104. Section 1(1).
105. Section 90(1).
107. For example, Section 1(1) of the Copyright, Design and Patents Act 1988 states that copyright is a property right and Section 90(1) states that it is personal property.
the very least, however, there is a very close and direct relationship between them.\textsuperscript{108}

Against the above background it is now appropriate to have a closer look at the meaning of ownership, which is the real focus of this chapter.

Goode concludes by saying that ownership, one of the most elusive concepts of English law, is conventionally defined as the residue of legal rights in an asset remaining in a person, or in persons concurrently, after specific rights over the asset have been granted to others.\textsuperscript{109}

Bell observes that the question of what ownership is, is seldom posed in practice. The reason for this seems to be that the methods by which ownership is acquired are few and well defined. Once the facts of a case have been established, it is almost always clear who is the owner. He then defines ownership as the greatest right or bundle of rights that can exist in relation to property.\textsuperscript{110}

Keenan states that ownership is a \textit{de jure} relationship; there is no need to possess the thing. It may be said that in a general sense all rights are capable of ownership,\textsuperscript{111} which is of many kinds, for example, corporeal – that is the ownership of a thing or chose in possession such as a watch or a fountain pen, or incorporeal – that is the ownership of a right only, for example, the right to recover a debt by an action at law, or the ownership of a chose in action. A share certificate is a chose in action, and ownership of it is incorporeal, for it is ownership of certain rights: the right to dividends as and when declared, the right to vote at meetings, and so on.\textsuperscript{112}

Dias, referring to several sources, states that the earliest known use of the word "owner" occurred in 1340 and "ownership" in 1583. According to him, ownership consists of an innumerable number of claims, liberties, powers and immunities with regard to the thing

\begin{itemize}
  \item \textsuperscript{108} See also Honoré, \textit{supra} note 101, at 128.
  \item \textsuperscript{109} Roy Goode, \textit{Commercial Law}, 1996, at 35.
  \item \textsuperscript{110} Bell, \textit{supra} note 92, at 66.
  \item \textsuperscript{111} See, however, Dias, \textit{supra} note 90, at 297, stating that not all rights are treated as things.
  \item \textsuperscript{112} Denis Keenan, \textit{Smith and Keenan's English Law}, 1992, at 482.
\end{itemize}
owned. The right of ownership comprises benefits and burdens. The claims which comprise the content of ownership may be vested in persons other than the owner. An owner may be divested of his claims to such an extent that he may be left with no immediate practical effect. He remains owner none the less. This is because his interest in the thing, which is ownership, outlasts that of other persons. His claims revive as soon as those vested in other persons have come to an end. That is why many modern writers have variously described ownership as the residuary, the ultimate, or the most enduring interest. Summing up, it may be said that a person is owner at English law when he becomes entitled in specified ways to some thing designated as such, the scope of which is determined by policy; and his interest, constituted in this way, outlasts the interests of other persons in the same thing.\textsuperscript{113}

One of the most comprehensive studies on ownership in English Law is that done by Honoré, who provisionally defines ownership as the greatest possible interest in a thing which a mature system of law recognizes.\textsuperscript{114} He then goes on to list the eleven standard or leading incidents of ownership, with the qualification, though, that ownership extends to cases in which not all the listed incidents are present:

Ownership comprises:

- The right to possess: To have exclusive physical control of a thing, or to have such control as the nature of the thing admits, is the foundation on which the whole superstructure of ownership rests.
- The right to use: On a narrow interpretation, “use” refers to the owner’s personal use and enjoyment of the thing owned. On this interpretation it excludes management and income.
- The right to manage: This is the right to decide how and by whom the thing owned shall be used. This right depends, legally, on a cluster of powers, chiefly powers of licensing acts which would otherwise be unlawful and powers of contracting.
- The right to the income of the thing: Income in the ordinary sense (fruits, rents, profits) may be thought of as a surrogate of

\textsuperscript{113} Dias, \textit{supra} note 90, at 292-298.

\textsuperscript{114} Honoré, \textit{supra} note 101, at 108.
use, a benefit derived from forgoing personal use and allowing others to use it for reward.

- The right to the capital: This right consists in the power to alienate the thing and the liberty to consume, waste or destroy the whole or part of it.

- The right to security: An important aspect of the owner’s position is that he should be able to look forward to remaining owner indefinitely if he so chooses and remains solvent. Legally, this is in effect an immunity from expropriation.

- The right to the prohibition of harmful use: An owner’s liberty to use and manage the thing owned as he chooses is subject to the condition that uses harmful to other members of society are forbidden.

- Liability to execution: The liability of the owner’s interest to be taken away from him for debt, which may be called the incident of executability, seems to constitute one of the standard ingredients of the liberal idea of ownership.

- The incident of residuarity: It is a characteristic of ownership that an owner has a residuary right in the thing owned. Whenever an interest less than ownership terminates, legal systems always provide for corresponding rights to vest in another.

- The incident of transmissibility: One of the main characteristics of the owner’s interest is its duration. “Unlimited duration” comprises at least two elements: (i) that the interest can be transmitted to the holder’s successors and so on ad infinitum, and

- The incident of absence of term: (ii) that it is not certain to determine at a future date.115

Walker defines ownership as the legal relationship between a person and an object of rights, whether corporeal or incorporeal. He then identifies the rights of ownership on a similar basis as Honoré above:

A person having ownership has the fullest group of rights which a person can legally have in relation to things of that kind, including at least some of the rights to occupy, possess, use, abuse, use up, let out, lend, transfer in security, sell, exchange, gift, bequeath, and destroy. The precise rights vary as between immovables, movables, and incorporeals.116

115. Honoré, supra note 101, at 113-128.
It is noteworthy that neither Honoré nor Walker includes in their lists the benefit of capital appreciation and the risk of capital depreciation. It does, however, seem reasonable to conclude that such benefit and risk are in most instances encompassed by some of the other rights, for example, the right to the capital. As is seen from the discussion in the next section, as well as in later chapters, in the United States these two economic criteria play an important role in the determination of the owner for tax purposes and the beneficial owner. There is certainly a lot to be said for applying these two yardsticks when looking for the owner.

The reason for not focusing on the hope of gain or the risk of loss in England appears to be the fact that ownership is seen strictly as a legal, and not an economic test, in England. A comment by Millett J. in *Sainsbury* in England, although dealing with beneficial ownership, probably explains the position also with regard to ownership:

I do not accept what lies behind the Crown’s submission that the beneficial ownership of shares necessarily involves the hope of gain or the risk of loss. ... Any such requirement [that the value of the shares must be capable of fluctuation or must reflect the changing profitability or value of the company] would substitute an economic test for a legal one and confuse the existence of legal rights with their value. “Beneficial ownership” has nothing to do with value or the economic attributes of ownership.117

The legal approach in England is supported by Australia, another common law state. In *Bellinz Pty Ltd v. The Commissioner of Taxation*, Merkel J., in holding that a lessee with an unexercised option to purchase is not the owner of the property, said the following:

Ultimately ownership consists of rights over property. Accordingly, unless the legal or natural meaning is displaced by the context in which the issue of ownership arises a legal or jurisprudential, rather than a commercial or popular, analysis of these rights is required.118

Although there appears to be some uncertainty as to the role of economic criteria in the determination of ownership, the real question should rather be whether the economic criteria are supported by ownership rights. In many instances the economic criteria runs with the ownership rights. If there is a separation between the two, or if the economic value of the rights is impeded (for example, in terms of an option granted, as was the case in *Sainsbury* above) then the question of ownership must be determined by a legal analysis of the rights, as explained in the two quotations above.

In summary, although the commentaries above use different wording (bundle of rights, benefits and burdens, leading incidents), there is great similarity between the different ways in which ownership is defined. Honoré comments that it is fashionable to speak of ownership as if it were just a bundle of rights, in which case at least two items in his list would have to be omitted. It is therefore a question of whether only the rights or also the burdens of ownership should be considered. In the opinion of this study, in the investigation about whether a specific person should be regarded as the owner of the thing concerned, the question whether that person also carries the burdens of ownership, is certainly important. It may therefore be more appropriate to talk of the attributes of ownership, which includes both rights as well as burdens (see also 6.3.2.8.1.).

Lastly, for purposes of the discussion in 4.7., it can be concluded that all of intellectual property, licences, debts and money can be owned in terms of English law.  

4.3. UNITED STATES

Seeing that both states belong to the common law family, the similarities between property law in England and the United States is not surprising. As far as the (non-tax) meaning of ownership is concerned, the statement by Hay that “property” means, on the one

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120. Intellectual property: See 4.2.2.; Licence: See Bell, *supra* note 92, at 12-13, on the basis that it can be assigned; Debt: See Bell, *supra* note 92, at 8 and 22; Money: See Honoré, *supra* note 101, at 120.
hand, “ownership”, and, on the other hand, also means “things”, confirms the similarity with England. From literature on the subject in the United States it appears as if “property” and “ownership” are often used interchangeably, with a preference given to the use of “property”, as is illustrated by the following statement by Nimmer. In addition, the statement confirms the bundle of rights approach, as well as the restrictions on ownership, as is the position in England:

Property (or property ownership) refers to a bundle of rights recognized in law as flowing to an individual or entity in respect to a particular subject matter. Thus, for tangibles, the owner of a car has the right to have possession and use of the automobile, the right to sell the car, and the right to collect if someone damages the car. But property rights are seldom absolute. The right to use a car, however, is subject to licensing and safety laws. The method of use is constrained by the rights of other drivers.

Webster's New International Dictionary, second edition, defines property as:

5. That to which a person has a legal title; thing owned; an estate, whether in lands, goods, money or intangible rights, such as copyright, patent rights, etc.; anything, or those things collectively, in or to which a man has a right protected by law.

The Supreme Court of Florida gave the following explanation on property:

While the word “property”, in common use, is applied to the tangible physical thing commonly called property, in law it is not the material object, but the right and interest which one has in it, to the exclusion of others, which constitutes property.

Because of the similarity with England as far as the (general) meaning of ownership is concerned, the rest of this section on the United States is focused on the meaning of ownership for tax purposes in order to get a different perspective on the issue. A word of caution is appropriate at the start of the discussion. A tax system

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based on the principle that substance prevails over form\(^\text{124}\) may produce results which legal purists in the civil law, and even other common law states, may frown upon. See, for example, the discussions\(^\text{125}\) of various court cases in the United States where the lessee was held, either explicitly or by implication, to be the owner for tax purposes.\(^\text{126}\) Such results may, however, be better understood if the importance of the concepts of ownership and property in United States tax law is realized, and if the concept of owner for tax purposes is seen as comparable to that of economic ownership (as opposed to legal ownership) in certain other legal jurisdictions.

It is also important to investigate whether the bundle of rights associated with ownership is different where tax ownership is concerned, as opposed to an investigation for non-tax purposes. Should there be a difference, the next question may be which of the two sets of rules should apply to the investigation of the meaning of beneficial ownership in bilateral tax treaties?

As Faber explains, the United States tax system functions by classifying events or transactions, with tax consequences flowing from that classification. It is therefore necessary to determine the owner of property. Cases addressing ownership issues essentially follow the premise that an asset can have only one tax owner (even where the rights are owned by different persons) and attempt to determine who that owner is by treating ownership as represented by a bundle of rights.\(^\text{127}\)

Cunningham identifies four areas where ownership of property is important for tax purposes: first, usually the owner is taxed on the income produced by the property regardless of possession or enjoyment of the income interest; second, the owner is entitled to claim

\(^{124}\) See Peter L. Faber, “Determining the Owner of an Asset For Tax Purposes”, *Taxes-The Tax Magazine* 1983/12, at 795.


\(^{126}\) On the contrary, in the Netherlands a lessee is not regarded as an owner (see 4.4.1.). Similarly in England, Honoré, *supra* note 101, at 111 mentions that, even in a lease for 2000 years, the lessor will remain the owner.

\(^{127}\) Faber, et al., *supra* note 125, at 768.
depreciation deductions; third, several tax incentives or benefits are available only to the property’s owner; and four, a sale or disposition (that is, a transfer of ownership) triggers realization of gain or loss. Ownership is, however, not defined by Congress for these purposes.\textsuperscript{128}

In order to find out what the guidelines or, more specifically, the bundle of rights determining tax ownership are, one must turn to court decisions for help. Unfortunately, an analysis of court decisions brings no clarity on the issue. This conclusion is echoed by other commentators. Cunningham comments that the tremendous amount of litigation in this respect has led to inconsistent and sometimes arbitrary results.\textsuperscript{129} Faber comments that one point on which the courts tend to agree is that bare legal title or nominal ownership is not controlling. Substance prevails over form.\textsuperscript{130}

A great number of cases on the issue deal with the question whether the lessor or lessee should be regarded as the tax owner in sale-leaseback situations. In his article on the subject, Faber refers to some of the factors which, according to IRS guidelines and rulings, determine ownership. These include whether the lessee has an option to buy the property at a fixed price; whether the lessor has made an at-risk investment of at least a certain minimum percentage of the property’s cost; the length of the lease term in relation to the property’s expected useful life; the amount of the property’s residual value in relation to its original cost; whether the lessee finances any part of the lessor’s original cost; whether the lessee guarantees any part of the lessor’s indebtedness; whether the lessee pays for improvements or additions to the leased property; a cash flow analysis showing that the lessor expects to receive a profit on the transaction apart from the value of tax benefits; the intent of the parties; whether the total of rental payments and any option price approxi-


\textsuperscript{129} Cunningham, supra note 128, at 725.

\textsuperscript{130} Faber, et al., supra note 125, at 770.
mated the price at which the equipment could have been acquired by the purchaser at the outset plus interest.131

Quite a few of the above factors are not supported by case law, and are questionable as criteria representing ownership. The opportunity to provide clear guidelines presented itself to the Supreme Court in Frank Lyon Co. v. United States,132 maybe the most well-known case on sale-leaseback transactions. Unfortunately, the court failed to clarify the issue and this decision has, quite rightly, been severely criticized.133 In Frank Lyon, Worthen Bank sold its building to Frank Lyon and then leased it back. The potential lease term was sixty five years and Worthen Bank had an option to repurchase the building. The Supreme Court found for the taxpayer, holding, by implication, that Frank Lyon was the owner.

Major factors influencing the court in its decision were the extent to which the form of the transaction was dictated by business and regulatory requirements and the relative absence of tax-avoidance motives. As mentioned before – the fact that the foregoing can be factors determining ownership, is certainly confusing. As is rightly observed by Faber: "The parties' reasons for entering into an economic relationship do not affect the nature of that relationship."134

The decision of the Supreme Court in Frank Lyon was a reversal of the decision of the Court of Appeals for the Eighth Circuit.135 The lower court did make an analysis of the bundle of rights, which is worthwhile examining, bearing in mind that the investigation of this study into the case is not so much whether the correct answer was reached, but rather to identify the correct bundle of rights in respect of ownership. According to the court, the testimony suggested the following allocation among the contracting parties of the benefits and burdens generated by the building: Worthen retained the tax deduction for investment credit and sales tax; Worthen had the right to purchase the building in the event that Frank Lyon contemplated

131. Faber, supra note 124, at 797.
133. See, for example, all the commentaries mentioned in supra note 125.
134. Faber, supra note 124, at 809.
135. 38 AFTR 2d 76-5060 (1976).
selling it to a third party; any appreciation in value of the building as the result of its destruction or condemnation accrued to Worthen; the purchase-option price was calculated as the unpaid balance plus interest and no account was taken of the likely appreciation in the value of the building; the provisions of a ground lease provided Frank Lyon with the opportunity to recoup his full investment, should Worthen exercise his purchase option; Worthen retained ultimate control over the disposition of the building. The court concluded that all responsibilities incident to the operation and ownership of the building rested with Worthen. The only economic advantages to Frank Lyon were tax shelter benefits. The contract provided for no return related to ownership risk. In sum, the benefits, risks, and burdens which Frank Lyon had incurred with respect to the building were simply too insubstantial for him to be regarded the owner for tax purposes.136

Faber concludes as follows on ownership:

Ownership of property has traditionally been regarded as consisting of many elements, including capital appreciation, capital depreciation, current cash flow, the power to sell or mortgage the property, and the power to manage the property. Of these sticks in the bundle, the ones relating to appreciation and depreciation in value seem to be the most important for tax purposes and are most often emphasized by the courts.137

What can be concluded from this discussion on ownership for tax purposes and bundles of rights in the United States? First, that there does not appear to be established and consistent rules, bearing in mind also that the United States courts take a more relaxed view with respect to the precedential value of previous decided cases than the English courts.138 Second, the discussion is on the ownership for tax purposes. Therefore, although many of the guidelines or rights listed above by the IRS and the courts may be valid for purposes of an ownership test, it is so clouded by the substance over form and tax avoidance purpose tests which are simultaneously applied that it

136. Id. at 76-5065.
137. Faber, supra note 124, at 770 and 809.
cannot, as a whole, be seen as the bundle of rights that determine ownership for non-tax purposes. Particularly, the business purpose and tax avoidance purpose tests applied by the Supreme Court in *Frank Lyon* must be rejected as forming part of the bundle of rights in respect of ownership. Neither was that proposed by the Supreme Court – who did not in its own decision refer to the bundle of rights principle – to be the case. Third, the conclusion by Faber that ownership is a bundle of sticks is comparable with the position in England, although the focus, unlike the position in England, is on the economic criteria of capital appreciation and depreciation (see 4.2.4. for further discussion).

4.4. THE NETHERLANDS

4.4.1. Ownership

The Dutch equivalent for beneficial owner is *uiteindelijk gerechtigde*, which is not a direct translation of beneficial owner. A direct translation of *uiteindelijk gerechtigde* is “the person who is ultimately entitled”. *Uiteindelijk gerechtigde* therefore does not directly refer to ownership. A direct Dutch translation of beneficial owner is *voordeelgerechtigd eigenaar*. Another possibility would be *economisch eigenaar* (economic owner), a term that is known in Dutch law and comparable to beneficial ownership (see also 5.6.). The translation of beneficial ownership into Dutch and other languages, and possible reasons why these are not always literal translations from English, is discussed in 6.2.12. For purposes of the current chapter, because of the fact that the Dutch treaty partner may use the term “beneficial owner” and the fact that when a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, it is still necessary to investigate the characteristics of ownership in Dutch domestic law.

Unlike the position in England, commercial law in the Netherlands is codified. The Dutch Civil Code (*Burgerlijk Wetboek*) defines ownership (*eigendom*) as the most comprehensive right that

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139. Vienna Convention, Article 33.
a person can have in respect of a thing (zaak). A thing is a tangible object, in other words, any part of nature, anything that man can perceive with his senses.

The BW also says the following on ownership: The owner has freedom, to the exclusion of anyone else, to make use of the thing, provided that such use does not infringe upon the rights of others. The owner of the thing is also owner of the fruits therefrom, subject to the rights of others. The owner of the thing can demand it from anyone holding it unlawfully. In so far the Act does not stipulate otherwise, the owner of a thing is the owner of all the elements thereof.

From the above it is clear that, although ownership is the most comprehensive right, the power of the owner is not unlimited. In the use of his thing, he is not allowed to infringe upon the rights of others. For example, he is not allowed to set his house on fire in a way that will cause damage to his neighbours.

Pitlo adds the following on ownership: The owner is entitled to limit his own rights in respect of the thing, either contractually, such as renting it out, or by granting a limited right (beperkt recht), such as a hereditary tenure (eeuwigdurend erfpachtsrecht) in respect thereof. The last mentioned case illustrates another characteristic of ownership in Dutch law, namely that a formal rather than an economic criterion is used. Although the owner has given up the use of his land for eternity, he remains the owner nonetheless. The example can also be used to illustrate a further characteristic of ownership, that of elasticity (elasticiteit), which is similar to what is described as “its residuary character” in English law (see 4.2.4.). As mother right (moederrecht), ownership embodies in essence all other rights and therefore has the tendency to fill up again whenever part of it has been (qualitatively) detached. Should the long lease come to an end, the bare dominium will automatically fill up to full ownership again.

140. BW 5, Article 1.
141. BW 3, Article 2; A. Pitlo, Het systeem van het Nederlandse privaatrecht, revised by P.H.M. Gerver, et al., 1995, at 94.
142. BW 5, Article 1-3.
143. Pitlo, supra note 141, at 199.
144. Pitlo, supra note 141, at 200-206.
4.4.2. Ownership of intellectual property, licences, claims and money

In 4.7., ownership of royalties is discussed. As is apparent from that discussion, there is some uncertainty about whether the object of the ownership of a royalty is the underlying intellectual property, the licence, the claim for payment of the royalty, or the actual payment or money received. It is necessary therefore to investigate in respect of each of these categories whether it can be owned in Dutch law.

From the discussion in 4.4.1. it follows that only things, that is tangible objects such as books and machines, can be owned in terms of Dutch law. Rights in respect of intellectual products, such as patents or trade marks cannot be owned because these are not things.145

As soon as some sort of legal protection is granted to the creator of an intellectual product, a property right is formed.146 These rights, such as copyrights, patent rights and trade mark rights are classified147 as absolute rights in respect of an idea.148 The fact that they are classified as property rights (vermogensrechten) means that they can be transferred and valued in money.149 The fact that they are also classified as absolute rights (absolute rechten) means that they can be asserted against all third parties (a so-called right against the world).150

146. Asser, supra note 145, at 45.
147. It should be cautioned that terminology such as property rights, real rights and absolute rights may have different meanings in different legal systems. Wolfgang Mincke, “Property: Assets or Power? Objects or Relations as Substrata of Property Rights”, in J.W. Harris (ed.), Property Problems from Genes to Pension Funds, 1997, at 80, states that rights are traditionally classified either as iura in re and iura in personam, or absolute and relative.
148. Pitlo, supra note 141, at 112.
149. Pitlo, supra note 141, at 109; BW 3, Article 6.
150. Pitlo, supra note 141, at 94.
Even more important as far as the current investigation is concerned, is the fact that the rights in respect of intellectual products are dealt with in separate acts such as *de Rijksoctrooiewet* 1995 (in respect of patents), *de Auteurswet* 1912 (in respect of copyright) and *de Eenvormige Beneluxwet op de warenmerken* 1971 (in respect of trademarks). The rules in respect of these products are determined by these separate acts and a study of the legal nature of the products should focus on these acts.

It is therefore not correct to use the term *intellectuele eigendom* in Dutch law,\(^\text{151}\) the term being translated here as “intellectual ownership”\(^\text{,152}\). *Eigendom*, in Dutch law, refers strictly to things, that is tangible objects.

For the same reason, namely that it is not a thing, it is not possible, legally speaking, to own a licence in Dutch law.

Any claim (*vorderingsrecht*) in respect of a royalty payment is classified as a personal right in Dutch law, meaning that this claim can be asserted against one person only and not against the whole world.\(^\text{153}\) From the discussion in 4.4.1., it follows that such a claim or right to receive a royalty payment cannot be owned because it is not regarded as a thing.

Dealing with the legal nature of the actual payment is more problematic, bearing in mind that payment does not have to be in tangible money but can also be by means of, for example, electronic transfer, or bearer or order document (*toonder- of order papier*) such as a bill of exchange or cheque. By applying the method of induction to some articles in the BW, however, it appears that both tangible

\(^\text{151.}^{\text{Pitlo, supra note 141, at 199; Asser, supra note 145, at 45; G. van Empel and P.G.F.A. Geerts, Bescherming van de Intellectuele Eigendom, 1995, at 10; B.C. Wentink, De licentie in het vermogensrecht, 1995, at 7.}}\)

\(^\text{152.}^{\text{Eigendom can also be translated as “property”. It appears that in the context of the BW, however, eigendom should be translated as “ownership”. The BW, although using the term vermogensrechten, which could be translated as “property rights”, does not appear to use the term “property”. BW 5 refers, for example, to movable and immovable property ownership as eigendom van roerende en onroerende zaken.}}\)

\(^\text{153.}^{\text{Pitlo, supra note 141, at 110-111 and 199.}}\)
money and bearer and order documents are things and can therefore be owned.\textsuperscript{154}

Although acknowledging the position in Dutch law, in the rest of this study the terms intellectual property, licence owner and debt owner is used. This is done for reasons of consistency and also because such usage is probably in line with the broad international way of speaking.

4.5. INTELLECTUAL PROPERTY

In the sections above, the meaning of ownership was analysed with respect to the common law in England, tax law in the United States, and the civil law in the Netherlands. In each of these states, however, as is the case in many other states, intellectual property such as copyright, patents and trade marks are governed by specific statutes. These statutes govern everything in respect of the intellectual property concerned. They determine the rights that are protected and prescribe how these rights can be dealt with. An investigation into the bundle of rights associated with ownership of specially protected intellectual property therefore must focus on the relevant copyright, patent, trade mark, etc., statutes.

As this study mainly deals with royalties in respect of intellectual property, it is necessary to have a closer look at the rights protected by these statutes. The analyses is limited to three of the most important types of intellectual property, i.e. copyright, patents and trade marks. Although the detail provisions of intellectual property statutes differs around the world, the existence of various international conventions\textsuperscript{155} in respect of intellectual property means that there is a great level of similarity as to the core provisions. As an

\textsuperscript{154} BW 3, Article 86; BW 5, Article 9.

\textsuperscript{155} See Bainbridge, supra note 102, Appendix 1, for lists of member states of some of the international conventions.
example of the content of such statutes, the position in the United Kingdom is investigated.\textsuperscript{156}

It has become fashionable to speak of the bundle of rights in respect of copyright, for example. As is seen from the discussion below, there are various levels of rights connected with copyright (and other types of intellectual property. It is necessary to investigate which of these rights, on their own or in combination with other rights, constitute ownership.

4.5.1. Copyright

Cornish observes that one characteristic shared by all types of intellectual property to date is that the rights granted are essentially negative: they are rights to stop others doing certain things – rights in other words to stop pirates, counterfeiters, imitators and even in some cases third parties who have independently reached the same ideas, from exploiting them without the licence of the right owner.\textsuperscript{157}

According to Bainbridge, copyright can be considered to comprise a bundle of rights, associated with the acts restricted by the copyright. These are the acts that only the copyright owner is allowed to do or authorize.\textsuperscript{158}

In terms of the Copyright, Designs and Patents Act 1988 ("1988 Act"), the owner of the copyright for a work has the exclusive right to do the following acts in the United Kingdom:
- to copy the work;
- to issue copies of the work to the public;
- to perform, show or play the work in public;
- to broadcast the work or include it in a cable program service;

\textsuperscript{156} In this Section, as in the next Section on assignments and licences, the aim is not to make a comparative study of the position in different states. The idea is merely to get a general background on the nature of the issues discussed, by referring to the position in one state.


\textsuperscript{158} Bainbridge, \textit{supra} note 102, at 33.
to make an adaptation of the work or do any of the above in relation to an adaptation.

Copyright in a work is infringed by a person who without the licence of the copyright owner does, or authorizes another to do, any of the above acts restricted by copyright.159

The "works", referred to above, which are protected, are:
- original literary, dramatic, musical or artistic works,
- sound recordings, films, broadcasts or cable programmes, and
- the typographical arrangement of published editions.160

As is shown by the following example by Bainbridge, however, the number of rights that can exist in respect of copyright is far more complex and diverse than the above relatively short list seems to suggest: Consider a song which has been recorded as a sound recording. The following rights can exist: musical copyright, literary copyright, copyright in the sound recording, performance rights (neighbouring rights to copyright), composer's moral rights161 and the lyricist's moral rights. The rights themselves can be subdivided, for example in the above case the following cross-cutting rights are important: the right to make copies of the sound recording, the right to play the sound recording in public, the right to permit rental of copies of the sound recording.162

Cornish provides an even more elaborate example: The most lucrative copyright works are often exploited in a number of ways. Take a popular novel: there are the volume rights, the serial rights (in newspapers and magazines), the translation rights, the film rights, the dramatization rights (play, opera, musical, ballet). Now there are also electronic rights. Add the fact that for some of these it may be desirable to split the rights of exploitation language by language. And there is the possibility of dealing with each national copyright separately. The result is an elaborate concoction of prospects.163

159. Sections 16(1)-(2).
160. Section 1(1).
161. Moral rights are not investigated in this study.
162. Bainbridge, supra note 102, at 74-75.
163. Cornish, supra note 157, at 405.
In summary: The rights making up the bundle of rights associated with copyright are numerous and identifying all of them and the borders separating them can be a complicated task. What is important for the current investigation, however, is the fact that, as confirmed by Cornish, as far as British copyright is concerned, the 1988 Act permits the various rights bundled together as copyright not only to be licensed but also to be assigned separately. Furthermore, co-ownership by assignment does not arise when different aspects of the copyright (publishing rights, performing rights, film rights, etc.) are transferred to different persons. Each has the exclusive rights over his apportioned subject matter.\textsuperscript{164}

Skone James states that the 1988 Act makes it clear that there will be separate and independent owners of the copyright in respect of the doing of different acts, or different classes of acts, and at different times. Rights of this character can be divided up horizontally and vertically so that different people can own different rights in different countries.\textsuperscript{165}

It is therefore wrong, when looking for the copyright owner, to list all the rights mentioned above and to question whether they are all held by the same person. Each of the rights can be owned separately and the ownership test must be performed individually in respect of each of the rights.

A case in point is that of \textit{Rohmer et ux. v. Commissioner}\textsuperscript{166} in the United States. In that case the copyright owner transferred (for an unlimited time) only his serial rights, reserving, \textit{inter alia}, the book rights, motion picture rights and most of the dramatic rights. The court held that, because the copyright owner transferred substantially less than the entire bundle of rights conferred by the copyright, the transaction could not be regarded as a sale and the payment therefore was regarded as royalties. It is submitted that under modern copyright law, certainly in the United Kingdom, this finding is no longer valid. The different rights making up copyright can be sold (assigned) and owned separately.

\textsuperscript{164} Cornish, \textit{supra} note 157, at 405 and 410.
\textsuperscript{165} E.P. Skone James, \textit{et al.}, \textit{Copinger and Skone James on Copyright}, 1991, at 111.
\textsuperscript{166} 153 F.2d 61 (2d Cir. 1946).
4.5.2. Patents

The owner of a patent in the United Kingdom is referred to as its proprietor. In terms of the Patents Act 1977 a person infringes a patent if he does any of the following things in the United Kingdom in relation to the invention without the consent of the proprietor of the patent:

- where the invention is a *product*: he makes, disposes of, offers to dispose of, uses or imports the product or keeps it, whether for disposal or otherwise;
- where the invention is a *process*: he uses the process or he offers it for use in the United Kingdom when he knows, or it is obvious to a reasonable person in the circumstances, that its use there without the consent of the proprietor would be an infringement of the patent;
- where the invention is a *process*: he disposes of, offers to dispose of, uses or imports any product obtained directly by means of that process or keeps any such product whether for disposal or otherwise.\(^\text{167}\)

There are also other types of patent infringements, but for purposes of the current discussion the ones listed above will suffice. In short, the main monopoly rights conferred by United Kingdom patent law, are that of use, manufacture and sale.

4.5.3. Registered trade marks

The owner of a registered trade mark is also referred to as the proprietor. The exclusive right conferred upon the proprietor of a registered trade mark is the right to use the trade mark.\(^\text{168}\) This right is infringed if used in the course of trade by any person without the consent of the proprietor under the circumstances stipulated by the

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\(^{167}\) Section 60.

\(^{168}\) Trade Marks Act 1994, Section 9(1).
Trade Marks Act 1994.\textsuperscript{169} For these purposes a person uses a sign\textsuperscript{170} if he:

- affixes it to goods or the packaging thereof,
- offers or exposes goods for sale, puts them on the market or stocks them for those purposes under the sign, or offers or supplies services under the sign;
- imports or exports goods under the sign; or
- uses the sign on business papers or in advertising.\textsuperscript{171}

The fact that the right of use is the only right protected does not mean that there is only a single right that can be dealt with by assignment or licensing. For example, rights can be dealt with separately in respect of the different goods and services for which the mark is registered and can also be dealt with separately in respect of different locations.\textsuperscript{172}

4.6. ASSIGNMENTS AND LICENCES

According to Van Empel, there are in principle three different ways in which an intellectual property right can be exploited:

- the holder of the right can perform the restricted actions himself;
- he can contractually grant permission to someone else (licence);
- he can assign the right to someone else.\textsuperscript{173}

The last mentioned two options give rise to payments of some kind, including royalties. Before looking at the ownership of royalties, it is therefore necessary first to investigate the meaning of assignment and licence.

\textsuperscript{169} Section 10(1)-(3).
\textsuperscript{170} Section 1(1) of the Trade Marks Act 1994, defines a “trade mark” as “any sign capable of being represented graphically which is capable of distinguishing goods or services of one undertaking from those of other undertakings”.
\textsuperscript{171} Section 10(4).
\textsuperscript{172} Bainbridge, supra note 102, at 464-465.
\textsuperscript{173} Van Empel, supra note 151, at 12.
4.6.1. Assignments

The legal nature of an assignment (sale) of an intellectual property right may differ from state to state. An investigation of the position in the United Kingdom, however, gives a good indication as to the legal nature thereof.

Bainbridge defines assignment as:

The transfer of the title in a chose in action. For example, ownership of copyright is transferred by means of an assignment in writing which is signed by or on behalf of the previous owner of the copyright, that is the assignor. In intellectual property law, an assignment must be distinguished from an exclusive licence, which is similar in many practical respects, but which does not involve the transfer of the title in the right.\footnote{Bainbridge, supra note 102, at xxx. See also Mark Anderson, “Applying Traditional Property Laws to Intellectual Property Transactions”, European Intellectual Property Review 1995/5, at 237.}

As was seen in the discussion in 3.3.3.7., consideration paid for the transfer of the full ownership in intellectual property cannot represent a royalty in terms of Article 12 of the OECD Model. That follows from the fact that where the ownership of rights has been alienated in full or in part, the consideration cannot be for the use of the rights.

The fact that consideration for an assignment is not a royalty in terms of the OECD Model does not, however, mean that the issue is of no further interest for the current study. First, an investigation into its meaning is necessary in order to be able to distinguish between an assignment and a licence. Second, assigning an intellectual property right to another entity, instead of licensing it out, can be an alternative way of making use of tax treaty benefits. The question of whether the new entity is the beneficial owner of the royalties generated by the right is therefore of importance. Third, as is clear from the discussion in 3.3.3.7., various bilateral tax treaties include the alienation of property and rights under the definition of royalties.

As discussed in 4.5.1., it is possible to separately assign the different rights making up copyright or other types of intellectual prop-
In this respect Skone James warns that, having regard to the various derivative rights which flow from ownership of copyright, an assignor of copyright should always take care that the assignment is drawn in such a way as not to carry rights in excess of those intended to be assigned. An assignment of "copyright" would operate, in the absence of contrary intention, to convey to the assignee all the rights which go to make up copyright.\textsuperscript{175}

Lastly, it is necessary to take note of the fact that it is possible to assign a copyright only for a limited period.\textsuperscript{176} The full rights revert to the original owner after the period has run out. Such assignment for a limited period was possible even before the 1988 Act, as is shown by the decision in \textit{Withers v. Nethersole}.\textsuperscript{177} In this case the sole and exclusive motion picture rights throughout the world in respect of a novel were assigned to a company for a period of ten years. The House of Lords held that proceeds in this respect were not royalties, but that the transaction represented a sale of property. The court explained as follows:

Any such assignment is a parting with the whole rights, limited, it is true, ... for a particular period, but still to the extent a complete diverting of the property in the copyright from one owner to another. ... The relevant fact is that an owner of an asset, entitled by law to divide it into two distinct assets, has done so by selling one of those assets for an agreed consideration payable in a lump sum. ... [B]ut the consideration was paid, not in respect of the temporary use of another's property, but for the purchase of property with a limited life.\textsuperscript{178}

4.6.2 Licences

Wentink notes that the word "licence" is derived from the Latin word "licentia", which, \textit{inter alia}, means freedom, permission or consent. If an intellectual right is licensed to another, it means that the other person is granted (for compensation) the freedom to use
something which otherwise would not have been allowed – a legally protected intellectual right, for example the right to a patent.\textsuperscript{179}

According to Van Empel, several variations are possible in respect of licences. A licence can be limited in respect of geographical application or lifespan or it can be unlimited. The licence can also be exclusive, which means that only the licensee is permitted to perform the restricted actions, even the licensor can contractually be barred from performing these actions. A licence can be assigned. That means that the licensee transfers the permission to perform the restricted actions to a third party. The licence can also be sublicensed, which means that the licensee grants permission to others in terms of his licence.\textsuperscript{180}

Wentink points out that, although there are many variations in the content of licences, they generally share the following characteristics:

- Commercial co-operation for the mutual benefit of all parties involved.
- Legal and economic independence of the different parties. Each party acts for his own account and at his own risk.
- The holder of the intellectual right must allow the licensee to use the right during the agreed period and under the determined conditions.
- The licensee will have to compensate the licensor for the use of the intellectual right. The manner of calculating the compensation can vary. It can, \textit{inter alia}, be a lump sum, a percentage of the sales or cost prize of the product which is the object of the licence (a royalty) or a percentage of the profit.\textsuperscript{181}

A study of United Kingdom material shows a great similarity with the Dutch situation as discussed above.\textsuperscript{182} The United Kingdom commentators add the following:

\begin{itemize}
\item \textsuperscript{179} Wentink, \textit{supra} note 151, at 4.
\item \textsuperscript{180} Van Empel, \textit{supra} note 151, at 12.
\item \textsuperscript{181} Wentink, \textit{supra} note 151, at 5-6.
\item \textsuperscript{182} See, for example, Bainbridge, \textit{supra} note 102, at xxxi.
\end{itemize}
- Intellectual property licences are usually contractual in nature and the licensor will usually receive royalties by way of consideration for the permission.\textsuperscript{183}

- A licence is regarded as a right under the intellectual property, rather than a right or interest in the property. A licence, which amounts merely to a consent, passes no interest, but only makes an action lawful which, without it, would have been unlawful.\textsuperscript{184}

- Even though a licence is exclusive, it need not apply to all the restricted acts and may encompass only one or some of them, such as publishing a book, and the owner will be free to deal with other rights, such as the broadcasting rights. In the case of a non-exclusive licence, the licensor may make several agreements in respect of the same restricted acts.\textsuperscript{185}

- In obeisance to freedom to contract, English courts have generally left the parties to patent licences and assignments to determine the scope and extent of obligations by mutual agreement between themselves. Accordingly, a licence gives each party what he was strong enough to demand, or canny enough to include. In actual business life, the terms of licences vary greatly.\textsuperscript{186}

- Often, there is a choice whether to grant rights by assignment or by exclusive licence. Provided that the contract in which the grant is made is clear about consequential matters, it makes no difference which type is used. But if ambiguities are left, their resolution may be affected by the fact that an assignment is in essence a transfer of ownership, while a licence is in essence permission to do what otherwise would be infringement. Thus a licensee’s freedom to make alterations in the work may be more restricted than an assignee’s. The licensee may well not be entitled to assign or sub-license his interest, while his licensor will retain the right to grant licences to others, unless he has granted exclusive rights to the licensee.\textsuperscript{187}

\textsuperscript{183} Bainbridge, \textit{supra} note 102, at xxxi.
\textsuperscript{184} Anderson, \textit{supra} note 174, at 237; Skone James, \textit{supra} note 165, at 122.
\textsuperscript{185} Bainbridge, \textit{supra} note 102, at 79.
\textsuperscript{186} Cornish, \textit{supra} note 157, at 238-239.
\textsuperscript{187} Cornish, \textit{supra} note 157, at 406. See also Skone James, \textit{supra} note 165, at 471.
In summary: royalties, in the context of intellectual property, are paid as compensation for the granting of licences to use intellectual property rights. An understanding of the nature of licences and the rights of a licence owner are therefore important in the study of royalty ownership. Questions such as whether a licensee has freedom to sub-license, including the decision on who to sub-license to and on what terms, or whether he has freedom to make alterations to the work, may well reflect on the question of ownership of the royalty received by the licensee in terms of the sub-licence (see also 4.7.).

4.6.3. Assignments, licences and royalties

Royalties can accrue to a person either because he is the original owner of an intellectual property right or he has become the owner through assignment, or it can accrue to a licensee in terms of a sub-licence granted by him. A person can become a licensee either because of a licence granted directly by the owner of the intellectual property right or because of the assignment of an existing licence from someone else. In addition, royalties can also be paid to a person because the right to receive royalties (the debt or claim), as opposed to the licence, was ceded to him (see, however, discussion in 3.3.2.1.2.).

It is therefore clear that a complexity of different situations can exist in respect of a claim to royalty payments and it may be necessary to identify the specific situation at stake, as a first step into the investigation of the ownership of royalties.

4.7. OWNERSHIP OF ROYALTIES

This study is about the meaning of beneficial ownership. As it turned out, there is an equally problematic and important question to be answered: What is the object of the beneficial ownership of royalties? Does the ownership of royalties refer to the ownership of the underlying intellectual property, ownership of the licence, ownership of the right to receive payment (the debt or claim) or ownership of the actual payment received? To use the legal language of
England: What is the thing that is owned as far as royalties are concerned?

This study searched in vain for any literature on the legal nature of royalties. Also private conversations with legal experts, including some of those quoted in this study, provided no answer. Responses include the following: “Under English law I suppose it must be classed as a thing in action”; “A royalty is merely a right to payment and does not have the attributes of property”; “Because royalties are not an actual right, but compensation for a right, there will be no literature on the legal nature of royalties”; “We just work with the concept [of royalties] without ever really analysing it!”

The responses are helpful in the sense that they are thought provoking. Further investigation is, however, necessary in order to find out the extent to which they are correct.

An example may throw more light on the issue: Holding Company A, the owner of a copyright in a novel, licenses the serial rights out to subsidiary B, who in turn licenses it out to fellow subsidiary C. Royalties are calculated as a fixed percentage of turnover and is paid quarterly in arrears, by C to B, and by B to A.

Looking at the example from B’s point of view, there are at least four different things that can be the object of ownership. First, there is the ownership of the copyright in the novel. Second, there is the ownership of the licence granted to B. Third, there is B’s right to receive payment from C, a debt or claim, in other words. Fourth, there is the actual payment at the end of each quarter by C to B.

The relevance of the question on the object of the ownership of royalties is, first, the fact that all four things may well not be owned by the same person. Second, the bundle of rights may differ among the four objects. It is therefore necessary to have certainty on the object of ownership. There is also the possibility that the object of ownership could be all four, or any three or two, of the possibilities mentioned.

It is fairly easy to dispose of the first alternative and to conclude that ownership of royalties does not refer to the underlying intellectual property. The reasons therefore are the following: First, the wording of the OECD Model (and, subsequently, the actual treaties)
refers to beneficial ownership of royalties. If it was the intention to refer to the underlying intellectual property, it would have been easy to state so in clear wording. Second, if the object of beneficial ownership is to be the underlying intellectual property, it immediately rules out any possibility that a sub-licensor can be a beneficial owner. As is stated in 4.6.2., a licence is merely a right under the intellectual property, as opposed to a right or interest in the property. A licensee (the sub-licensor in the current situation) is therefore not the owner or beneficial owner of the patent, copyright, trade mark or any other intellectual property. It is unlikely that it was the intention of the drafters of the OECD Model to rule out the possibility that the sub-licensor can be a beneficial owner. Third, the Dutch Hoge Raad\textsuperscript{188} clearly rejected an argument that, in order to be the beneficial owner of a dividend, a person must also be the beneficial owner of the shares. The wording of Article 10 of the OECD Model in respect of dividends is similar to that of Article 12 in respect of royalties. This same principle therefore applies to royalties. There is no requirement that the owner of the royalties must be the owner or beneficial owner of the underlying intellectual property.

It is best to deal next with the fourth alternative: the ownership of the actual payment received.

“Royalty” is variously defined as “a payment mechanism”\textsuperscript{189}, “payments received, or to be received, for the right to ...”\textsuperscript{190} and “a sum paid to a patentee for the use of ...”\textsuperscript{191} The definition in Article 12(2) of the OECD Model of “payments of any kind received as a consideration for ...”, is in line with the aforementioned definitions. \textit{West’s Tax Law Dictionary} defines a “royalty owner” as: An owner who is entitled to compensation for the use of property, usually copyrighted material, patent or natural resources, expressed as a

\textsuperscript{188} See discussion in 6.2.2. See also Jürgen Killius, “The concept of ‘beneficial ownership’ of items of income under German tax treaties”, \textit{Intertax} 1989/8-9, at 341.
\textsuperscript{189} Bainbridge, \textit{supra} note 102, at xxxi.
\textsuperscript{190} \textit{West’s Tax Law Dictionary}, 1995, at 752.
With reference to the above definitions, it is the opinion of this study that the object of the beneficial ownership of royalties is the actual payment. In the same way that “interest” is defined as “money paid for the use of money lent”,193 “royalty”, for purposes of Article 12 of the OECD Model, is the name that is given to the payment/compensation for the use of, or the right to use intellectual property and the provision of know-how. The key word is “payment” (“payment” being used in its widest sense). An investigation into the ownership of a royalty is an investigation into the ownership of the payment received – the actual money paid.

Article 12 of the OECD Model is concerned with the flow of royalties across borders and with taxes and withholding taxes in respect of such royalties. Treaty benefits should only be available if the royalties are beneficially owned by the resident of the relevant contracting state. From this it follows that the “thing” which is the object and focus of beneficial ownership, is the same as that which is the subject of Article 12 – the actual royalty payments. In practice, it is at the time when the payment of royalties is to be made when the issue of beneficial ownership and withholding tax arise. It is at that time when the payer of the royalties must consider whether the person for whose account it is paid, is the beneficial owner. Further support for the focus on “payment” comes from the Dutch Hoge Raad (see 6.2.2.), which held that the question of whom the beneficial owner is must not be answered at the time the dividend is announced, but at the time when the dividend is made payable.

Having concluded that ownership refers to the actual royalty payments, does not automatically rule out the possibility that the ownership of the license does not also come into play. The question of the beneficial ownership of royalties, in the majority of cases, most probably arises in a situation where an intellectual property right is licensed out to an intermediary who, in turn, sub-licensed it out to a third party. The extent to which the intermediary has control over, or a say in the specifics of the sub-licence – in other words the

192. West’s Tax Law Dictionary, supra note 190, at 753.
extent to which he can freely avail of a licence, for example exploiting it either himself or sub-license it out – and is free to decide on whom to sub-license it out to, and for what period and what compensation, can shed much light on the question of the beneficial ownership of the royalties. In fact, the important question may not be whether beneficial ownership of the licence can shed light on the beneficial ownership of the royalty. The answer to this question is most likely yes. The only question may be whether it is allowed to refer to the beneficial ownership of the licence in order to determine the beneficial ownership of the royalty.

This study could not find any direct precedent assisting in the answer to the question. But it may be worthwhile to refer to the *Hoge Raad* decision in the *Royal Dutch Oil* dividends case once more. There the court said (see 6.2.2.): “It can further be assumed that subsequent to the purchase the taxpayer could freely avail of those coupons and, subsequently to the cashing thereof, could freely avail of the distribution.” It is noted that beneficial ownership was considered on two levels, one being in respect of whether the taxpayer could freely avail of *the coupons* and, whether he could freely avail of *the distribution* (the dividend payment). Is it possible to see an analogy between the coupon and the licence? The coupon was the key, the instrument, giving access to the receipt of the dividends. Is it not true that a licence is similarly the key or instrument giving rise to the receipt of the royalty? The fact that the taxpayer could freely deal with the coupon (for example, by selling it to someone else before the dividend is paid) appeared to have played an important role in deciding that the taxpayer was the beneficial owner of the dividend.

On the other hand, there is a difference in the legal nature of a dividend coupon and a licence agreement. A dividend coupon is normally a bearer document, whereas a licence agreement is a contractual arrangement between two parties. Actual payment is made to the holder of the coupon. In contrast, as is discussed below, it is possible to “dislodge” the royalty payment from the licence. The coupon in respect of a particular dividend ceases to exist after the

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194 It should be noted, though, that dividends can also be declared and paid without the existence of coupons.
dividend is paid, whereas a licence continues to exist after a royalty payment. Viewed from this perspective, a coupon is probably closer connected to a specific payment than is a licence.

Leaving for the moment the question as to the position of a licence unanswered, what remains is to consider whether the right to receive the payment, the debt or claim, in other words, can be the object of ownership of royalties. The right to receive payment, although flowing from a licence agreement and eventually giving rise to payment, is a different legal phenomenon from the licence and the payment and can be dealt with separately. For example, the right to receive payment can be ceded to a third party, thereby “dislodging” it from the licence. The right to receive the royalty payment can, for example, take the form of a promissory note. Promissory notes in the form of bearer documents can be dealt with freely.

Actual payment is made to the person holding the right to receive payment (in the form of a promissory note, for example) at the time when payment becomes due. This means that it is not possible to “dislodge” the payment from the right to receive payment. It can therefore be argued, with reference to the Royal Dutch Oil dividends case above, that it is the right to receive payment, and not the licence, which must be seen as analogous to the dividend coupons. In terms of this argument, the right to receive the payment, together with the actual payment received, is then the objects of ownership of royalties.195

In conclusion: The object of the ownership of royalties is the actual payment received and the beneficial ownership test should focus on the ownership attributes in respect of the payment. It is further submitted that, because of the close relationship between the right to receive payment and the actual payment (it is difficult to see how these two things can be dislodged), the ownership attributes in respect of the right to receive can also be considered.196 As far as the

195. It appears that in the process leading up to the incorporation of beneficial ownership into the OECD Model, the OECD actually discussed the issue of whether beneficial ownership should be on the claim, or only on the payment. See infra note 384.

196. See also Van Brunschot, infra note 339.
bundle of rights in respect of the ownership of the actual payment is concerned, it can be observed that probably most of the incidents of ownership identified by Honoré (see 4.2.4.) can be applied to payments. Similarly, the Dutch definition of ownership as the most comprehensive right that a person can have in respect of a thing, can also be applied to payments.

As far as the ownership attributes in respect of the licence is concerned it is submitted that, although reference to such attributes may be helpful, it should not be conclusive. The wording of the royalties article in the OECD Model shows that the beneficial ownership test must be applied to the actual payments. It is quite possible that ownership of the licence and ownership of the payments can be in different persons. In such cases the latter should be regarded as the beneficial owner (see also the discussion of Vogel’s view in 6.2.1.). It should also be noted that there are many commercial reasons why the owner of intellectual property may enforce strict control over licensees and sub-licences. That, in itself, does not mean that the licensee is not the beneficial owner of any payment received. For example, Schmitthoff points out that in respect of franchising agreements, for reasons of uniformity, almost every aspect of the licensed business is controlled by the franchisor. The franchisee, however, still owns the outlet and risks his own capital.\textsuperscript{197} The control over his activities does not therefore, on its own, mean that the franchisee is not the owner of income received by him. As already mentioned, the beneficial ownership test should focus on the payment, and the control over the licence should be treated with caution.

4.8. CONCLUSION

Although there are major differences in their respective legal systems, there is great similarity between the concept of ownership in England and the United States, on the one hand, and the Netherlands, on the other hand. Particularly noteworthy is the similarity between the definition of ownership as the greatest right or

bundle of rights in England; and the most comprehensive right, embodying in essence all other rights, in the Netherlands. Both legal systems also acknowledge the residuary nature of ownership. In addition, all the states recognize that ownership is subject to certain restrictions.

This similarity appears to extend to other states as well. The French civil code, for example, defines ownership as the right of enjoying and disposing of things in the most absolute manner, provided that one abstains from any use forbidden by statute or subordinate legislation; while the civil code of the former Soviet Union, provided, in very similar language that, within the limits laid down by law, the owner has the right to possess, to use and to dispose of his property.\textsuperscript{198} Honoré best summarizes the issue as follows:

There is indeed, a substantial similarity in the position of one who "owns" an umbrella in England, France, Russia, China, and any other modern country one may care to mention. Everywhere the "owner" can, in the simple uncomplicated case, in which no other person has an interest in the thing, use it, stop others using it, lend it, sell it or leave it by will. Nowhere may he use it to poke his neighbour in the ribs or to knock over his vase.\textsuperscript{199}

Despite the similarities there are, however, also differences which are important for purposes of this study. As is discussed more fully later in this study (5.2.6., 5.6., and 6.3.2.8.1.) the common law states allow the splitting of ownership between a legal owner and a beneficial owner, whereas splitting of ownership is, generally speaking, not allowed in the civil law states.

Importantly, though, is that the discussion in this chapter has shown that the question of ownership is a legal question and involves an investigation into the nature of the rights held by different persons. In this regard, the question whether the rights held by a person involves a claim of performance against one person only, or is a claim to a thing that can be asserted against the whole world, is very important. The next chapters investigate the extent to which the foregoing characteristics of ownership apply to beneficial ownership.

\textsuperscript{198} Translated and quoted by Honoré, supra note 101, at 110.
\textsuperscript{199} Honoré, supra note 101, at 108.
An investigation into the ownership of royalties must focus on the ownership of the actual payment received. The ownership of the right to receive payment can also be considered. The ownership of the underlying intellectual property should not be considered at all, whereas reference to the ownership of the licence can be helpful, but should be treated with caution.

5.1 INTRODUCTION

This chapter investigates the domestic meaning of beneficial ownership in those states in which the term is recognized for purposes of domestic law. The term "beneficial ownership" is not defined for purposes of its use in Article 12 of the OECD Model. In order to establish its meaning—for purposes of international tax treaties, the domestic meaning thereof may provide important clues. As is argued in 5.3.2.1, such domestic meaning should be taken as the starting point for finding the international tax treatment.

As far as domestic law is concerned, beneficial ownership is a term which is mainly used by states which form part of the common law family. This chapter therefore focuses on the common meaning of the term in England, the United States, Australia, and India, all common law states. The position in civil law states is not examined.

5.2 ENGLAND/UNITED KINGDOM

There is more than one reason why beneficial ownership was not given attention in the domestic law of England. First, it is a term of foreign origin, and second, it is not widely used as a term in English law. Both reasons mean that the term is not very familiar to England's international community; not all foreign residents or prisoners of war, for example, may be so familiar with the term.

Second, as is discussed in 5.3.2.1, the concept of beneficial ownership was not widely used in England before its incorporation into the OECD Model. Before the model, the United Kingdom was represented in the OECD as the "United Kingdom" which incorporated the term into the definition of "beneficial ownership". This is significant because it means that the meaning attributed to the term in the model is the meaning accepted by the United Kingdom.
This similarity appears to extend to other states as well. The French civil code, for example, defines ownership as the right of enjoying and disposing of things in the most absolute manner, provided that one abstains from any use forbidden by statute or subordinate legislation, while the civil code of the former Soviet Union provided, in very similar language that, within the limits laid down by law, the owner has the right to possess, to use and to dispose of his property. 168 Honore best summarizes the issue as follows:

There is indeed, a substantial similarity in the position of one who "owns" an umbrella in England, France, Russia, China, and any other modern country, one may care to mention. Everywhere the "owner" can, in the simple uncomplicated case, in which no other person has an interest in the thing, use it, stop others using it; lend it, sell it or leave it by will. No one may be use it to pelt his neighbour in the face or to knock over his vase. 169

Despite the similarities there are, however, also differences which are important for purposes of this study. As is discussed more fully later in this study (§ 2.6, § 5.6, and § 6.3.3.3.1) the common law does allow the splitting of ownership between a legal owner and a beneficial owner, whereas splitting of ownership is, generally speaking, not allowed in the civil law states.

Importantly, though, is that the discussion in this chapter has shown that the question of ownership is a legal question and involves an investigation into the nature of the rights held by different persons. In this regard, the question whether the rights held by a person involve a claim of performance against one person only, or a claim to a thing that can be asserted against the whole world, is very important. The next chapter investigates the extent to which the foregoing characteristics of ownership apply to beneficial ownership.

168. Ibid, quoted by Honore supra note 101, at 110.
169. Honore, supra note 104, at 146.