Alexandre Quiquerez

IP holding companies: perfect match or liaisons dangereuses between tax law and IP law?

A crossborder perspective

IP holding companies: perfect match or *liaisons dangereuses* between tax law and IP law? A cross-border perspective

About the author:
Alexandre Quiquerez is a Lecturer at the University of Lyon since 2012, after having defended a PhD on IP securitizations at the University of Luxembourg.

Introduction

A French pioneering booklet written by an inventor and entrepreneur in 1930 dealt with patent holding companies. Significantly, the book's second title was "Connecting Entities between Inventor and Capitalist"[1]. This study was published in the context of the emergence of IP holding companies, in particular in the US, thanks to the development of financial engineering and the existence of a large pool of investors. These entities also appeared in Europe, especially in Switzerland[2] and Luxembourg[3], countries which have provided attractive tax regimes since the 1920s.

As a first approach, an IP holding company is a company which owns IP rights, isolated from another company with which the IP holding company has direct or indirect equity links. The business object of IP holding companies does not normally involve the direct use of the creative work protected under IP law, but rather these entities license their IP rights to an affiliate company (parent company or subsidiary), or exceptionally to a company outside the group.

In research and development (R&D) and the design industry, international companies frequently transfer their IP rights to holding companies. Despite the fact that very little public information is disseminated about the IP holding companies which actually exist, a few examples can be found in

[1] René Bergerioux, *Les Holdings de brevets*, 1930, (*tr.*).
[2] Serge Paquier, *Swiss Holding Companies from the Mid-Nineteenth Century to the Early 1930s: the Forerunners and Subsequent Waves of Creations*, Financial History Review (2001), 8, p. 163.
[3] "1929 holding companies", which were exempt from income tax, were expressly authorised to acquire patents and trademarks; these structures were quickly and frequently used in practice: Bernard Delvaux and Jacques Delvaux, *Droits intellectuels pouvant figurer comme participations dans une société holding luxembourgeoise*, Journal de l'OECL, no. 2, February 1968, p. 12.

corporate and official publications[4] and can have been obtained through some discussions with professionals we had the opportunity to meet during this research.

As a first example, a Delaware *LLC* company is the wholly-owned subsidiary of a well-known US vehicle manufacturer, which owns and manages the patents, know-how and trade secrets for the whole group[5].

Also, a Dutch company which is one of the many subsidiaries of a famous group of companies selling household products. Its specific purpose is to own patents, trademarks, domain names and copyright belonging to the group and to license the IP rights inside the corporate group.

IP holding companies are organised by individuals as well: a successful designer transfers all of his IP rights, including copyright and registered designs, and allocates his new IP rights to a company incorporated in Guernsey. This company enters into a sub-licence with a UK company. In turn, the UK company licenses third parties to manufacture and sell the designs.

In reality, IP holding companies are not a recent phenomenon in the sphere of R&D. As early as 1878, the American inventor Thomas Edison assigned his patents on electronic inventions to a company whose only assets were the equity in the other companies of the group and patents subject to the payment of royalties by manufacturers[6]. In the first half of the 20th century, similar structures appeared in the economically strategic sectors of communication and transport[7].

In the music and film production industries[8] it is not rare for copyright and related rights to be owned by holding companies. Thus, an Australian film production company has a subsidiary based in the British Virgin Islands. This subsidiary owns copyright in a large portfolio of blockbusters. It grants licences to other subsidiaries of the group and to third parties. It is also used as a financing vehicle, issuing bonds to institutional investors for producing new films.

It is also worth mentioning that the British singers in a famous band have created a company in the Netherlands whose specific purpose is to collect the royalties arising from their copyright[9]. The singers have transferred their copyright in music and lyrics to this company. The name of the band, of its members and the band's logo are owned as trademarks by another company also set up in the Netherlands.

IP holding companies are particularly successful in the area of e-commerce[10], which is one the fastest growing economic sectors[11]. Multinational e-businesses establish direct or indirect affiliates

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[4] See also the companies managed by a bank which are created to acquire patents in areas such as biotechnology, renewable energy, electronics and medical devices; their equity is held by German funds assigned to repay various investors: www.see- ifa.eu; for other practical examples: Lanning Bryer, Scott J. Lebson and Matthew D. Asbell, *Intellectual Property Strategies for the 21st Century Corporation*, Wiley, 2011, p. 7; on an IP holding company in the software sector: William J. Murphy, John L. Orcutt and Paul C. Remus, *Patent Valuation*, Wiley, 2012, p. 343.

[5] Bruce Berman, *From Ideas to Assets*, Wiley, 2002, p. 264.

[6] About the *Edison Electric Light Company*: Alasdair Nairn, *Engines That Move Markets*, Wiley, 2002, p. 129.

[7] Steve J. Wurtzler, *Electric Sounds: Technological Change and the Rise of Corporate Mass Media*, Columbia University Press, 2009, p. 22.

[8] See the recent French examples of "holding ISF Cinéma" which enable their investors to reduce their wealth tax: http://www.isfcinema.com/index.html.

[9] Lynnley Browning, *The Netherlands, the New Tax Shelter Hot Spot*, 4 February 2007.

[10] Chris Reed, *Internet Law*, 2nd ed., Cambridge, 2004, p. 270.

[11] OECD, *The Future of the Internet Economy*, 2011; see the statistics of the US Department of Commerce: http://www.census.gov.

whose main purpose is to hold IP rights and to charge royalties, commissions, marketing expenses, manufacturing costs and fees for advertising services and technical assistance to the subsidiaries of the group.

IP holding companies may be created for various purposes. One of the most common objective is mitigating the income tax burden through the location of the IP holding company[12]. The tax scheme may be very straightforward as regards holding companies. It consists of justifying the substantial fee which is to be paid by the operating company to the holding company so that revenues (otherwise taxed at a relatively high rate in the country of the operating company) are taxed at a lower rate in an offshore jurisdiction[13]. The profits from the operating company are therefore accumulated and collected by the holding company, which is taxed in its country of incorporation. Applied to IP, the tax advantages of this structure are twofold: on the one hand the royalties or fees paid in compensation for the licence-back or for services represent costs for the operating company that it can normally deduct as operating costs from its income tax base. On the other hand, the money collected by the holding company is taxed under a favourable regime in the offshore country where it is located[14]. The state of domicile should be tax-friendly as regards the collection of IP revenues as well as the distribution of dividends, especially so as to avoid withholding taxes. A suitable holding company jurisdiction will not tax such dividends or capital gains, and so net earnings can be reinvested in new ventures, either in the holding company jurisdiction or abroad.

Thus, the possibity to locate the IP holding company in an attractive juridiction from a tax point of view provides interesting opportunities for any IP holder to reduce its taxable income (see section 1 below). However, the interaction between tax planning and IP enforcement generates certain tensions or risks which should deserve careful discussion in practice before implementing an IP holding company (see section 2 below), which lead us to consider that IP holding companies cannot be viewed as the tax panacea for all IP holders.

1. The “tax-appeal” of IP holding companies

1.1 Basic structure. Holding companies are extremely heterogeneous in form, which is also the case within the family of IP holding companies. The selection factors regarding structure depend on the constraints and motivations of the promoter. Though it may be difficult to identify in practice, because of the complexity and opacity of corporate structures, every holding company has a promoter, which is generally an operating company[15], i.e. a company which is primarily engaged in production, sales and services. The promoter is the person for whom the holding company is created for a strategic purpose[16]. Once the holding company has been formed, the promoter does not step

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[12] Raffaele Russo, *Fundamentals of International Tax Planning*, IBFD, 2007; Nicolas Binctin, *Le capital intellectuel*, Litec, coll. Bibl. dr. ent., Vol. 75, 2007, § 71 and 105.

[13] This is often defined as a jurisdiction that provides zero or very low taxation along with a high degree of confidentiality and flexible but effective regulation: Edward Siemes, *Offshore Company Law*, Academy and Finance, 2009, p. 3; Rose-Marie Antoine, *Trusts and Related Tax Issues in Offshore Financial Law*, Oxford, 2005, § 1.05; whilst “offshore” literally means “overseas”, it actually refers to a jurisdiction that is attractive from a legal or taxation point of view.

[14] Joint Committee on Taxation (US), *Report*: *Present Law and Background Related to Possible Income Shifting and Transfer Pricing*, July 2010, p. 103; Philippe Dominati and Eric Bocquet (dir. by), *Rapport sur l’évasion des capitaux et des actifs hors de France et ses incidences fiscales,* Sénat (France), 2012, p. 120 and 171.

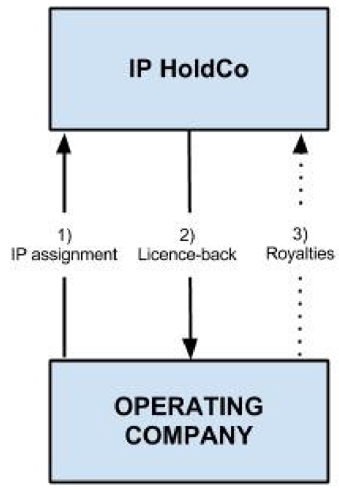
[15] Besides, as we already mentioned, some artists and sportsmen discreetly transfer their royalties or salaries to companies located in offshore jurisdictions via entities sometimes called in practice “rent-a-star companies”: Martin Jau, “Star Companies in International Tax Law”, *Taxation of Artists and Sportsmen in International Tax Law*, Taxmann, 2007, p. 247.

[16] Douglas Smith, *Company Law*, Taylor & Francis, 1999, p. 48: the promoter is the “*motive force for a company creation*”.

out of the transaction: it continues to control the management of the holding company by taking part in strategic decisions. So as to accomplish this, some former members of the promoter generally join the board of directors of the IP holding company.

The structure must be tailored to the objectives. The most basic IP structure is the use of a newly created company (IP HoldCo) whose specific objective is to own IP, for instance through an IP sale, called an assignment[17]. After the initial assets of the operating company are sold, new assets are automatically transferred or attributed to IP HoldCo[18]. In order to authorise the operating company to commercialise the IP, a licence-back contract is entered into between IP HoldCo and the operating company. Then, the shareholders of the operating company contribute their shares to IP HoldCo and subscribe to the equity of the latter. As a result, IP HoldCo owns the IP rights as well as the future royalties from the IP. These revenues ultimately revert to the shareholders in the form of dividends.

DIAGRAM OF A BASIC STRUCTURE



This global structure is similar to that of certain real estate holding companies which function by means of a sale and leaseback of the real estate[19]. The basic principle is to transfer the property in tangible or intangible goods to the holding company. A holding company does not build any buildings or manufacture any products on its own behalf; nor does it sell any goods to customers. Rather, it simply transfers its rights to other companies to enable them to perform such material activities.

An alternative is to transfer to the IP holding company not the IP itself, but the receivables arising from the commercialisation of this IP, in other words the royalties[20]. This can be a better solution, avoiding the complex and costly formalities of IP transfers and enabling the operating company to maintain full control of the IP. However, it may create adverse tax consequences given that state tax

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[17] Peter Groves, *A Dictionary of Intellectual Property Law*, Edward Elgar, 2011, see Assignment; another possible form of transfer is contribution: the intellectual property, the license or simply the royalties can be contributed to a company.

[18] For instance, patents and trademarks can be registered in the name of any legal person, including a holding company, which allocates IP to this entity; the holding company can automatically own the copyright if it is the "employer for hire" under Art. § 201 of US Copyright Law.

[19] Glen Arnold, *Corporate Financial Management*, Pearson, 2005, p. 556.

[20] Peter Groves, *cited above*, see Royalty.

advantages usually attach to IP transfers and not to royalties transfers[21]. Therefore, a tax-efficient IP holding structure would typically require the actual assignment of IP.

Instead of an IP assignment or a receivables assignment, the contract between the operating company and the IP holding company can be a cost sharing agreement (CSA), also named cost contribution arrangement. The operating company enters into a CSA with an IP holding company to develop new intellectual assets. The CSA is a contract whereby the two companies agree to share the development costs of new creations in proportion to the anticipated revenues[22]. From an IP perspective, the legal ownership can be shared under a co-ownership agreement. When one party to a CSA makes an intellectual work available to the CSA, the other parties who did not contribute towards the development or acquisition costs of the intellectual work must pay a "buy-in" to the contributor. The term "buy-in payment" is typically used in practice to refer to the payment that the IP holding company must make to the owner as compensation for use of pre-existing intellectual works. This "buy-in" may take several forms, such as a lump sum or periodic royalties, either fixed or decreasing[23]. CSAs are used in particular by US multinationals in the areas of e-commerce and software[24].

1.2 Double or multiple structures. Corporate structures involving IP holding companies are rarely so simple in practice. The creation of an IP holding company is often associated with the creation of intermediary holding companies. Additional levels of complexity are generally justified for tax reasons. The promoters take advantage of an extensive network of double taxation treaties and the application of EU directives prohibiting double taxation when choosing the location of the holding company according to the least expensive tax treatment[25]. It is even essential to find such locations for holding IP because of the high withholding tax rates applied in most jurisdictions to royalties paid by companies[26]. To give an example of this tax treaty shopping: a company operates in country A where the tax burden is high. Its board of directors decides to create an IP holding company in a favourable tax jurisdiction to reduce its tax liability. To avoid any withholding taxes on dividends, interest or royalties paid by the operating company, this holding company is located in country B, with which country A has signed a double taxation treaty, and not in country C – which offers however a more attractive income tax rate – because there is no double taxation treaty between A and C, whereas B and C have signed such a treaty. A second holding entity, the parent company of the holding company located in B, is therefore domiciled in offshore jurisdiction C[27].

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[21] Collective, *Cut your IP Tax Bill, Managing Intellectual Property*, May 2010, no. 199, p. 41.

[22] Wolfgang Schön and Kai A. Konrad (edited by), *Fundamentals of International Transfer Pricing in Law and Economic*, 2012, Springer, p. 200; Lanning Bryer and Matthew Asbell, *Combining Trademarks in a Jointly Owned IP Holding Company*, Trademark Reporter, June 2008, p. 834.

[23] In other words, upfront payment or running royalties: Amanda Johnson, *US Transfer Pricing Sourcebook*, WorldTrade Executive, 2005, p. 76.

[24] Senate Permanent Subcommittee on Investigations, *Offshore Profit Shifting and the US Tax Code*, See part 2, 2013, p. 10; see below 3.3.5.

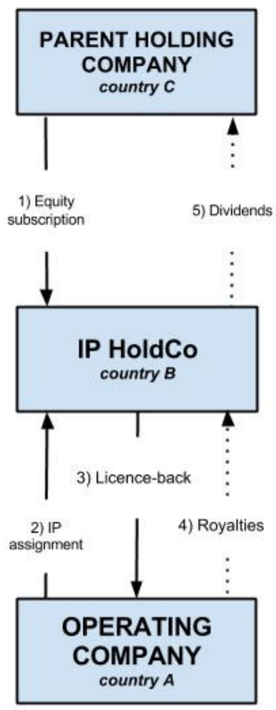
[25] See above for the example of *Royalty Pharma*; the practice of holding companies owning only IP royalties seems to be less common than that of holding companies owning the IP rights themselves, but it may be more secretive due to the fact that the transfer of the royalties is not subject to official publication in the official IP registers.

[26] See the booklet edited by *Deloitte* on withholding tax rates in 2012: http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/matrices/dttl_WHT_rates_2012.pdf.

[27] For another example of "treaty shopping" and "directive shopping" through an offshore licensing holding company: Luc de Broe, *International Tax Planning and Prevention of Abuse: a Study Under Domestic Tax Law, Tax Treaties and EC Law in Relation to Conduit and Base Companies*, IBFD, Doctoral Series, 2008, p. 30.

In the example represented by the diagram below, the operating company deducts the full amount of the royalties it pays to IP HoldCo. The majority of the income received by IP HoldCo is paid onwards to the Parent Holding Company in the form of dividends. This parent company is incorporated in a country where the dividends are subject to minimum tax only or are even completely tax-free. The royalty payment made by the operating company to IP HoldCo is free of withholding tax, while the dividends paid by IP HoldCo to the Parent Holding Company are also exempt from withholding tax.

DIAGRAM OF A DOUBLE STRUCTURE



This arrangement can take the form of a "Double Irish With a Dutch Sandwich"[28]. According to a simplified example inspired from the Google's structure, an operating parent company owns IrishCo1, which is a company incorporated in Ireland but managed in Bermuda. IrishCo1 owns IrishCo 2, which is incorporated in Ireland and is an Irish-resident. IrishCo 2 owns European subsidiaries (OpCos). IrishCo1 enters into agreement with the parent company to share cost of developing IP. The parent company predicts that 25% of the IP value will be used outside the U.S., so IrishCo1 bears 25% of the cost and owns IP rights. IrishCo1 licenses the IP to IrishCo2. The OpCos pay an arm's length royalty that is deductible from their local taxable income. No withholding tax is imposed because of the EC Interest and Royalty Directive. IrishCo 2 pays a royalty to IrishCo1 equal to 90% of the royalty income it receives from the OpCos and pays income tax on that small spread at the Irish rate of 12.5%. Ireland imposes no withholding tax on the royalty paid by IrishCo2. IrishCo1 is resident in Bermuda, which has no income tax[29]. According to the estimations of a tax analyst we have interviewed during this research, the effective tax rate may be only 2% thanks to this structure.

[28] David P. Twomey, *Anderson's Business Law and the Legal Environment*, Cengage Learning, 2013, p. 120.
[29] John E. Karayan and Charles W. Swenson, *Strategic Business Tax Planning*, Wiley, 2007, p. 264.

1.3 The issue of tax reassessment. In the interests of promoters and stakeholders (including employees and commercial creditors), IP holding companies should endeavour to avoid tax reassessment. On the one hand, the structure should not be exclusively designed to avoid the tax regime applicable to the royalties generated by the promoter, otherwise it may be sued by the tax authorities in the promoter's country. On the other hand, a holding company which does not benefit from the diversity of tax regimes would certainly be less than optimal. The structure chosen achieve a balance between these two constraints[30].

The risk of tax reassessment is not imaginary, even in the niche activity of IP holding companies[31]. In this connection, several US states have already launched a crusade against IP holding companies, suing them with success in a few noteworthy cases[32].

To give an example, Geoffrey Inc. was a "Delaware investment holding company" that owned and licensed the trademarks and trade names of a toy manufacturer to the top holding company, and had neither employees nor offices. The South Carolina Supreme Court concluded that the South Carolina Commission was allowed to tax the royalties collected by the holding company because it had directed its economic activities to this state where its licensees were located[33]. Under US tax law, a state can require a company to pay taxes if it has a minimal connection – or nexus – with the taxing state, whether this connection is physical or economical[34].

National tax authorities have recently initiated similar proceedings in the UK[35] and in France[36] against companies in the information technologies sector. To date, no precise information has been published on these tax reassessments and investigations, but it seems that these cases were initiated because of high levels of external expenditure on royalties paid to offshore IP holding companies. The increase in similar proceedings in Europe, which especially targets e-business[37], is very probably not a mere coincidence: governments announced at the G20 meeting held in Mexico in November 2012 that inter-state cooperation in the fight against tax evasion by multinational companies will be strengthened[38]. The G20 confirmed this objective in the meeting held in Russia in February 2013 in the light of an OECD report entitled "Addressing Base Erosion and Profit Shifting"[39]. This report

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[30] That balance is represented by the distinction, though blurred in practice because of the diversity of situations and the complexity of tax rules, between tax evasion (presumed to be clearly illegal) and tax avoidance (whose legality is questionable): Nabil Orow, *General Anti-Avoidance Rules: a Comparative International Analysis*, Jordans, 2000, p. 15.

[31] See e.g.: Elisabetta Povoledo, *Judge in Italy Puts Off Ruling in D. & G. Case*, ft.com, 25 March 2011; full decision available on: http://www.penalecontemporaneo.it..

[32] Foley (edited by), *IP Holding Companies Under Attack*, LegalNews, www.foley.com, March 2012; *Federal Circuit Heightens Standard for Plaintiff Presence that Will Weigh Against Transfer. — In re Zimmer Holdings*, Inc., 609 F.3d 1378 (Fed. Cir. 2010) Harvard Law Review, Vol. 124, December 2010, no. 2, p. 632.

[33] *Geoffrey, Inc. v South Carolina Tax Commission*, S.C., 437 S.E. 2d. 13, cert. den. 114 S.Ct. 550 (1993), http://www.mtc.gov.

[34] Julie Roman Lackner, *The Evolution and Future of Substantial Nexus in State Taxation of Corporate Income*, 48 B.C.L. Rev. 1387 (2007); John B. Harper, *Jurisdiction and Nexus*, 41st Ann. Tax Conf. XLIII 1995.

[35] See, among numerous press articles: Simon Neville and Jill Treanor, *Starbucks to Pay £20m in Tax Over Next Two Years After Customer Revolt*, The Guardian, 6 Dec. 2012.

[36] Court of Appeal, Paris, 15 May 2012, *Google v Direction générale des finances publiques*; Cécile Crouzel, *Fisc: les multinationales dans le collimateur*, Le Figaro, 14 Déc. 2012.

[37] Pierre Collin and Nicolas Colin, *Mission d'expertise sur la fiscalité du commerce électronique*, 2013, p. 20.

[38] Roland Watson, Fay Schlesinger and Soraya Kishtwari, *G20 Leaders Call For Clampdown on Multinational Tax Avoidance*, The Times, 6 Nov. 2012; Andrew Grice, *G8 Summit: David Cameron Hails Landmark Deal to Rewrite Global Rules to Stamp out Tax Evasion*, The Independent, 18 June 2013.

[39] OECD, *Addressing Base Erosion and Profit Shifting*, 2013, See esp. p. 79 for two examples of IP holding structures.

strongly encourages the consolidation of anti-avoidance rules at domestic as well as international level.

However, we should emphasise that IP holding companies that are created for tax purposes are not necessarily unlawful. Tax law generally prohibits a particular tax scheme only when it is fraudulent, or constitutes an abuse of a right in that the structure is exclusively artificial[40]. Promoters therefore strive to give substance to holding companies by allocating employees, an office and equipment to them. Hiring specialists to manage the assets helps the holding company to have a real economic activity and ensures that its creation is not exclusively motivated by tax considerations. If such an entity has no staff and is merely an empty shell, tax authorities are more likely to consider its activities as artificial. For example, it is essential that the directors of IP holding companies are not fictitious and actually manage the day-to-day affairs of the holding company.

Thus, IP holding companies raise some critical tax issues which are not, however, impossible to overcome, if we consider how popupar these entities have become popular. Only a small number of them are actually challenged by tax authorities. However, the setting up of such entities gives rise to the challenge of multiple legal obstacles in IP which appear to be serious and prone to undermine their success.

2. The various legal risks in IP law

As far as IP law is concerned, there are several barriers to effectively establishing an IP holding company, which cannot be listed exhaustively since they depend on a variety of objectives and the jurisdiction in which the company in question is active. Nevertheless, material precautions that are specific to IP holding entities should be addressed, at least briefly, so as to illustrate the considerable structuring difficulties.

2.1 The validity of the IP ownership. The validity of ownership under certain IP regimes is subject to a condition of domicile. Companies with large IP portfolios need to take into account tax considerations and potential savings, as well as the benefits of protection, by using a company located in a signatory country to key international IP treaties[41].

To focus on the Madrid Protocol as an example, this international treaty offers a trademark owner the possibility of having his trademark protected in several countries by simply filing one application with his own national or regional trademark office. To date, the Madrid Protocol has been signed by more than 80 states or organisations, including the US and the EU [42]. The Madrid Protocol provides that an application for international registration can be filed only by a natural person or a legal entity which has a real and effective industrial or commercial establishment in, or is domiciled in, or is a national of, a contracting party to the Madrid Protocol[43]. The Madrid agreement, which is the other treaty that composes the Madrid system for the international registration of trademarks, sets forth the same condition[44]. For instance, a company located in the British Virgin Islands is not a member of this system, with the consequence that a company domiciled there may not be able to

[40] Administrative Court of Appeal, Paris, 13 June 2008, decision no. 07/3558.

[41] This issue also arises in patent law: Art. 9 of the Patent Cooperation Treaty, 19 June 1970; Convention on the Grant of European Patents (European Patent Convention) of 5 October 1973; however, the Berne Convention for the Protection of Literary and Artistic Works of 9 September 1886, has been signed by a large number of states, including many offshore jurisdictions.

[42] For the updated list: http://www.wipo.int/export/sites/www/treaties/en/documents/pdf/madrid_marks.pdf.

[43] Madrid Protocol of 1989, Art. 2; in addition, it is not possible to transfer any of the international applications to an IP holding company which is not domiciled in a contracting party of the Madrid Protocol: Art. 9-bis § 2.

[44] Madrid Agreement of 1891, Art. 1.

take advantage of the Protocol. While some countries, such as the British Virgin Islands[45], offer extremely attractive tax advantages, a trademark holding company located there would not be able to benefit from this system. By contrast, other countries which offer an attractive tax regime, such as Ireland, Luxembourg, and the Netherlands, are members of the Madrid Protocol.

Another class of intellectual asset, the ".eu" domain name, can be requested by any undertaking having its registered office, central administration or principal place of business within the European Union, or by any organisation established within the Union without prejudice to the application of national law, or by any natural person resident within the Union[46]. A European holding company owning a portfolio of ".eu" domain names could be created in order to allow an applicant established outside the EU to hold these domains.

It is also important to check the validity and effectiveness of the various IP transfers, particularly in the case of sublicences, which are a common and often necessary component of IP holding entities. A long chain of IP transfers makes it difficult to check whether the assignor or the IP licensor has a proper right to transfer its own right to another entity[47].

As a general precaution, it is advisable to ensure that the country of location of the holding company recognises the validity of the intellectual asset[48]. A legal opinion should be obtained to the effect that the IP right can be transferred to the holding company in compliance with legal rules, contractual provisions and the holding company's articles of association. The importance of such a check is made clear in an old Swiss case involving the holding company of a chocolate manufacturer[49]. The national trademark office opposed the transfer of the sole trademark to the holding company on the grounds of a rule, applicable at that time[50], which provided that only industrialists, other producers, and traders could register a trademark. Nevertheless, the Federal Supreme Court of Switzerland accepted this transaction by distinguishing two cases. It held that "only holding companies which are industrial companies of control (*Verwaltungsholding*) can claim this right and not financing companies, which are limited to taking equity in various companies of a group"[51]. The Swiss Federal Law of 28 August 1992, which repealed the Law of 1890, now provides that anyone can register a trademark[52]. This result is justified, since any legal personality, whatever its business purpose, should be entitled to own trademarks[53].

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[45] The rate of income tax for resident companies and individuals is at 0%.

[46] Regulation (EC) No 733/2002 of the European Parliament and of the Council of 22 April 2002 on the implementation of the .eu Top Level Domain, Art. 4: http://www.eurid.eu.

[47] Pierre-Yves Gautier, *Propriété littéraire et artistique*, 8^e ed., PUF, 2012, § 670; for an example of the difficulty of identifying the IP owner in the case of holding companies located in the Cayman Islands: Court of Cassation, 1^st civil chamber, 14 November 2012.

[48] Edward Siemens, *Offshore Company Law*, Academy & Finance, 2009, p. 176; Louise Gellman, *Trademarks and Tax Havens*, Trademark World, November 2007, p. 29.

[49] François Dessemontet, *La marque holding et la marque de groupe*, in *Marke und Marketing*, Berne 1990, p. 121.

[50] Swiss Federal Law of 26 September 1890, Art. 7.

[51] Federal Supreme Court of Switzerland, 29 November 1949 *Suchard Holding S. A. v Bureau fédéral de la propriété intellectuelle*, By Verwaltungs- und Disziplinarrecht, Registersachen no. 57, p. 340, http://www.servat.unibe.ch.

[52] Swiss Federal Law of 28 August 1992, Art. 28-1.

[53] D. C. Maday, *Trademark Rights of Holding Companies in Western Europe*, 68 Trademark Rep. 28 (1978).

2.2 Specific rules in US trademark law. An issue may also arise from the legal requirement that goodwill must be assigned with a trademark[54]. Under US trademark law[55], an assignment of a trademark is invalid if goodwill is not also assigned with the trademark[56]. The transfer of the trademark must be accompanied, in order to be valid, by the transfer of some assets to the assignee which enables the latter to produce the items or provide the services at the same level of quality, so that customers are not misled by the trademark as used by its new owner[57]. Thus, holding companies owning US trademarks should also own a portion of the assignor's business with which the trademark is associated, which may oblige a trademark holding company to own other assets, such as trade secrets, or to hire employees from the assignor[58].

2.3 Creators' interests. It should not be forgotten that the creators are the essential originators of the intellectual work, whatever the IP regime involved: copyright (in the case of artists, writers, composers, software developers) and patents (in the case of inventors), and trademarks as well, which are often the result of a creator's work (e.g., logos, advertising slogans, jingles, etc.). Authors, inventors, designers and performers generally do not participate in the formation and operation of the IP holding company, but their interests should be taken into account. In some legal systems, as under French copyright law[59], creators retain the right, for example, to be paid a percentage of the gross revenues of films. In that respect, legal counsel should identify how to reconcile their financial rights with the promoter's interests.

Creators' moral rights cannot be ignored either, but a holding company does not normally infringe such rights as it is merely a tax and/or financing tool. Authors and actors are always entitled to require recognition of their name and to protect the integrity of their creations.

It is also important for the promoter to inform the creators with whom it has entered into a contract that an IP asset may be used as security, because this transaction may have an indirect impact on third parties. Before setting up an IP holding company, the promoter should analyse solutions which are likely to merge creators' interests with their own.

A good example of a possible conflict between a creator and his contract counterpart (publisher or producer), which arose as a result of the formation of an international group of companies, is the litigation initiated in France by Albert Uderzo, the famous cartoonist who co-created *Asterix*, against his publisher *Dargaud*[60]. The latter created several subsidiaries in Europe whose purpose was to sub-publish the rights in their respective countries. The cartoonist alleged that the terms of his remuneration were unlawful under French author's rights rules because his royalties were subject to a deduction of the fees paid by *Dargaud* to the subsidiaries. According to Uderzo, such fees were in

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[54] Pamela Chestek, *Control of Trademarks by the Intellectual Property Holding Company*, Journal of Law and Technology, 2001, 41 J.L. & TECH. 1; Tamsen Valoir and Margreet Nijhof, *Tax-Speak for Intellectual Property Counsel*, Intellectual Property Today, January 2010, p. 30.

[55] See also the limitations in Australian trademark law: Mark J. Davison, Ann Louise Monotti and Leanne Wiseman, *Australian Intellectual Property Law*, Cambridge University Press, 2008, p. 170.

[56] See 15 U.S.C. § 1060 Lanham Act; Irene Calboli, *Trademark Assignment "With Goodwill": A Concept Whose Time Has Gone*, (2005), Faculty Publications, Paper 542, http://scholarship.law.marquette.edu/facpub/542.

[57] Russell L. Parr and Gordon V. Smith, *Intellectual Property: Valuation, Exploitation, and Infringement Damages*, Wiley, 2005 p. 43.

[58] See e.g. *Marshak v Green*, 505 F. Supp. 1054 (S.D.N.Y.1981); Neal Platt, *Good Will Enduring: How To Ensure That Trademark Priority Will Not Be Destroyed by the Sale of a Business*, 99 Trademark Rep. 788 (2009).

[59] This principle is, however, subject to several conditions: Art. L. 131-4 of the Intellectual Property Code, and Art. L. 132-6 § 2 of the same code: "Lump sum remuneration may also be paid for the assignment of rights by or to a person or enterprise established abroad".

[60] Court of Appeal, Paris, 9 September 1998, JCP G. 1999, II 10181 comm. A. Lucas; JCP E. 1999, p. 320, no. 5, obs. H.-J. Lucas; Court of Cassation, 1st civil chamber, 15 October 1996, JCP E. 1997, I, 683, obs. H.-J. Lucas.

fact compensation for artificial services. The case went on for several years and was delayed by *Dargaud*'s refusal to communicate the financial statements of its subsidiaries to Uderzo or to the legal expert. The Court of Appeal in Paris dismissed the complaint on the ground that there was no evidence that said structure had cheated Uderzo out of his economic rights. It ruled that the cartoonist had no right to criticise the policy of his publisher since he was not a shareholder. However, the final appeal was decided in favour of the author. The court held that the publisher had executed the contract with Uderzo in bad faith. The judge ordered the termination of the publishing contract and a significant amount of compensation for Uderzo with respect to the unlawful reduction of his royalties.

The largest number of lawsuits involving this type of abusive structure is found in the US and relates to what is known as "Hollywood accounting" (also known as "creative accounting")[61]. Recent cases have revealed that some studios, producers or distributors establish and control a separate company for the purpose of owning the copyright or simply collecting the royalties for each film[62]. The "film holding company" subsequently charges considerable fees to the co-contracting party of the creator. This basic structure – the details of which vary depending on the case – has the purpose of shifting the net profits from the film to the film holding company, while the studio or producer suffers losses. To optimise net profits, the film holding company is frequently located in an offshore jurisdiction. As a consequence of such a structure, a lesser amount of royalties than normal is paid to the creators.

A highly publicised case involved the principal writers and actors of the film *Crash*, who sued several companies which were, in reality, all owned and controlled by the two producers of the film. The court considered that the defendant companies were the alter egos of one another and were created to hide and divert the funds from the plaintiffs, such that their separate existence was artificial. It held that the producers of the film, which generated more than USD 100 million in global box office revenues yet made no "net profits", had engaged in inappropriate accounting methods[63]. The defendant companies were created with a view to manipulating the royalty base by increasing deductions or exclusions before royalties were calculated and paid[64].

Such abusive structures could be applied to any IP right. However, actions brought by creators of inventions or brands against IP holding companies seem to be less common. This does not mean that such lawsuits have not been filed, because complex legal disputes in IP are frequently settled out of court[65].

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[61] Edward Jay Epstein, *The Hollywood Economist: The Hidden Financial Reality Behind the Movies*, Melville House, 2012; John W. Cones, *The Feature Film Distribution Deal: A Critical Analysis of the Single Most Important Film Industry Agreement*, SIU Press, 1996, p. 4; Harold Vogel, *Entertainment Industry Economics: A Guide for Financial Analysis*, Cambridge University Press, 2010, p. 231.

[62] See e.g. Dawn C. Chmielewski, *Jury Orders Disney to Pay About $270 million to 'Millionaire' Creator*, Los Angeles Times, 8 July 2010; Ross Johnson, *Lord of the Rings*, The New York Times, 27 June 2005; Eriq Gardner, *Kevin Costner Sues to Collect 'Robin Hood' Money*, The Hollywood Reporter, 24 July 2012; in the music industry: *Cher, Sonny Bono sue Universal Music Group for Unpaid Royalties*, Daily Telegraph, 3 June 2009.

[63] Superior Court of the State of California, 26 July 2011: http://www.hollywoodreporter.com/sites/default/files/fraserruling.pdf; Eriq Gardner, *Paul Haggis, Brendan Fraser Win $12 Million From 'Crash' Producer Bob Yari*, The Hollywood Reporter, 21 December 2011; Ben Child, *Director Paul Haggis Wins Crash Lawsuit Against Producer*, The Guardian, 29 July 2011.

[64] To access the lawsuit: http://www.thewrap.com/movies/article/michael-moore-sues-weinstein-co-27-million-24515?page=0,0.

[65] Janet Wasko, *How Hollywood Works*, Sage, 2003, p. 101; Michael Moore recently complained through his production company that the company founded by the brothers Weinstein to own the copyright on *Fahrenheit 9/11* improperly deducted abusive fees from gross receipts: Xan Brooks, *Michael Moore and Harvey Weinstein settle Fahrenheit 9/11 dispute*, The Guardian, 16 February 2012.

In patent law, a UK case highlights the risk that, where there is a group of companies, the benefit to be derived from an invention may be shifted to an affiliate company, thus diminishing revenues for the actual employer and jeopardising the right of the employee to obtain fair compensation. In this case, Professor Shanks created an innovative blood-test for diabetes while working for a research company which assigned the patent on this invention to its parent company, Unilever Plc, for a modest amount of royalties. After years of not exploiting Shanks's invention, Unilever Plc licensed the patent to third parties, which resulted in royalties amounting to £23m. Professor Shanks sued Unilever Plc, as well as his employer and a Dutch subsidiary, for compensation under the Section 41 of Patents Act 1977, which provides "for the employee a fair share (having regard to all the circumstances) of the benefit which the employer has derived, or may reasonably be expected to derive, from the patent or from the assignment, assignation or grant to a person connected with the employer". Shanks argued that this section referred not to the actual benefit, i.e. the licence fees of £23 million, but to an arm's length assignment of the patents on the open market, which would generate a larger amount of royalties. However, the Court of Appeal ruled that, under the Patents Act, "the amount of any benefit derived or expected to be derived by an employer from the assignment" meant the actual benefit received by the assignor[66]. Therefore, the UK case law is that the employee's rights to a share of patent benefits relates to actual revenue obtained by employer and not what the employer might have earned. Nevertheless, it is clear that inventors are entitled to make a claim for a share of the benefit earned by the subsidiaries of the employer.

Obviously, IP holding companies should not be used for the fraudulent transfer of the IP rights or royalties of creators. The relative secrecy of such entities, for example, when they are domiciled in an offshore jurisdiction which has no public company register or official IP register, and where their purpose is to isolate the intellectual assets from the promoter, is legally suspect[67].

Even if the creator is not a shareholder in the IP holding company, he should be considered as a stakeholder. The concept of "stakeholder" includes individuals or groups whose interests are impacted by the activities of the company[68]. Stakeholders' interests should always be considered with a view to generating general profits and avoiding any risk of litigation. It is therefore advisable to include in the IP licence contractual provisions by which the creator is granted a right to be informed about new licences and sublicences and a right to request information about specific contractually-stipulated matters. An IP holding company should also consider fair methods for rewarding outstanding contributions made by creators.

In return for these prerogatives, the creator should have contractual obligations, such as providing information about his new creative works, and should respect the principle of confidentiality as regards the activity of the holding company. The creator should also be obliged to respect the right of the IP holding company to exploit the IP, even if he originally contracted only with the promoter. The IP holding company's right of exploitation is indisputable if, for example, the contract between the creator and the promoter specifies that the licence of the IP provided by the creator may be extended to subsidiaries and affiliates of the licensee.

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[66] *Shanks v Unilever* EWCA Civ 1283, [2011] R.P.C. 12, High Court of Justice, Court of Appeal, Civil Division, 20 October 2010. The case is still pending following a substantive hearing held last year on whether the amounts Unilever had actually earned were "outstanding" and hence whether Professor Shanks was entitled to an award.

[67] For examples of US case law on alleged IP fraudulent transfers involving operating companies and IP holding companies see: *1st Technology LLC v Bodog Entertainment Group S.A. and Bodog IP Holdings Ltd.*, US District Court Western of Washington, http://www.newmanlaw.com; *Herbert Richter Metall Waren-Apparatebau GMBH v GIB Service LLC*, 2011 WL 2517232 (E.D. Va., Slip Copy, 4 June 2011).

[68] Christine Mallin, *Corporate Governance*, 2nd ed., Oxford, 2007, p. 49.

2.4 The IP holding company as victim of IP infringement. It will always be necessary to determine who the IP owner is. This can be a tricky operation, given the complexity of international corporate structures. The use of an IP holding company does not necessarily help to identify the IP owner because of the large number of contracts governing the structure and the complex legal characterisation of these contracts. There may be several IP owners if a co-ownership is executed between the IP holding company and another party. Legal standing to sue for IP infringement will normally depend on the law applicable to the co-ownership agreement[69].

IP holding companies also use licenses, sublicenses and co-ownership agreements which blur the identity of the IP owner. The IP holding company should be granted a clear right to intervene and enforce the IP rights it owns. IP counsel should investigate the validity of the IP ownership and the nature of the entity owning the IP as well as licensing and other arrangements involving the IP, including between related entities. In this context, the entity having legal standing to enforce the patents in the event of acts of infringement should be identified: is it the operating company or the holding company, or both?[70] The solution provided by national laws usually depends on the ownership or the exclusive or non-exclusive nature of the licence or sublicence[71]. In order to enable the IP holding company to sue infringers, the IP rights should be assigned or exclusively licensed to this entity – typically, a non-exclusive licence is not enough.

2.5 The IP holding company as IP infringer. A holding company is a separate legal person from its promoter. As a result, if the promoter sells products that infringe IP rights, the IP owners can, in principle, only sue the promoter, not the holding company. However, separate liability may not be justified when the separate legal personality is deemed artificial because both entities are essentially controlled and managed by the same company.

Under US law, in extraordinary circumstances, one company can be held liable for the torts or infringements of another company. Indeed, under the Veil Piercing Doctrine, a parent company can be held personally responsible for the acts of its subsidiary when the latter is held not to have a separate identity[72]. This theory has been applied by the US courts to find parent companies liable for acts of IP infringement committed by their subsidiaries[73].

Similarly, under French law, a parent company can be held jointly and severally liable for the debts of its subsidiaries where there is management interference in the directly infringing entity[74]. However, there is little case law with regard to IP infringement[75].

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[69] Under French law: Art. L. 613-29 CPI.

[70] Paul Dau, Paul Devinsky and Justin Hill, *Intellectual Property Holding Companies: Tax Panacea or IP Mistake?* January 2008, Vol. 10, http://www.mwe.com; Robert A. Matthews, *A Potential Hidden Cost of a Patent-Holding Company: The Loss of Lost-Profit Damages*, 32 AIPLA Q. J. 503 2004.

[71] E.g., under UK law: Patents Act 1977, c. 37, s. 67 (1); in French law, under Art. L. 716-5, paragraphs 1 and 2, of the Intellectual Property Code; under US law, when a patent is exclusively licensed, the exclusive licensee must join with the patentee in suing the patent infringer, unless it contractually agrees to be bound by the decision in an action that the patentee brings: see Robert A. Matthews, *Annotated Patent Digest* § 9:41 (2012); same author: *Legal Nuances when a Patentholding Company Seeks to Enforce a US Patent*, 49 IDEA-The Intellectual Property Law Review 549 (2009); Patrick O'Reilley, *Nouvelles de l'étranger: Récents développements en droit américain de la propriété intellectuelle*, Propriétés intellectuelles 2005, p. 368; US District Court, D. New Jersey, 804 F.Supp. 614 (1992), *Ciba-Geigy Corp. v Alza Corp*.

[72] Supreme Court of the US, 524 US L. Ed. 2d 43 (1998), *US v Bestfoods.*

[73] *Streck, Inc. v Research & Diagnostic Sys., Inc*., 2010 WL 3926059, (D. Neb. 30 September 2010); *A. Stucki Co. v Worthington Industries, Inc.,* 849 F.2d 593, 596 (Fed.Cir.1988): ruling that a holding company's ability to control a subsidiary and stop alleged infringement required liability to be imputed to the parent.

[74] On the concept of "*immixtion"* (interference): Pierre-Yves Gautier, RTD Civ. 1994, p. 881.

Regarding an issue of exhaustion of rights, a UK case[76] involved Revlon Inc., the American parent company of Revlon Suisse S.A. which acquired the trademarks on shampoos from its parent. Revlon Inc. manufactured and sold the shampoos in the US, whereas in the UK these products were sold by a UK subsidiary. The shampoos in the US were unsuccessful and were donated to a charity that subsequently sold them to others who marketed the shampoos in the UK. The shampoos were also marked to indicate that they originated from the same group of companies. The Court of Appeal in London decided that the registered owners and users of the mark in the United Kingdom could not prevent the sale of the US shampoos in the UK on the basis of trademark infringement because every company in the Revlon group was subject to the control of the US parent company. Since the parent company could not stop the parallel importation, subsidiaries of the Revlon group were not entitled to do so either. The court ruled that "since, however, all the relevant companies are wholly owned subsidiaries of Revlon Inc., it is undoubted that the mark is, albeit remotely, an asset of Revlon and its exploitation is for the ultimate benefit of no one but Revlon […] The mark is an asset of the Revlon group of companies regarded as a whole, which all belong to Revlon". The Court observed that "this does not constitute piercing the veil but recognises the legal and factual relationship between the companies".

Finally, it is clear from the US, French and UK case law that the principle of distinct personality and responsibility remains intact. The Veil Piercing Doctrine is applied by judges in extraordinary cases and should not be relied upon as a sure-fire strategy.

Concluding remarks

It appears that the interaction between tax law and IP law provides practical solutions forged for optimizing tax liabilities of creators and innovative companies. Forming an IP holding company is one of these solutions.

By offering a flexible legal framework and solid financial experience, certain countries provide an opportune location for IP holding companies. IP holding companies are useful and even sometimes vital to intellectual asset owners if they are to increase their return on investment. Since the effective tax rate is over 20% in most EU countries, and is even higher in the US, many entrepreneurs have the impression that they have to be creative to reduce their taxes to a lower rate in order to be more competitive with other companies. In the context of a globalised economy, tax planning is not merely an opportunity; it is an economic necessity.

However, the friction between tax advantages and IP constraints should lead to reconsider the implementation of IP holding companies. In some sense, these crown jewels are too important to be left only to accountants and tax consultants who need legal assistance with the development, maintenance and defence of intellectual assets. The activities of major IP holders must be harnessed to produce IP that reflects companies' long-term business planning and strategic goals. As for the management and development of IP portfolios, it is preferable for IP counsel and creators to communicate regularly with those in the business who are informed about the company's technological developments and product pipeline, as well as its strategic goals. Thus, the company's IP counsel should meet regularly with the heads of product development, marketing, business

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[75] Court of Appeal, Paris, 23 May 2007, *France Telecom, Wanadoo E. Merchant v Syndicat de la Librairie française*, JCP E. 2008, obs. Sophie Alma-Delettre: the joint and several liability between the company and its parent was not found in this case involving unfair competition because of a lack of interference.

[76] *Revlon Inc v Cripp & Lee Ltd*, 1980, FSR 85; Neil J. Wilkof, *Trade Mark Licensing*, 2nd ed., Sweet & Maxwell, 2005, p. 364.

development, general counsel, tax advisers, and even the CEO, so as to build and maintain an IP portfolio that provides the company with all IP advantages.

Finally, there is another force at work that will also lead to pressure on IP holding companies: reputational risks for multinationals or famous creators that use tax havens like Bermuda or the Caymans as IP holding company jurisdictions. No tax at all is paid in these sunny islands and journalists have found it out. From their publications, a wave of criticism has arisen, first amongst members of parliament in several countries, but soon after also amongst the general public. Since some innovative enterprises refuse to pay their fair share of taxes and because the tax burden is shifted to smaller business and private individuals, their products have been boycotted. Starbucks was the first victim in the UK of this new hostile approach, caused by the financial crisis, and has succumbed to the pressure by publicly agreeing to pay tax. In this context, will IP holding company jurisdictions lose their attractiveness due to the public demands for tax transparency?