[¶ 4742F] Capital Gain or Loss Treatment for Terminations

• • *CCH Explanation*

.04 Lapse, cancellation or abandonment.—The capital gain and loss provisions of the Internal Revenue Code apply only if there is a sale or exchange of a capital asset. Court decisions have interpreted this requirement to mean that, when a disposition is not a sale or exchange of a capital asset, but is, for example, a lapse, cancellation, or abandonment, the disposition produces ordinary income or loss. See *M. Leh*, CA-9, 58-2 USTC ¶ 9889, 260 F2d 489, and *Pittston Co.*, CA-2, 58-1 USTC ¶ 9284, 252 F2d 344, cert. denied, 357 U. S. 919, at ¶ 4717.431 and .4865. As a result, losses from the termination, cancellation, lapse, abandonment or other disposition of property that are not sales or exchanges of property could be reported as fully deductible ordinary losses instead of as capital losses. This technique has been used in situations involving cancellations of forward contracts for currency or securities.

The Economic Recovery Tax Act of 1981 eliminates the use of this technique. It provides that gains or losses attributable to the cancellation, lapse, expiration, or other termination of a right or obligation with respect to personal property that is, or that would be if acquired, a capital asset in the hands of the taxpayer are treated as gains or losses from the sale of a capital asset. Property subject to this rule includes personal property as defined in Code Sec. 1092(d)(1) (see ¶ 4691B).

This provision applies to property acquired and positions established by the taxpayer after June 23, 1981, in taxable years ending after that date.—CCH.

[¶ 4743] SALE OR EXCHANGE OF PATENTS

'54 Code

Sec. 1235 [1954 Code]. (a) GENERAL.—A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than one year * regardless of whether or not payments in consideration of such transfer are—

(1) payable periodically over a period generally coterminous with the transferee's use of the patent, or

(2) contingent on the productivity, use, or disposition of the property transferred.

(b) "HOLDER" DEFINED.—For purposes of this section, the term "holder" means—

(1) any individual whose efforts created such property, or

(2) any other individual who has acquired his interest in such property in exchange for consideration in money or money's worth paid to such creator prior to actual reduction to practice of the invention covered by the patent, if such individual is neither—

(A) the employer of such creator, nor

(B) related to such creator (within the meaning of subsection (d)).

* The Tax Reform Act of 1976 increased the holding period from more than 6 months to more than 9 months for tax years beginning in 1977 and to more than one year for tax years beginning after 1977.

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'54 Code

(c) EFFECTIVE DATE.—This section shall be applicable with regard to any amounts received, or payments made, pursuant to a transfer described in subsection (a) in any taxable year to which this subtitle applies, regardless of the taxable year in which such transfer occurred.

(d) RELATED PERSONS.—Subsection (a) shall not apply to any transfer, directly or indirectly, between persons specified within any one of the paragraphs of section 267(b); except that, in applying section 267(b) and (c) for purposes of this section—

(1) the phrase "25 percent or more" shall be substituted for the phrase "more than 50 percent" each place it appears in section 267(b), and

(2) paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants.

(e) CROSS REFERENCE.—

For special rule relating to nonresident aliens, see section 871(a).

.01 Amended by P. L. 94-455 and P. L. 85-866. For details, see the Code Volumes.

.05 Committee Reports on P. L. 94-455 are at 1976-3 CB 49, 695, 807.

.10 Committee Reports on P. L. 85-866 are at 1958-3 CB 842, 899, 999.

.15 Committee Report on P. L. 629, which added subsection (q) to 1939 Code Sec. 117, is at 1956-2 CB 1226.

.20 Committee Reports on 1954 Code Sec. 1235 as originally enacted were reproduced at 564 CCH ¶ 4743.20-4743.21.

• *Regulations*

[¶ 4744] § 1.1235-1. **Sale or exchange of patents.**—(a) *General rule.* Section 1235 provides that a transfer (other than by gift, inheritance, or devise) of all substantial rights to a patent, or of an undivided interest in all such rights to a patent, by a holder to a person other than a related person constitutes the sale or exchange of a capital asset held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), whether or not payments therefor are—

(1) Payable periodically over a period generally coterminous with the transferee's use of the patent, or

(2) Contingent on the productivity, use, or disposition of the property transferred.

(b) *Scope of section 1235.* If a transfer is not one described in paragraph (a) of this section, section 1235 shall be disregarded in determining whether or not such transfer is the sale or exchange of a capital asset. For example, a transfer by a person other than a holder or a transfer by a holder to a related person is not governed by section 1235. The tax consequences of such transfers shall be determined under other provisions of the internal revenue laws.

(c) *Special rules*—(1) *Payments for infringement.* If section 1235 applies to the transfer of all substantial rights to a patent (or an undivided interest therein), amounts received in settlement of, or as the award of damages in, a suit for compensatory damages for infringement of the patent shall be considered payments attributable to a transfer to which section 1235 applies to the extent that such amounts relate to the interest transferred. For taxable years beginning before January 1, 1964, see section 1304, as in effect before such date, and § 1.1304a-1 for treatment of compensatory damages for patent infringement.

(2) *Payments to an employee.* Payments received by an employee as compensation for services rendered as an employee under an employment contract requiring the employee to transfer to the employer the rights to any invention by such employee are not attributable to a transfer to which section 1235 applies. However, whether payments received by an employee from his employer (under an employment contract or otherwise) are attributable to

[¶ 4744]—Continued

the transfer by the employee of all substantial rights to a patent (or an undivided interest therein) or are compensation for services rendered the employer by the employee is a question of fact. In determining which is the case, consideration shall be given not only to all the facts and circumstances of the employment relationship but also to whether the amount of such payments depends upon the production, sale, or use by, or the value to, the employer of the patent rights transferred by the employee. If it is determined that payments are attributable to the transfer of patent rights, and all other requirements under section 1235 are met, such payments shall be treated as proceeds derived from the sale of a patent.

(3) *Successive transfers.* The applicability of section 1235 to transfers of undivided interest in patents, or to successive transfers of such rights, shall be determined separately with respect to each transfer. For example, X, who is a holder, and Y, who is not a holder, transfer their respective two-thirds and one-third undivided interests in a patent to Z. Assume the transfer by X qualifies under section 1235 and that X in a later transfer acquires all the rights with respect to Y's interest, including the rights to payments from Z. One-third of all the payments thereafter received by X from Z are not attributable to a transfer to which section 1235 applies.

(d) *Payor's treatment of payments in a transfer under section 1235.* Payments made by the transferee of patent rights pursuant to a transfer satisfying the requirements of section 1235 are payments of the purchase price for the patent rights and are not the payment of royalties.

(e) *Effective date.* Amounts received or accrued, and payments made or accrued, during any taxable year beginning after December 31, 1953 and ending after August 16, 1954, pursuant to a transfer satisfying the requirements of section 1235, whether such transfer occurred in a taxable year to which the Internal Revenue Code of 1954 applies, or in a year prior thereto, are subject to the provisions of section 1235.

(f) *Nonresident aliens.* For the special rule relating to nonresident aliens who have gains arising from a transfer to which section 1235 applies, see section 871 and the regulations thereunder. For withholding of tax from income of nonresident aliens, see section 1441 and the regulations thereunder [Reg. § 1.1235-1.]

.01 Historical Comment: Proposed 5/9/56. Adopted 11/5/57 by T. D. 6263. Amended 6/1/66 by T. D. 6885 to reflect enactment of Code Secs. 1301-1305 by P. L. 88-272. Amended 10/31/80 by T. D. 7728 to reflect P. L. 94-455. The Preamble to T. D. 7728 is at 80(10) CCH ¶ 6824A.

• *Regulations*

[¶ 4744A] § 1.1235-2. Definition of terms.—For the purposes of section 1235 and § 1.1235-1—

(a) *Patent.* The term "patent" means a patent granted under the provisions of title 35 of the United States Code, or any foreign patent granting rights generally similar to those under a United States patent. It is not necessary that the patent or patent application for the invention be in existence if the requirements of section 1235 are otherwise met.

(b) *All substantial rights to a patent.* (1) The term "all substantial rights to a patent" means all rights (whether or not then held by the grantor) which are of value at the time the rights to the patent (or an undivided interest therein) are transferred. The term "all substantial rights to a patent" does not include a grant of rights to a patent—

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(i) Which is limited geographically within the country of issuance;

(ii) Which is limited in duration by the terms of the agreement to a period less than the remaining life of the patent;

(iii) Which grants rights to the grantee, in fields of use within trades or industries, which are less than all the rights covered by the patent, which exist and have value at the time of the grant; or

(iv) Which grants to the grantee less than all the claims or inventions covered by the patent which exist and have value at the time of the grant.

The circumstances of the whole transaction, rather than the particular terminology used in the instrument of transfer, shall be considered in determining whether or not all substantial rights to a patent are transferred in a transaction.

(2) Rights which are not considered substantial for purposes of section 1235 may be retained by the holder. Examples of such rights are:

(i) The retention by the transferor of legal title for the purpose of securing performance or payment by the transferee in a transaction involving transfer of an exclusive license to manufacture, use, and sell for the life of the patent:

(ii) The retention by the transferor of rights in the property which are not inconsistent with the passage of ownership, such as the retention of a security interest (such as a vendor's lien), or a reservation in the nature of a condition subsequent (such as a provision for forfeiture on account of nonperformance).

(3) Examples of rights which may or may not be substantial, depending upon the circumstances of the whole transaction in which rights to a patent are transferred, are:

(i) The retention by the transferor of an absolute right to prohibit sublicensing or subassignment by the transferee;

(ii) The failure to convey to the transferee the right to use or to sell the patent property.

(4) The retention of a right to terminate the transfer at will is the retention of a substantial right for the purposes of section 1235.

(c) *Undivided interest.* A person owns an "undivided interest" in all substantial rights to a patent when he owns the same fractional share of each and every substantial right to the patent. It does not include, for example, a right to the income from a patent, or a license limited geographically, or a license which covers some, but not all, of the valuable claims or uses covered by the patent. A transfer limited in duration by the terms of the instrument to a period less than the remaining life of the patent is not a transfer of an undivided interest in all substantial rights to a patent.

(d) *Holder.* (1) The term "holder" means any individual—

(i) Whose efforts created the patent property and who would qualify as the "original and first" inventor, or joint inventor, within the meaning of title 35 of the United States Code, or

(ii) Who has acquired his interest in the patent property in exchange for a consideration paid to the inventor in money or money's worth

[¶ 4744A]—Continued

prior to the actual reduction of the invention to practice (see paragraph (e) of this section), provided that such individual was neither the employer of the inventor nor related to him (see paragraph (f) of this section). The requirement that such individual is neither the employer of the inventor nor related to him must be satisfied at the time when the substantive rights as to the interest to be acquired are determined, and at the time when the consideration in money or money's worth to be paid is definitely fixed. For example, if prior to the actual reduction to practice of an invention an individual who is neither the employer of the inventor nor related to him agrees to pay the inventor a sum of money definitely fixed as to amount in return for an undivided one-half interest in rights to a patent and at a later date, when such individual has become the employer of the inventor, he pays the definitely fixed sum of money pursuant to the earlier agreement, such individual will not be denied the status of a holder because of such employment relationship.

(2) Although a partnership cannot be a holder, each member of a partnership who is an individual may qualify as a holder as to his share of a patent owned by the partnership. For example, if an inventor who is a member of a partnership composed solely of individuals uses partnership property in the development of his invention with the understanding that the patent when issued will become partnership property, each of the inventor's partners during this period would qualify as a holder. If, in this example, the partnership were not composed solely of individuals, nevertheless, each of the individual partners' distributive shares of income attributable to the transfer of all substantial rights to the patent or an undivided interest therein, would be considered proceeds from the sale or exchange of a capital asset held for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977).

(3) An individual may qualify as a holder whether or not he is in the business of making inventions or in the business of buying and selling patents.

(e) *Actual reduction to practice.* For the purposes of determining whether an individual is a holder under paragraph (d) of this section, the term "actual reduction to practice" has the same meaning as it does under section 102(g) of title 35 of the United States Code. Generally, an invention is reduced to actual practice when it has been tested and operated successfully under operating conditions. This may occur either before or after application for a patent but cannot occur later than the earliest time that commercial exploitation of the invention occurs.

(f) *Related person.* (1) The term "related person" means one whose relationship to another person at the time of the transfer is described in section 267(b), except that the term does not include a brother or sister, whether of the whole or the half blood. Thus, if a holder transfers all his substantial rights to a patent to his brother or sister, or both, such transfer is not to a related person.

(2) If, prior to September 3, 1958, a holder transferred all his substantial rights to a patent to a corporation in which he owned more than 50 percent in value of the outstanding stock, he is considered as having transferred such rights to a related person for the purpose of section 1235. On the other hand, if a holder, prior to September 3, 1958, transferred all his substantial rights to a patent to a corporation in which he owned 50 percent or less in value of the outstanding stock and his brother owned the remaining stock, he is not considered as having transferred such rights to a related person since the brother relationship is to be disregarded for purposes of section 1235.

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(3) If, subsequent to September 2, 1958, a holder transfers all his substantial rights to a patent to a corporation in which he owns 25 percent or more in value of the outstanding stock, he is considered as transferring such rights to a related person for the purpose of section 1235. On the other hand if a holder, subsequent to September 2, 1958, transfers all his substantial rights to a patent to a corporation in which he owns less than 25 percent in value of the outstanding stock and his brother owns the remaining stock, he is not considered as transferring such rights to a related person since the brother relationship is to be disregarded for purposes of section 1235.

(4) If a relationship described in section 267(b) exists independently of family status, the brother-sister exception, described in subparagraphs (1), (2), and (3) of this paragraph, does not apply. Thus, if a holder transfers all his substantial rights to a patent to the fiduciary of a trust of which the holder is the grantor, the holder and the fiduciary are related persons for purposes of section 1235(d). (See section 267(b)(4).) The transfer, therefore, would not qualify under section 1235(a). This result obtains whether or not the fiduciary is the brother or sister of the holder since the disqualifying relationship exists because of the grantor-fiduciary status and not because of family status. [Reg. § 1.1235-2.]

.01 Historical Comment: Proposed 5/9/56. Adopted 11/5/57 by T. D. 6263. Amended 7/1/59 by T. D. 6394 to reflect P. L. 85-866. Amended 10/5/65 by T. D. 6852 to clarify the treatment of income from transfers of patent rights. A corresponding amendment was made to Reg. 118, § 39.117(q)-2(b)(1), applicable under the 1939 Code. Amended 10/31/80 by T. D. 7728 to reflect P. L. 94-455. The Preamble to T. D. 7728 is at 80(10) CCH ¶ 6824A.

[¶ 4745] Gains from Certain Sales or Exchanges of Patents

• • *CCH Explanation*

.04 Scope of Sec. 1235.—If an inventor or other "holder" transfers a patent under the conditions mentioned at .05, below, but capital gains treatment is denied because the transfer is made, for example, to a related party, is capital gains treatment available under any other provision of the Code? The Regulations (Reg. § 1.1235-1(b) at ¶ 4744) provide that if Code Sec. 1235 does not apply because a transfer is made to a related person, the tax consequences of the transfer are to be determined under other provisions of the Code.

Capital gains treatment is available for transfers of patent rights under other Code sections when Code Sec. 1235 does not apply (Rev. Rul. 69-482, 1969-2 CB 164; *D. C. MacDonald*, 55 TC 840, Dec. 30,665). See, also, ¶ 4729.405.

When an inventor sells his patent on a royalty basis to a corporation in which he owns stock, he has two possibilities of obtaining capital gain. This is because Code Sec. 1235 permits long-term capital gain on an inventor's transfer on a royalty basis to a corporation so long as he does not own, directly or indirectly, 25% or more of the corporation's outstanding stock. And Code Sec. 1239 prescribes ordinary income tax treatment for gain from the sale of depreciable property between an individual and a corporation in which he and/or his spouse own 80% or more of the outstanding stock. Thus, an inventor who owns 25% or more of a corporation's stock and who is therefore admittedly disqualified from the long-term capital gain treatment permitted by Code Sec. 1235 could still seek capital gain treatment under other Code provisions so long as he or specified relatives do not own 80% or more of the corporation's stock. The Regu-

Gains from Certain Sales or Exchanges of Patents

[¶ 4745.04]—Continued

• • *CCH Explanation*

lations state that "a transfer by a holder to a related person is not governed by section 1235" and is determined under other provisions of the internal revenue laws. The IRS has reaffirmed this position; it states in Rev. Rul. 69-482 (.56, below) that the Tax Court decision in *Poole* (.56, below), in which the court took the position that Code Sec. 1235 is the only recourse available to an inventor to obtain long-term capital gain upon the sale of a patent on a royalty basis, will not be followed.

The special benefits under Code Sec. 1235 do not apply to transfers of patents by nonholders. Thus, the tax consequences of the sale of patents by nonholders, such as corporations or the inventor's employer, are governed by other provisions of the Code. Similarly, if a patent is a capital asset under Code Sec. 1221, and if its transfer does not fall within the scope of Sec. 1235, the question of whether profit is capital gain or ordinary income depends upon whether there has been a "sale or exchange" as explained at ¶ 4717.43 and following. Similarly, if a patent is used in a trade or business and its transfer does not fall within the scope of Sec. 1235, capital gain could be realized under Code Sec. 1231 from the sale or exchange of a depreciable property used in the trade or business. And if a transfer of a patent which is held for sale in the ordinary course of a trade or business is outside the scope of Code Sec. 1235, ordinary income will be realized under Code Secs. 61 and 1221.

.05 Individuals allowed capital gains benefits.—Code Sec. 1235 makes long-term capital gains treatment applicable in specified cases to gain on the transfer (other than by gift, inheritance or devise) of all substantial rights to a patent or of an undivided interest therein (Reg. § 1.1235-2(b), (c)). It is available to the inventor, amateur or professional, regardless of how short a time he has held the patent. The retroactive enactment of these provisions has been held not to create a new claim against the United States for which suit would be governed by the six-year limitation period; the three-year period applicable to tax refund suits applies. See ¶ 5473.408.

The capital gains benefits are not available when a patent is transferred to a related person described in Code Sec. 267(b), except that brothers and sisters are not to be considered as related persons. A "25 percent or more" stock ownership test is substituted for the "50 percent or more" test in Sec. 267(b) in determining whether a corporation is a related person. In applying the constructive stock ownership rules of Sec. 267(c), an individual's family includes only his spouse, ancestors and lineal descendants—not his brothers and sisters. Sec. 1249 governs the sale of a patent to a controlled foreign corporation. See ¶ 4773CC.01.

The capital gains benefits are available also to an *individual* who acquired his interest from the original inventor for money or money's worth prior to actual reduction of the invention to practice. The other individual, however, may not be the inventor's employer or a related person described in Code Sec. 267(b), except brothers and sisters.

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Gains from Certain Sales or Exchanges of Patents

• • *CCH Explanation*

The patent or patent application for the invention need not be in existence, according to Reg. § 1.1235-2(a) (¶ 4744A), if the requirements of Code Sec. 1235 are otherwise met. Apparently, therefore, the term "patent" includes "invention." This is supported by the fact that the Regulations provide that a person may qualify as a "holder" whether or not he is in the business of "making inventions" or in the business of buying and selling patents. The Regulations could be interpreted, however, as requiring that a patent must eventually come into existence. The Tax Court has held (.18, below) that percentage payments received for the transfer of ownership of an unpatented invention were capital gains, overruling the Commissioner's contention that ownership of the invention could not be transferred because it had not been patented. The Commissioner acquiesced in this holding.

The Court of Appeals for the Fifth Circuit (.70, below) holds that secret formulas and trade names are sufficiently akin to patents to warrant the application, by analogy, of the tax law that has been developed relating to the transfer of patent rights, in tax cases involving transfers of secret formulas and trade names.

Partnerships cannot qualify for the capital gains treatment. However, Reg. § 1.1235-2(d) provides that each partner who is an individual can qualify for capital gains treatment as to his share of a patent owned by the partnership. Each individual partner's distributive share of income from the transfer of all substantial rights to a patent or an undivided interest therein would be capital gains.

Payments received for a transfer within the scope of Sec. 1235 are capital gains, even though they are to be made periodically during the transferee's use of the patent, or are to be contingent on the productivity, use, or other disposition of the transferee's rights in the patent. The Regulations, § 1.1235-1(c), state that if Code Sec. 1235 applies to a transfer, damages for infringement for the period after the transfer are also capital gains under Sec. 1235. Payments received by an employee as compensation under an employment contract requiring him to transfer a patent to his employer are not capital gains.

A transferee's payments which are capital gains to the transferor under Code Sec. 1235 are payments of the purchase price for the patent rights. See Reg. § 1.1235-1(d).

.051 All substantial rights or undivided interest.—Capital gain benefits for payments received for transfer of a patent under Code Sec. 1235 apply only if "all substantial rights" or an "undivided interest" therein are transferred.

The Tax Court and the IRS agree that capital gain treatment is available on the sale of all of the patent rights held by the seller even though non-exclusive rights in the patent are outstanding. Thus a taxpayer who purchased all of the rights in a patent remaining after the grant of a non-exclusive license could obtain capital gain treatment of the resale of all of his rights. (See *MacDonald*, .404, below.)

"All substantial rights to a patent", according to the Regulations, means all rights (whether or not then held by the grantor) which are of value at the time the rights to the patent (or an undivided interest in it) are transferred. Reg. § 1.1235-2(b)(1) denies capital gain treat-

Gains from Certain Sales or Exchanges of Patents

[¶ 4745.051]—Continued

• • *CCH Explanation*

ment to any patent grant which is limited geographically within the country of issuance, which is limited in duration by the terms of an agreement to a period less than the remaining life of the patent, or which has a field of use restriction.

The circumstances surrounding the entire transaction, rather than the particular terminology used in the instrument of transfer, will be considered in determining whether all substantial rights to a patent have, in fact, been transferred. Rights which may be retained by the transferor, because they are not "substantial," include: (1) retention of legal title to secure performance or payment by the transferee in a transaction involving transfer of an exclusive license to manufacture, use and sell for the life of the patent and (2) retention of a security interest such as a vendor's lien, or a reservation in the nature of a condition subsequent, such as a provision for forfeiture because of nonperformance. See Reg. § 1.1235-2(b)(3) for rights which may or may not be substantial.

In regard to a transfer to which Code Sec. 1235 did not apply because it was made by a corporation, the IRS has ruled that a sale of a patent by a company that was not a dealer in patents was a sale of property used in a trade or business under Code Sec. 1231 even though the patent was subject to a nonexclusive, royalty-free license acquired by an unrelated party from a prior owner of the patent (Rev. Rul. 78-328, 1978-2 CB 215). See ¶ 4729.405.

An "undivided interest" in a patent consists of ownership of a fraction of the whole patent and of a share in each of the substantial rights under the patent equal to that fraction. It does not include a right to the income from a patent, or a license limited geographically, or a license covering less than all of the valuable claims or uses covered by the patent. A transfer limited in duration by the terms of the instrument to a period less than the remaining life of the patent is not a transfer of an undivided interest in all substantial rights to a patent.

.07 Loss on sale of patents.—The law states that a "transfer [of all substantial rights to a patent] shall be considered the sale or exchange of a capital asset held for more than one year" (after 1977). Therefore, losses on the sale of a patent or patent application are long-term capital losses if the transaction is one described in .05, above.

The tax consequences of a loss on a transfer of a patent by a holder which fails to qualify within the scope of Sec. 1235 (for instance, because it is made to a related party) would be governed by other provisions of the Code. For example, losses on the sale or exchange of a patent under conditions or between parties not coming within the scope of Sec. 1235 are either ordinary losses or capital losses, depending on the nature of the asset in the hands of the seller and whether or not the transfer is a sale or exchange. A patent application, for example, is not depreciable and, therefore, is not a Sec. 1231 asset. It is a capital asset. A patent, however, is depreciable and the courts have held that granting the right to another to use the patent and receiving royalties therefor, even though they are only minimum royalties, is a trade or business (*Harvey*, (CA-9) 49-1 USTC ¶ 9124, 171

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Gains from Certain Sales or Exchanges of Patents

• • *CCH Explanation*

F. 2d 952). Therefore, a patent is a Sec. 1231 asset and, if sold at a loss, is deductible as an ordinary loss if and to the extent that it is not offset by Sec. 1231 gains on sales or exchanges in the taxable year.—CCH.

• • • *Annotations by Topic*

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.12 Assignment to licensee.—The owner of a patent assigned it to the holder of a non-exclusive license, his controlled corporation, for a nominal consideration "upon condition" that, during the assignor's lifetime, the assignee continue payment of the royalties specified in the licensing agreement. The continued payments were proceeds from the sale of the patent, a capital asset, and therefore capital gain.

H. W. Taylor, 16 TC 376, Dec. 18,125 (Nonacq.).

.14 Contract right to royalty payments.—Stockholders who, in consideration for the surrender of their stock, received a contract right to royalty payments accruing to the corporation under licensing agreements had no proprietary interest in the patents. A settlement agreement was not a sale or exchange and payments received were ordinary income.

L. F. Levy, (DC) 60-1 USTC ¶ 9214.

.15 Controlled corporation as buyer.—See ¶ 4757.35. For controlled foreign corporations, see ¶ 4773Z.

.17 Dividends v. sale proceeds.—Royalties received by taxpayer from a controlled corporation to which he had transferred all rights to his patents were capital gains, and not disguised dividends. Provisions for termination of the agreement were not inconsistent with a sale. However, proceeds received by the corporation in settlement of a suit against a third party for patent infringement, and turned over by it to the taxpayer, were dividends.

F. H. Magnus, (CA-3) 58-2 USTC ¶ 9853, 259 F. 2d 893.

Similarly.

E. A. Neugass, (DC) 59-1 USTC ¶ 9310.

.18 Employee.—Percentage payments received by an individual from his employer-corporation, to which he had transferred complete ownership of an invention which he had perfected but not patented, were part of the purchase price of the patent, rather than compensation, and were long-term capital gain, the taxpayer having worked on the invention for many years and having made drawings and models more than one year before the sale.

F. E. Speicher, 28 TC 938, Dec. 22,519 (Acq.).

Capital gain treatment was allowed on payments received by an employee in exchange for inventions assigned to his employer, where the employee, as a condition of his employment, had signed an agreement assigning to his employer all property rights in inventions conceived by him during the course of his employment.

T. G. Hill, 22 TCM 1056, Dec. 26,248(M), TC Memo. 1963-211.

Similarly.

T. H. McClain, 40 TC 841, Dec. 26,252 (Acq.).

Similarly, where the transfer of the invention was conditioned on acceptance by the employer.

E. Chilton, 40 TC 552, Dec. 26,189.

The percentage of profits from a business paid to an employee in return for his agreement to perform services and to assign to the employer all inventions and applications for patents made by him during his employment was compensation for services

[¶ 4745.18]—Continued

rendered and not payment for the transfer of patents.

G. Komarek, (DC) 66-2 USTC ¶ 9648.
K. R. Komarek, 26 TCM 253, Dec. 28,471(M), TC Memo. 1967-112.

Similarly.

G. A. Dean, 25 TCM 1321, Dec. 28,192(M), TC Memo. 1966-258, and 56 TC 895, Dec. 30,901.

See also .701 and .702 below, for "substantial rights" of an employee.

Taxpayer and co-inventor formed a corporation with others who put up the capital. The invention was then assigned to the corporation in return for which the taxpayer and co-inventor received more than one-half of the issued stock plus the right to receive additional stock which would give them ⅔ of the issued shares. Co-inventor then sold his stock and rights to another stockholder for cash. Taxpayer was permitted to receive ⅓ of the corporation's issued stock without gain.

Hamrick, 43 TC 21, Dec. 27,008 (Acq.).

.181 Section 1235 did not apply to payments received by an engineer who was employed at a fixed monthly fee to reduce to practical application the concept originated by his employer of an electric hospital bed. The employer held the patent rights to the bed at all times and did not receive such rights by a transfer from the taxpayer.

W. T. Downs, 49 TC 533, Dec. 28,859.

.182 The award that the taxpayer received from his employer for his inventive ability was taxable as ordinary income. When the taxpayer entered into his employment, he agreed to assign all rights and interest in any inventions developed during his employment and the contract provided that no further consideration was due the taxpayer. Further, the award was not based upon the value of inventions to the employer.

W. F. Beausoleil, 66 TC 244, Dec. 33,814.

.183 Estoppel.—See ¶ 4745.70.

.184 Evidence.—Taxpayer's motion for a new trial or for a judgment notwithstanding the jury's verdict that the taxpayer had not assigned all his interest in patents to his corporation and therefore realized royalty income rather than capital gains was denied. The weight of the evidence conspired against the jury's accepting the taxpayer's story of a lost assignment of the patents. Nor did a double question sent in by the jury concerning the treatment of the patents in the financial statements imply that the taxpayer's corporation did not in fact own any patents. Further, the evidence indicated that there was not enough substance in the patent dealings between the taxpayer and his corporation to determine that a sale actually transpired.

J. B. Thomson, (DC) 70-1 USTC ¶ 9193.

Payments received for certain wheel alignment devices patented by the taxpayer and sold to a corporation under an exclusive purchase agreement were ordinary income since there was no evidence that the buyer corporation had elected to exercise an option to obtain an exclusive license to manufacture the devices.

E. D. Wilkerson, (CA-3) 71-1 USTC ¶ 9190, 435 F. 2d 845.

.185 Fact finding.—Fact findings were made that the taxpayer qualified as a "holder" under Code Sec. 1235(b)(2).

E. Meiners, 42 TC 653, Dec. 26,863. Gov't's appeal to CA-7 dismissed 3/10/65 pursuant to stipulation.

A domestic manufacturing corporation's gain from the sale of a patent under a binding contract, entered into before October 9, 1969 with all amounts received before 1975, is not a gain from the sale or exchange of a capital asset within the meaning of Code Sec. 1235 because, as defined by Code Sec. 1235(b), a corporation cannot be a holder of a patent.

Rev. Rul. 76-414, 1976-2 CB 248.

.20 Form.—The fact that an instrument was entitled "License Agreement" had little significance. Nor was a sale precluded by a provision for termination of the exclusive nature of the assignment upon the happening of a condition subsequent.

O. E. Watson, (CA-10) 55-1 USTC ¶ 9455, 222 F. 2d 689.

.22 Fraction transferred.—A transfer of a fraction of a whole patent which includes a share in each of the substantial rights under the patent equal to that fraction is a transfer of an "undivided interest" in all substantial rights to the patent within the meaning of Code Sec. 1235.

Rev. Rul. 59-175, 1959-1 CB 213.

The taxpayer could not report income from his assignment of patent rights as capital gains. He granted nonexclusive licenses instead of transferring an undivided interest in that he retained the power to create additional interests by making additional assignments and he retained the right to payments or royalties based upon use.

Allen G. Eickmeyer, CA-10, 78-2 USTC ¶ 9611, rev'g 66 TC 109, Dec. 33,772.

.24 Industry limitation.—A transfer of all rights to a patent to the extent of their use for the manufacture of gate valves was a sale entitled to capital gains treatment.

M. P. Laurent, 34 TC 385, Dec. 24,202 (Nonacq.).

.25 Intent.—Individuals did not intend or accomplish a sale to their wholly owned corporation where the license agreement required the corporation to assign to them royalties from sublicenses and where

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the individuals thereafter referred to the patents as "our" patents.
R. C. Switzer, (CA-6) 55-2 USTC ¶ 9721, 226 F. 2d 329.

Similarly.
J. A. McDermott, 41 TC 50, Dec. 26,356.

.251 A transaction suffices as a sale or exchange if it appears from the agreement and surrounding circumstances that the parties intended that the patentee surrender all his rights in and to the invention throughout the United States or some part thereof and that, regardless of imperfections in draftsmanship or the words used, such surrender did occur.
Rose Marie Reid, 26 TC 622, Dec. 21,806 (Acq.).

.2511 Followed, although one-half of the payments received were held to be compensation, inasmuch as the employee-inventor had threatened suit if he were not compensated for his rights in the invention.
W. E. Ost, 17 TCM 80, Dec. 22,835(M), TC Memo. 1958-18.

.30 Joint venture.—An assignment of a patent to the taxpayer's employer under an arrangement by which the taxpayer was to be available for consultation, the employer would exploit the patent, and the taxpayer would receive one-third of the royalties, created a joint venture from which the taxpayer derived ordinary income.
Kleinschmidt, (DC) 56-2 USTC ¶ 9977, 146 F. Supp. 253.

.40 License v. sale — Transfer of all substantial rights.—Under Sec. 1235, a "transfer of all substantial rights to a patent," whether by license, assignment or sale, is considered to be a sale or exchange of the patent, resulting in capital gain if the other requirements of the law are met. The following cases, decided under the law prior to Sec. 1235, held that assignments or exclusive licenses of patent rights constituted sales and that "royalties" were in fact payments of the purchase price, taxable as capital gain. These cases are applicable under the 1954 Code where the transfer is made by a corporation or other taxpayer who does not qualify as a "holder" under 1954 Code Sec. 1235, and may also be used as a guide in determining whether there has been a transfer of all substantial rights. In *Rodgers*, .405, below, the Tax Court specifically affirmed the application of pre-1954 Code case law to Code Sec. 1235.—CCH.

The IRS has announced that it will no longer take the position that the mere retention of an interest resembling a royalty in a transaction which otherwise has the characteristics of a sale but does not come within the purview of Sec. 1235 in and of itself prevents capital gain treatment.
Rev. Rul. 58-353, 1958-2 CB 408, revoking Mim. 6490, 1950-1 CB 9, and Rev. Rul. 55-58, 1955-1 CB 97.

Retention of an undivided interest in the exclusive patent rights did not prevent a transfer from being a sale.
Edwin R. Evans, (CA-6) 51-1 USTC ¶ 9228, 188 F. 2d 234.

Parol evidence was admissible to show that an ambiguous agreement was intended to give the grantee the right to exclusive "use" of the patent, so that there was a sale.
Richard W. Werner, (CA-5) 51-2 USTC ¶ 9398, 190 F. 2d 840.

Limitation of the right to use a patent in the tuna canning industry did not prohibit a finding that a "license" was in fact a sale.
Eben H. Carruthers, (CA-9) 55-1 USTC ¶ 9223, 219 F. 2d 21.
The First Nat. Bank of Princeton, Exr., (DC) 56-1 USTC ¶ 9203, 136 F. Supp. 818. Gov't appeal to CA-3 dismissed.

Similarly.
W. S. Rouverol, 42 TC 186, Dec. 26,748 (Nonacq.). Gov't's appeal to CA-9 dismissed 12/11/64 pursuant to stipulation.

The taxpayer was entitled to capital gain treatment of the entire amount received in exchange for the transfer of certain patent rights in 1954; the transfer was a sale or assignment and not a license since all substantial rights in the patents had been transferred. The government's claim that a portion of the proceeds represented either consideration for two transfers of know-how—one in 1952 and the other in 1954—or for cancellation of an earlier licensing agreement was not supported by the evidence. The rights retained by the taxpayer were of no substantial value.
E. I. du Pont de Nemours and Co., (CA-3) 70-2 USTC ¶ 9645, 432 F. 2d 1052.

Payments received by the taxpayer related solely to the technological know-how rather than to any license under patents. The taxpayer conveyed all the substantial rights of ownership in the technological know-how and was entitled to treat the amounts received as capital gain. That the amounts were intended as consideration for the technology was evidenced by the facts, first, that the information contained in the patent applications which related to certain aspects of taxpayer's typer would not have enabled one to successfully manufacture the typer; second, that the manufacturer needed to obtain the means necessary to the successful manufacture of a typer; and thirdly, that the actions of the parties subsequent to the time of their original agreement had been consistent with the view that disputed amounts related to technology, rather than to any license under the patent applications. Furthermore, the fact that it was necessary to provide for an optional termination date seemed attributable to the taxpayer's position that the payments related only to the technology.
F. H. Shepard, Jr., 57 TC 600, Dec. 31,244 (Nonacq.). Rev'd in an opinion not published under rules of the court, CA-3, 8/21/73. Cert. den., 417 US 911.

[¶ 4745.40]—Continued

Royalty payments received were attributable to the taxpayer's sale of his patent and were capital gain. They were not attributable to a later agreement under which he re-acquired a 1/10th interest in the patent.

P. J. Massey, (CA-7) 55-2 USTC ¶ 9711, 226 F. 2d 724.

$10,000 of a $25,000 payment that an American corporation received from a Japanese corporation was attributable to the American corporation's sale of Japanese patent rights to its partition systems and was reportable as capital gain.

G. O'Brien Movable Partition Co., Inc., 70 TC 492, Dec. 35,240 (Acq.).

Payment of the purchase price by using a percentage of the price for which the manufactured articles are sold, or according to a stated amount per unit manufactured, does not prevent a transfer of exclusive rights to a patent from being a sale.

Hopkinson, (CA-2) 42-1 USTC ¶ 9330, 126 F. 2d 406.

W. E. King, (DC) 56-1 USTC ¶ 9157, 138 F. Supp. 207.

C. A. Roe, (DC) 56-1 USTC ¶ 9372, 138 F. Supp. 567.

W. R. King, (DC) 58-1 USTC ¶ 9158.

W. C. Reeder, (DC) 58-1 USTC ¶ 9497.

H. Decker, (DC) 59-1 USTC ¶ 9147.

Edward C. Myers, 6 TC 258, Dec. 14,992 (Acq.).

Carl G. Dreymann, 11 TC 153, Dec. 16,526 (Nonacq.).

Halsey W. Taylor, 16 TC 376, Dec. 18,125 (Nonacq.).

V. A. Marco, 25 TC 544, Dec. 21,388 (Acq.).

A. C. Ruge, 26 TC 138, Dec. 21,688 (Acq.).

R. J. Champayne, 26 TC 634, Dec. 21,807 (Acq.).

T. G. Graham, 26 TC 730, Dec. 21,822.

Carroll Pressure Roller Corp., 28 TC 1288, Dec. 22,594.

Golconda Corp., 29 TC 506, Dec. 22,708 (Acq.).

A. E. Hickman, 29 TC 864, Dec. 22,846 (Acq.).

R. L. Holcomb, 30 TC 354, Dec. 22,990 (Acq.).

H. C. Johnson, 30 TC 675, Dec. 23,047.

Josephine H. Tucker, BTA memo., Dec. 12,833-D.

Raymond M. Hessert, 6 TCM 1190, Dec. 16,120(M).

Elrod Slug Casting Machine Co., 7 TCM 157, Dec. 16,313(M).

Carl G. Dreymann, 9 TCM 132, Dec. 17,520(M).

General Spring Corp., 12 TCM 847, Dec. 19,822(M).

Heater Corp., 13 TCM 887, Dec. 20,547(M).

Magee-Hale Park-O-Meter Co., 15 TCM 254, Dec. 21,616(M), TC Memo. 1956-57.

M. E. Hudson, 15 TCM 284, Dec. 21,622(M), TC Memo. 1956-60. Gov't appeal to CA-4 dismissed pursuant to stipulation, July 26, 1956.

H. F. Silver, 15 TCM 489, Dec. 21,695(M), TC Memo. 1956-95.

D. H. Finkle, 15 TCM 743, Dec. 21,818(M), TC Memo. 1956-148.

Newton Insert Co., 61 TC 570, Dec. 32,439, aff'd *per curiam*, (CA-9) 77-1 USTC ¶ 9132, 545 F2d 1259.

There was a sale where the transferor was to receive a percentage of the exclusive licensee's net sales, although the transferor reserved a "license back" to apply the invention in specified fields and to terminate the agreement on nonpayment or bankruptcy of the transferee.

H. H. Lamar, (DC) 51-2 USTC ¶ 9386, 99 F. Supp. 17.

There was a grant of non-exclusive license rather than a sale of patents where the agreements did not convey the whole patents rights but only segregated rights to some of the uses of the patents.

Redler Conveyor Co., (CA-1) 62-2 USTC ¶ 9523, 303 F. 2d 567.

Exclusive license between inventors and licensee under a royalty arrangement amounted to a capital gains transaction.

G. Puschelberg, (CA-6) 64-1 USTC ¶ 9372, 330 F. 2d 56.

Gain on partnership's transfer of know-how to foreign corporation was ordinary income because transferee received only the right to license the know-how rather than transferor's entire interest in it.

Photocircuits Corp., (CtCls) 74-2 USTC ¶ 9558, adopting CtCls Com Rpt, 77-7 CCH ¶ 7910.

Rights in a patent may be limited geographically or to a particular industry. An undivided share of the patent rights may be sold, and a transaction may be a sale with a license back from the buyer to the seller. Also, there may be a sale although the seller retains the right to terminate the arrangement, as for failure to pay royalties. See, also, .405.

R. H. Crook, (DC) 55-2 USTC ¶ 9736, 135 F. Supp. 242.

Retention of right to manufacture, sell and distribute patented item in a limited geographical area did not defeat capital gain treatment of payments to patent owner. See, also, .405.

W. W. Taylor, 29 TCM 1488, Dec. 30,435(M), TC Memo. 1970-325.

Amounts received by the taxpayer pursuant to a contractual agreement with a corporation whereby he received a monthly fee plus a stock option in exchange for a transfer of two patents to the corporation constituted ordinary income. The taxpayer failed to sustain his burden of proving that the contractual agreement between himself and the corporation was an exclusive licensing of his patented processes and that, therefore, amounts received pursuant to the agreement qualified as long-term capital gains.

H. C. Schulz, 40 TCM 1234, Dec. 37,243(M), TC Memo 1980-385.

.401 The exclusive right "to use [the patent] for the manufacture and sale" of the patented article was a sale, although there was no transfer of an unlimited right to use, where the right to use

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the patented structure, apart from the manufacture or sale, was not shown to have any substantial value.

W. B. Gruber, (DC) 57-2 USTC ¶ 9762, 158 F. Supp. 510, as amended by 58-1 USTC ¶ 9249, 158 F. Supp. 510. Rev'd on other issues *sub nom. E. R. Mayer*, (CA-9) 61-1 USTC ¶ 9147, 285 F. 2d 683.

.402 Taxpayers, owners of patents for the construction of footwear, transferred to a corporation an exclusive right for the manufacture and sale of shoes. The omission of the word "use" in the assignment did not make the assignment a mere license, since the right to manufacture and sell footwear to the general public necessarily involves the right to use the patented articles for all practical purposes. A provision which restricted the transferee in the granting of sublicenses without the written consent of the transferors did not interfere with the full use of the patent by the assignee, since it served to protect both parties to the assignment in case the purchase price was paid in installments.

E. E. Rollman, (CA-4) 57-1 USTC ¶ 9677, 244 F. 2d 634.

On remand, the Tax Court found that the patents were not held for sale to customers in the ordinary course of business.

E. E. Rollman, 16 TCM 817, Dec. 22,589(M), TC Memo. 1957-182.

.403 Omission of the right to "use" in the granting clause, and limitation of the right to make patented rivets of ferrous material to the aviation industry, did not prevent a transfer of all substantial rights. The transfer was a sale.

G. J. Flanders, (DC) 59-1 USTC ¶ 9424, 172 F. Supp. 935.

.404 A transfer of patents by a U. S. transferor to a British company to manufacture and sell various pneumatic and hydraulic devices in several foreign countries qualified as a sale since the transferor parted with all substantial rights under the patents. Failure of the agreement specifically to grant the right to "use" the devices did not amount to retention of a substantial right by the transferor.

C. A. Norgren Co., (DC) 67-2 USTC ¶ 9540, 268 F. Supp. 816.

A corporation granted nonexclusive licenses in patents and then sold its remaining interests in the patents to the taxpayers. Subsequently, the taxpayers sold all their rights in the patents to their controlled corporation. This was a transfer of all substantial rights of the taxpayer.

D. C. MacDonald, 55 TC 840, Dec. 30,665 (Acq.).

A corporation that is not a dealer in patents sold all its rights to a patent used in its manufacturing business subject to a nonexclusive, royalty-free license granted by its predecessor transferor. The sale was a sale of property used in a trade or business within the meaning of Code Sec. 1231.

Rev. Rul. 78-328, 1978-2 CB 215.

.405 The taxpayers were not entitled to capital gains treatment on their transfer of the exclusive use of the patent rights within a specified area because this did not constitute a transfer of all substantial rights under the patent. The taxpayers transferred the right to use the patent in the eastern United States, but they retained the right to use the patent in the western United States. Because the record did not indicate that these retained rights were not substantial, the court held that the taxpayers did not transfer all substantial rights under the patent. In the above decision, the Tax Court stated that it would no longer follow the position it had taken in *Rodgers* and *Estate of Klein* below, in which it had allowed capital gain on the transfer of patent rights within a limited geographical area.

Kueneman & Harrell, 68 TC 609, Dec. 34,529, aff'd (CA-9) 80-2 USTC ¶ 9616.

Prior to its decision in *Kueneman & Harrell*, above, the Tax Court permitted capital gain treatment on the transfer of patent rights within a limited geographical area.

V. B. Rodgers, 51 TC 927, Dec. 29,482 (Acq. in result only).

The Tax Court followed its *Rodgers* decision in *G. T. Klein Est.*, 61 TC 332, Dec. 32,244. However, on appeal, the Court of Appeals for the Seventh Circuit disagreed and held that the transfer of patent rights limited to specified areas of the United States did not constitute a transfer of all substantial rights to the patent.

G. T. Klein Est., CA-7, 75-1 USTC ¶ 9127, 507 F2d 617, rev'g and rem'g 61 TC 332, Dec. 32,244 (Nonacq.). Cert. denied, 421 US 991.

The transfer of patent rights by the taxpayer subject to a field-of-use restriction was not a transfer of all substantial rights to the patent so the taxpayer was subject to ordinary tax rates on his gain. Later, further rights were transferred for increased consideration.

A. A. Bros, CA-9, 74-1 USTC ¶ 9350, 493 F2d 813.

The exclusive license to make, use and sell one-to-one driving clutches, but only for marine service, was not a transfer of all the substantial rights to a patent where the patent had known value outside that field of use.

T. L. Fowick, (CA-6) 71-1 USTC ¶ 9147, 436 F2d 655 rev'g 52 TC 104, Dec. 29,540 (Nonacq.).

A patent holder was not entitled to capital gain treatment with respect to royalties and infringement damages attributable to a patent license where he transferred a qualified patent use. The substantial rights in the patent had been transferred to a third party not involved in the suit.

[¶ 4745.405]—Continued

D. R. Blake, CA-6, 80-1 USTC ¶ 9247, 615 F2d 731.

The taxpayer was not entitled to capital gains treatment on the income received from the transfer of certain patent rights because it retained the right to use and to sell products manufactured pursuant to patents parallel to those it transferred.

Continental Carbon Co., DC, 75-2 USTC ¶ 9844.

.406 Each of five contracts, considered on the basis of its specific terms and conditions read as a whole, made a conveyance of exclusive patent rights, and such conveyance, in each instance, constituted a sale or exchange of property not held by taxpayer corporation primarily for sale to its customers in the ordinary course of its trade or business. The determination of what portion, if any, of the agreements are attributable directly to the patents involved in the agreement, rather than to the numerous services taxpayer was obligated to perform under the agreements, will await the second trial.

Armco Steel Corp., (DC) 67-1 USTC ¶ 9153, 363 F. Supp. 749.

.408 Payments received by taxpayer corporation under seven of nine separate agreements transferring patent and other rights were payments for the sale of those rights taxable as long-term capital gains. Payments under two of the separate agreements were for the license of such rights taxable as ordinary income.

Bell Intercontinental Corp., (Ct. Cls.) 67-2 USTC ¶ 9574, 381 F. 2d 1004.

.41 The following cases held that a license was not a sale or an assignment of a patent. Under the Supreme Court decision in *Waterman v. MacKenzie*, 138 U. S. 252 (cited only to show the distinction made by the Court between a license and a sale), the grant of an exclusive right under a patent within a certain district must include the right to make, the right to use, and the right to sell in order to constitute a sale or assignment of the patent.—CCH.

Mere right to use patents and to manufacture articles thereunder for specified royalties is not a sale.

E. G. Hoffman, 8 BTA 1272, Dec. 3049.

The amounts received from an English company by the taxpayer under an agreement permitting the English company to manufacture and sell taxpayer's products in Europe and the British Empire were taxable as ordinary income. The agreement was a license establishing an agency relationship for the distribution of taxpayer's products, not a sale of the patents.

Oak Manufacturing Co., (CA-7) 62-1 USTC ¶ 9388, 301 F. 2d 259.

The execution, simultaneously with an exclusive licensing agreement, of an option agreement in which the patentee warranted that it was the sole owner of the entire right, title and interest in and to the patents, with full power to assign and transfer them, was a factor expressly negativing any present intent to assign the patent.

Eterpen Financiera Sociedad de Responsabilidad Limitada, (Ct. Cls.) 52-2 USTC ¶ 9522, 108 F. Supp. 100. Cert. den., 346 U. S. 813.

Provisions for termination of an assignment one year from its date, although allegedly intended to protect the patentee against nonpayment of royalties and only impliedly granting the right to "use," granted only a license, so that royalties were ordinary income.

Dory J. Neale, (CA-10) 53-1 USTC ¶ 9156, 201 F. 2d 621.

A contract granting the exclusive right to manufacture and sell was a license, not a sale, where the patentee could make other commitments if the demand exceeded the grantee's capacity, the term of the agreement was for one year, subject to renewal or cancellation, and infringement suits could be brought by either party.

L. Gregg, 18 TC 291, Dec. 18,962, aff'd *per curiam*, (CA-3) 53-1 USTC ¶ 9339, 203 F. 2d 954.

Followed, where the licensee was not found to have the right to use, or the exclusive right to exploit, the patent in any specified territory.

National Bread Wrapping Machine Co., 30 TC 550, Dec. 23,027.

An agreement which had the effect of dividing the manufacture of products under patents between the licensor and licensee gave the licensee only limited rights and was not a sale.

American Chemical Paint Co., (DC) 55-1 USTC ¶ 9441, 131 F. Supp. 734.

An agreement granting the right to make and sell, but not including the right to "use," was not a sale of the patent.

Cleveland Graphite Bronze Co., 10 TC 974, Dec. 16,410. Aff'd without opinion, (CA-6) 49-2 USTC ¶ 9462, 177 F. 2d 200.

The transfer of the formula for making Listerine was a transfer of a license rather than a sale where the contract did not forbid the original owner of the formula from engaging in any activity respecting Listerine and had not given the transferee of the formula the right to forbid others from making, using or selling the product.

H. P. Whitmore, 24 TCM 633, Dec. 27,374(M), TC Memo. 1965-121.

.42 Even though franchise agreements conveying the exclusive and perpetual right to sell Dairy Queen products in a designated territory did not purport to convey exclusive rights under the patent

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on machinery used in making the products, the franchise amounted to a sale of assets, that is, property rights to use the patent.

Dairy Queen of Okla., Inc., (CA-10) 58-1 USTC ¶ 9155, 250 F. 2d 503.

On remand, the court found that subfranchises in the liquidation of the franchise were not sales of stock in trade, and that the gain was capital gain.

Dairy Queen of Okla, Inc., 18 TCM 522, Dec. 23,524(M), TC Memo. 1959-61.

.44 Manufacturing rights withheld.—Failure to transfer the right to manufacture does not establish as a matter of law that there was no sale. However, contracts granting territorial assignees the exclusive right "to use and sell (not to manufacture)" were licenses and not sales where the contracts stated that the assignor was the "sole owner" and was to defend any litigation.

J. L. Schmitt, (CA-9) 59-2 USTC ¶ 9718, 271 F. 2d 301.

Based on the evidence the Court found that a contract covering the construction and operation of parking units, in which the taxpayer made no grant of any interest in its patent rights and in which it reserved the right to construct the elevator portion of such units, was a license and not a sale. Consequently, the taxpayer was not entitled to capital gain treatment on the proceeds derived from the contract.

Pigeon-Hole Parking, Inc., (DC) 61-1 USTC ¶ 9295, 194 F. Supp. 591.

.45 Multiple transfers—Although an inadvertent omission of the word "use" from the agreement transferring a patent did not signify a purpose to retain for the owners any rights in the patent, a number of later transfers of the same patents in the names of the original owners or their representatives indicate retention of control inconsistent with a sale.

K. Leubsdorf, (Ct. Cls.) 58-2 USTC ¶ 9694, 164 F. Supp. 234.

.451 An original contract between an inventor and a manufacturer transferring the exclusive right to manufacture and sell patented processes throughout the world was effective to transfer all the taxpayer-inventor's substantial rights in the patents and to entitle him to treat the royalties received as capital gain. The fact that the taxpayer and manufacturer subsequently joined in other assignments, licensing other manufacturers to manufacture and sell the same patented processes, did not have the effect of transforming the original assignment of all the taxpayer's substantial rights into a mere license.

R. T. Wing, (CA-8) 60-2 USTC ¶ 9492, 278 F. 2d 656.

.48 Option to acquire patent license.—The amount received by a taxpayer for granting an option to acquire an exclusive license to patents which he holds, such amount to be applied against installment payments representing a percentage of the selling price of articles sold under the license, is an amount received from the sale of a capital asset held more than six months in the year the option was exercised provided the transaction entered into in granting the license qualifies as a sale or exchange of a capital asset under Code Sec. 1235. In the event the option is allowed to lapse, the fee retained by the taxpayer should be treated as ordinary income in the year the option lapses.

After the exercise of the option, amounts received under the contract by any person who is a "holder" within the meaning of Sec. 1235 are amounts received from the sale or exchange of a capital asset. Amounts received by related persons who have been assigned interests are not subject to capital gains treatment under Sec. 1235.

Rev. Rul. 57-40, 1957-1 CB 266.

.50 Ownership of patent.—Stockholders, who surrendered their stock in a corporation which was licensed to manufacture machines under a patent, in order that another company might be given an exclusive license, in exchange for certain royalties which were to be paid by the exclusive licensee, received such payments for the sale of their stock. They never owned any interest in the patent.

Lee H. Peck, 11 TCM 683, Dec. 19,074(M).

Payments received by an inventor-partner, who transferred his rights in a patent and invention to a partnership, under a subsequent royalty agreement under which he agreed to apply for a patent reissue, were royalties taxable as long-term capital gains and were governed by the 1954 Code, although the agreement was entered into prior to enactment of the 1954 Code.

Weller v. Brownell, (DC) 65-1 USTC ¶ 9326, 240 F. 2d 201. Gov't's appeal to CA-3 dismissed 7/12/67.

The taxpayer was the owner of a patent and an invention at the time he sold them to two companies for which he worked. Thus, he sold capital assets and realized capital gain, not ordinary income, from payments he received in 1964 and 1965. Although he invented both devices on company time, he had not been employed by either company to make these inventions and was therefore not legally obligated to turn them over to either company.

T. N. Melin, CtCls, 73-1 USTC ¶ 9434, 478 F2d 1210.

.501 The taxpayer, who assisted his brother in perfecting an invention which was patented in the brother's name, and who executed a contract entitling the

[¶ 4745.501]—Continued

taxpayer to 20% of royalties, did not have an interest in the invention. His share of the royalties was compensation for services.

C. A. Claus, 17 TCM 313, Dec. 22,935(M), TC Memo. 1958-64.

Similarly as to a taxpayer who financed an invention but had no interest in the invention other than the right to part of the royalties.

A. W. Newby, (CA-7) 62-2 USTC ¶ 9760, 309 F. 2d 48.

.503 But where the facts showed that the taxpayer's deceased husband was a joint-venturer in the development and exploitation of an invention, it was held that he acquired such an interest in the patents later obtained on the invention in the name of his co-adventurer as to make him a "holder" of those patents within the meaning of the Code. (California law applied.)

G. J. Flanders, (DC) 59-1 USTC ¶ 9424, 172 F. Supp. 935.

.56 Related party.—Capital gain treatment under Code Sec. 1235(d) is denied where the transfer is to a related person.

M. C. Poole, 46 TC 382, Dec. 28,002.
E. L. Childers, DC, 74-2 USTC ¶ 9735. Affirmed on another issue, (CA-4) 76-2 USTC ¶ 9725, 542 F2d 1243.

The mere fact that a patent transfer for contingent amounts does not qualify for long-term capital gains treatment under Code Sec. 1235 will not prevent it from qualifying for such treatment under other provisions of the Code. To the extent that the rationale of the court in the *Poole* case may be construed as contrary to the conclusion in this Revenue Ruling, it will not be followed.

Rev. Rul. 69-482, 1969-2 CB 164.

Although the taxpayer was the controlling (79%) shareholder of the corporation to which he sold patents, the Commissioner did not argue that capital gain treatment was prohibited by Code Sec. 1235.

R. E. Omholt, 60 TC 541, Dec. 32,043.

The taxpayer could report as capital gains amounts he received from a corporation on sale of a patent to it. The corporation was not "related" to him even though it had been formed to purchase the patent and the shareholders were close friends and business associates. Nor did the corporation's grant of licenses to other companies indicate the proscribed control. The taxpayer was never a stockholder of the corporation or in control of its policies, and he had business reasons for the sale. The corporation was held not to be a sham.

L. L. Charlson, CtCls, 75-1 USTC ¶ 9504.

See ¶ 4757.03 for the treatment of transfers of unpatented inventions and secret formulas to related parties.

.5603 No portion of the payments received under a license agreement for patents for inventions of a taxpayer which he transferred to a controlled corporation was unstated interest. Even though the capital gain allowable to the taxpayer did not derive from Sec. 1235(a) because the transfer was between related persons (Sec. 1235(d)), the transfer fell within the exception of Sec. 483(f)(4) since it was a transfer *described* in Sec. 1235(a).

F. G. Paxton, 53 TC 202, Dec. 29,822 (Acq., Nonacq. withdrawn.).

Followed, in the case of a sale of an interest in a patent to a related corporation.

C. T. Busse, CA-7, 73-2 USTC ¶ 9479, 479 F2d 1147 (Acq.).

Interest will not be imputed under section 483 of the Code to payments received for the transfer of all substantial rights to a patent meeting all the requirements of section 1235(a) even if the transfer is between related parties and, therefore, because of the application of section 1235(d), does not qualify for capital gains treatment under section 1235(a); interest will be imputed under section 483 if the transfer fails to meet all the requirements of section 1235(a) because the transferor is not a holder as defined in section 1235(b).

Rev. Rul. 78-124, 1978-1 CB 147, superseding Rev. Rul. 72-138, 1972-1 CB 140.

No portion of the consideration received for the transfer of patents between "related persons", as described in Code Sec. 1235(d), is treated as ordinary interest income. Since the broad phrasing of Code Secs. 483(f)(4) and 1235(a) exempts all receipts from the sale or exchange of patents, no interest was imputed to the transaction even though it occurred between related persons.

L. W. Goldman, DC, 74-2 USTC ¶ 9723.

See, also, .787, below.

.561 The following decisions decided before *Poole*, above, allowed capital gain or ordinary income treatment on transfers of patents in situations which did not qualify under 1954 Code Sec. 1235 and 1939 Code Sec. 117(q) to be determined under other Code provisions. See the discussion at .04, above.

Coplan, 28 TC 1189, Dec. 22,574 (Acq.).
Best Lock Corp., 31 TC 1217, Dec. 23,508.
G. N. Boffron, 35 TC 787, Dec. 24,678.
E. Sheen, (DC) 58-2 USTC ¶ 9735, 164 F. Supp. 543. Summary judgment entered (DC), 59-1 USTC ¶ 9325.
H. C. Johnson, 30 TC 675, Dec. 23,047.

For sale to an 80% controlled corporation, see ¶ 4757.35.

.565 Royalties received by two members of a joint venture from the transfer of a patent to a partnership composed of

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the third joint venturer, the inventor of a bath oil formula, and the wives of the other two were denied capital gains treatment since the transfer was between two partnerships 80% owned by the same or related parties.

M. A. Burds, (CA-2) 65-2 USTC ¶ 9733, 352 F. 2d 995. Cert. den., 383 U. S. 966.

Capital gain treatment also denied to the inventor of the bath oil formula.

M. F. Emory, 47 TC 710, Dec. 28,399. Taxpayer's appeal to CA-2 dismissed 8/11/67 pursuant to stipulation.

The taxpayer owned an equal interest in an inventor's patents which he subsequently sold to the inventor for a 10% royalty interest. The income derived from the royalty interest could be reported as capital gain.

T. Bostroem, 33 TCM 676, Dec. 32,638(M), TC Memo. 1974-156.

.567 An inventor was entitled to capital gain treatment on the transfer of all substantial rights to a patent on a center cartridge loader for shotgun shells and his one-half interest in another shotgun loader patent to a close corporation in which he owned a 24% stock interest (unrelated individuals owned the rest of the corporation's stock). The Government's contention that a transfer to a close corporation composed of unrelated stockholders could be excluded from capital gain treatment, regardless of the percentage of the transferee corporation's stock owned by the transferor, was rejected: However, since he acquired his remaining one-half interest in the patent from its co-inventor one year after the device covered by the patent had been reduced to actual practice, he was not entitled to capital gain treatment under Sec. 1235 and had to show that capital gain was available under other sections of the Code.

R. J. Lee, (DC) 69-2 USTC ¶ 9614, 302 F. Supp. 945.

Transfer of patents by foreign inventor to U. S. corporation in which he had a 50% interest was not governed by Code Sec. 1235.

Rev. Rul. 71-231, 1971-1 CB 229.

.58 Retained rights.—Taxpayer did not realize a capital gain from the transfer of his retained rights in a patent in which he had already transferred all of his *substantial* rights and interest.

First National Trust and Savings Bank of San Diego, (DC) 62-1 USTC ¶ 9220, 200 F. Supp. 274.

.581 Amounts received by taxpayer as his interest in royalties did not constitute gain derived from the sale or exchange of a capital asset where, under a 1957 agreement, he retained substantial rights to the interest in the patents he had purchased in 1954.

I. K. Schlamp, (DC) 70-1 USTC ¶ 9305.

An agreement by which the taxpayer purportedly purchased trademarks and trade names and the right to make and sell toy dolls was a license agreement, not a sale. Thus, the purchase price was a deductible royalty payment. A company related to the transferor had retained the rights to certain cartoon strips, the exhibition of which was essential to successful sales of the dolls.

Leisure Dynamics, Inc., (CA-8) 74-1 USTC ¶ 9328, 494 F2d 1340.

.60 Sale and assignment rights not transferred.—The grant of the exclusive right to manufacture, use and lease an invention may be a transfer of "all substantial rights," even though it does not include the right to sell. This was the case where neither party considered it advisable to sell a service tool which required skilled operators.

R. Lawrence, (CA-5) 57-1 USTC ¶ 9515, 242 F. 2d 542.

Parke, Davis & Co., 31 BTA 427, Dec. 8748 (Acq.).

.601 The reserved right to sell the invention or patent was unsubstantial where, pending application for the patent, taxpayer had transferred the exclusive right to manufacture, use and sell the patented devices.

L. W. Storm, (CA-5) 57-1 USTC ¶ 9625, 243 F. 2d 708.

.602 There was not a transfer of the exclusive right to make, use and sell where the licensee, a corporation controlled by the licensor, was required to obtain the latter's consent to an assignment of the license and either party could terminate the agreement for cause, such as the licensor's failure to develop designs.

W. M. Bailey Co., 15 TC 468, Dec. 17,882, aff'd *per curiam*, (CA-3) 51-2 USTC ¶ 9503, 192 F. 2d 574.

W. M. Bailey, 9 TCM 850, Dec. 17,895(M), aff'd *per curiam*, (CA-3) 51-1 USTC ¶ 9283, 188 F. 2d 360.

.606 Sale by tax-option corporation. — Stockholders of a tax-option corporation were entitled to long-term capital gain on amounts realized from the sale of patents by the tax-option corporation. The patents were depreciable property which had been held by the tax-option corporation for more than six months and which had not been held primarily for sale to customers in the ordinary course of the tax-option corporation's trade or business.

C. G. Perkins, (DC) 63-1 USTC ¶ 9447, 216 F. Supp. 618.

[¶ 4745]—Continued

.61 Separate inventions.—The assignment of the entire patent rights in one of several separate inventions covered by a single patent was a sale.

Merck & Co., Inc., (CA-3) 58-2 USTC ¶ 9959, 261 F. 2d 162.

.62 Services.—Whether payments for an inventor's services connected with the sale of the patent rights to his invention are part of the purchase price or compensation, and thus ordinary income, is a factual question. The court here found that payments for taxpayer's developmental work relating to the transfer of the invention were to be treated as capital gains. Any payment for services prior to sale was subsidiary to the granting of the option and the transfer of the invention and did not deprive him of capital gains treatment because the development of the underlying invention had progressed to the point where only technical problems relating to commercial marketability remained. The research work performed by the taxpayer was related to the development and implementation of the particular invention transferred rather than the general advancement of the purchaser's business.

H. S. Gable, 33 TCM 1427, Dec. 32,882(M), TC Memo. 1974-312.

There was a sale of a patent, and not a compensation agreement, although the transferor was required to render advisory services incidental to the transfer, where the patented device was technical and intricate.

R. M. Hessert, 6 TCM 1190, Dec. 16,120(M).

.621 An individual who was to receive a guaranteed yearly retainer plus commissions on license fees received by the assignee of his patent, and who was to render engineering and technical services, did not sustain the burden of proving that there was a sale of the patent.

G. M. Wright, (DC) 57-1 USTC ¶ 9419.

.622 The president of a corporation transferred his patents to it under an agreement providing that he was to receive 8% of sales in excess of $300,000 annually, and that the percentage would be decreased to 5% when he ceased to be president. The court concluded that 5% was capital gain from sale of the patents; the remaining 3% was compensation for services.

P. Spence, (Ct. Cls.) 58-1 USTC ¶ 9105, 156 F. Supp. 556.

$10,000 of a $25,000 payment the taxpayer received from a Japanese corporation was attributable to the taxpayer's sale of Japanese patent rights and was reportable as capital gain. The remainder represented compensation for the transfer of advisory services and technical know-how in which the taxpayer retained a substantial right and was ordinary income.

G. O'Brien Movable Partition Co., Inc., 70 TC 492, Dec. 35,240 (Acq.).

.623 No part of sale price of patent was for services where the contract contained no provision for services to be rendered by patent seller.

Heil Co., 38 TC 989, Dec. 25,682 (Acq.).

See also ¶ 644.3201 and following.

.66 Sublicense.—Where the owner of British patents reserved legal title in a licensing agreement, the licensee, upon making sublicense agreements, received ordinary income since it did not sell any property interests.

Federal Laboratories, Inc., 8 TC 1150, Dec. 15,811.

.70 "Substantial rights" defined.—The substantial rights secured by a patent are: (1) to make, (2) to use, and (3) to sell the patented article or device for the entire life of the patent. If any one, or a part of any one, or more of these three substantial rights are retained by the patentee after the execution of a particular contract, such a contract is not a sale.

L. G. Buckley, (DC) 57-1 USTC ¶ 9525.

W. W. Taylor, 29 TCM 1488, Dec. 30,435(M), TC Memo. 1970-325.

The Taylor-Winfield Corp., CA-6, 73-1 USTC ¶ 9113, 467 F2d 483.

Taxpayer did not transfer all substantial rights to certain secret formulas and tradenames under a 1957 contract giving the transferee exclusive right to use the formulas and tradenames, and manufacture and sell products derived from the formulas over a 25-year period. There was no evidence to show that the useful life of the formulas, on the date the contract was executed, would be limited to 25 years, and a second contract executed by the taxpayer in 1963 indicated by its terms that he still considered himself the owner of substantial rights in the formulas and trade names.

J. H. Pickren, (CA-5) 57-2 USTC ¶ 9477, 378 F. 2d 595.

Similarly.

J. R. Milberg, 52 TC 315, Dec. 29,597.

The taxpayer was bound by the prior decision by the doctrine of collateral estoppel for the taxable years 1963 and 1964. The only item before the court not present in the prior case was an agreement entered into in 1965 which extended the term of the license to coincide with the patent's expiration date. The agreement had no effect on the controlling facts in the prior litigation and therefore did not preclude application of collateral estoppel.

J. R. Milberg, 54 TC 1562, Dec. 30,271.

.701 An employee who assigned all right, title and interest in a patent to his employer had "substantial" rights which he could convey, even though the work on a model was done in the employer's plant with its material, since the only interest which the employer could have possessed in the inven-

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tion was a so-called "shop right," which was insufficient to dilute the employee's "substantial rights to a patent."
H. Jordan, 27 TC 265, Dec. 22,004 (Acq.).

.702 The taxpayer transferred to a corporation the exclusive right to "use" and sublicense patents. The agreement provided that when the taxpayer left the employment which he then held he could use the patents together with anyone with whom he was associated, could give the associate a license upon termination of their relationship, could enter into successive associations with the right to use the patent, and could veto any license granted by the corporation. It was held that the agreement was not an assignment of all substantial rights, or that, even if the taxpayer transferred ownership, he took back such substantial rights that as a result of the transaction he conveyed no more than a license.
J. R. Watkins, (CA-2) 58-1 USTC ¶ 9321, 253 F. 2d 722. Cert. den., 357 U. S. 936.

.7021 Where an exclusive interest (cancellable on 30 days' notice) in a patent was purchased from taxpayer-inventor as insurance against potential claims of patent infringement rather than for purposes of using the device which had no substantial, practical or commercial value, there was a sale of a capital asset entitling taxpayer to long-term capital gains treatment.
C. E. Bannister, (CA-5) 59-1 USTC ¶ 9155, 262 F. 2d 175.

For transfer of a fraction of a whole patent, see .22, above.

.71 The court found that there was no transfer of "all substantial rights" in a patent, within the meaning of Sec. 1235, since the transfer to a partnership composed of the transferees did not effect any substantial change in their positions (each held a ¼th interest before and after the transfer).
G. N. Soffron, 35 TC 787, Dec. 24,678.

There was no transfer of all substantial rights in a bath oil formula where before the transfer the taxpayer was the owner of an undivided one-third interest in the formula and after the transfer he had a one-third interest in a partnership which held the formula.
M. F. Emory, 47 TC 710, Dec. 28,399. Taxpayer's appeal to CA-2 dismissed 8/11/67 pursuant to stipulation.

.715 There was no transfer of all substantial rights in a patent where taxpayer retained some rights as to the manufacture and sale of the product.
J. H. Kirby, II, (CA-5) 62-1 USTC ¶ 9129, 297 F. 2d 466.
F. Martini, 39 TC 168, Dec. 25,473.

.717 A transfer of a patent to manufacture, use and sell a special wrapper in the cheese field did not qualify as a sale of the patent due to the transferor's retention of certain substantial rights under the patent. The transferor retained exclusive control over patent litigation, restricted the transferee's right of assignment solely to a successor in business, expressly reserved the right to grant a nonexclusive license in the cheese field to another firm, and retained the right to compel the transferee to sublicense anyone designated by the transferor.
Allied Chemical Corp., (CA-2) 67-1 USTC ¶ 9172, 370 F. 2d 697.

Payments received by a corporation pursuant to a value engineering incentive clause of a contract between it and the Air Force were payments for "data" rather than compensation for services rendered incident to performing under the contract. Under the clause, the Air Force paid the corporation substantial sums as its share of the cost savings realized from implementing change proposals submitted by the corporation. The proposals submitted by the corporation incorporated trade secrets and know-how which constituted capital assets.
C. V. Ofria, 77 TC —, No. 38, Dec. 38,198.

.72 Fact findings were made that all substantial rights were transferred.
C. Hawthorne, 19 TCM 770, Dec. 24,273(M), TC Memo. 1960-146.
E. Meiners, 42 TC 653, Dec. 26,863 (Acq.). Gov't's appeal to CA-7 dismissed 3/10/65 pursuant to stipulation.

.75 Termination rights retained.—Capital gain treatment will be accorded to transfer of rights to patents involving facts substantially the same as those involved in *Myers* and *Champayne* (both at .40, above) and in *Coplan* (.561, above). (But under Sec. 1239, transfers of depreciable property between some related interests are not allowed capital gain treatment.) The cases mentioned involved only the retention by the taxpayers of interests resembling royalties coupled with provisions for termination of the rights transferred upon failure of the transferee to pay specified minimum annual amounts, or upon the insolvency or at the instance of the transferee. In cases not within the purview of section 1235 of the 1954 Code or section 117(q) of the 1939 Code, where interests resembling royalties are retained by the transferor along with other rights, the transaction may fail to have sufficient characteristics of a sale to qualify for capital gain treatment.
Rev. Rul. 58-353, 1958-2 CB 408, revoking Mim. 6490, 1950-1 CB 9 and Rev. Rul. 55-58, 1955-1 CB 97.
T. I. R. No. 81, June 27, 1958, 586 CCH ¶ 6558

.751 Royalty payments under a contract granting an exclusive license to make, exercise or sell patent devices and reserving to the patentee the right to terminate the agreement and recapture the patent on default of the licensee were ordinary income.
F. G. Bloch, (CA-2) 52-2 USTC ¶ 9551, 200 F. 2d 63. Cert. den., 345 U. S. 935.

[¶ 4745.751]—Continued

Payments received under patent license contracts were ordinary income rather than capital gain, since licensor had retained the right to terminate the licenses at will.

A. Szegvari, 34 TCM 1232, Dec. 33,421(M), TC Memo 1975-284.

.7511 All substantial rights were not transferred where either party could terminate the assignment on 6 months' notice and, upon termination, the inventor-assignor could license any manufacturer who was not a member of the Manufacturers Aircraft Association and could exploit the patent himself.

A. M. Young, (CA-2) 59-2 USTC ¶ 9589, 269 F. 2d 89.

Similarly as to two agreements.

Bell Intercontinental Corp., (Ct. Cls.) 67-2 USTC ¶ 9574, 381 F. 2d 1004.

The transfer of unpatented technology under four agreements was for a fixed period of years and did not convey all substantial rights in the subject matter covered by the agreement. The transfers were only for a limited period and therefore could not qualify as sales under Code Secs. 1221, 1222 and 1231.

PPG Industries, Inc., 55 TC 928, Dec. 30,683.

See also .602, above.

.77 Third party conduit.—A partnership acquired an undivided one-half interest in the "View-Master" patent. It sold the patent to a photo corporation under an agreement providing for a leaseback of exclusive United States rights. In addition, the agreement provided that royalties paid by the partnership to the corporation were to be redistributed to the individual members of the partnership. The transfer was held to be a sale or exchange of a capital asset.

E. R. Mayer, (CA-9) 61-1 USTC ¶ 9147, 285 F. 2d 683. Rev'g and rem'g *sub nom. W. B. Gruber*, (DC) 58-1 USTC ¶ 9249, 158 F. Supp. 510.

.78 Title.—There was an assignment and not a license, although the taxpayer retained legal title to a patent, where it transferred the exclusive right to make and use the invention and neither party could sell or license without the permission of the other. Improvements were subject to the same conditions as the original patent rights.

Parke, Davis & Co., 31 BTA 427, Dec. 8748 (Acq.).

.781 Similarly.

D. Arras, (DC) 58-2 USTC ¶ 9582, 164 F. Supp. 150.

.785 Unissued patent.—It is not significant that a patent has not been issued or applied for at the time when all substantial rights are transferred.

F. H. Philbrick, 27 TC 346, Dec. 22,035 (Acq.).

M. P. Laurent, 34 TC 385, Dec. 24,202 (Nonacq.).

H. S. Gable, 33 TCM 1427, Dec. 32,882(M), TC Memo. 1974-312.

Since taxpayer failed to show that a patent application had any value, no part of an amount received in settlement of a proxy fight was attributable to the patent application.

N. Rodman, CA-2, 76-2 USTC ¶ 9710, 542 F2d 845.

.787 Unstated interest.—No part of the payments received from the transfer of certain patents was unstated interest. If a transaction is "described" in Code Sec. 1235(a) it is excluded from the imputed interest rules even though Sec. 1235(d) excludes it from Sec. 1235 treatment on other grounds. Code Sec. 483 was not intended to apply to transfers which, at the time of its enactment, qualified for capital gain treatment.

F. G. Paxton, 53 TC 202, Dec. 29,822 (Acq., Nonacq., withdrawn.).

Followed.

C. T. Busse, CA-7, 73-2 USTC ¶ 9479, 479 F2d 1147 (Acq.).

Interest will not be imputed under section 483 of the Code to payments received for the transfer of all substantial rights to a patent meeting all the requirements of section 1235(a), even if the transfer is between related parties and therefore, because of the application of section 1235(d), does not qualify for capital gains treatment under section 1235(a); interest will be imputed under section 483 if the transfer fails to meet all the requirements of section 1235(a) because the transferor is not a holder as defined in section 1235(b).

Rev. Rul. 78-124, 1978-1 CB 147, superseding Rev. Rul. 72-138, 1972-1 CB 140.

Since the taxpayer could not qualify as a "holder" within the meaning of Code Sec. 1235(b), her patent transfer could not be considered as one described in Code Sec. 1235(a) and she could not take advantage of the Code Sec. 483(f)(4) exception from the operation of the imputed interest provisions of Code Sec. 483 in regard to payments which she received in exchange for a transfer of her patent interests.

M. Busse, CtCls, 76-2 USTC ¶ 9716, 543 F2d 1321.

Since a taxpayer was a corporation, it could not qualify as a "holder" under Code Sec. 1235(b), and, therefore, it could not invoke the imputed interest rule exception for sales or exchanges of patents.

Ransburg Corp. and Subsidiaries, CA-7, 80-1 USTC ¶ 9426, 621 F2d 264.

.79 Veto power over additional transfers.—The fact that the grantee of a nonexclusive license was required to consent to additional licenses did not give it all substantial rights to the patent, where it was expected that further licenses would be granted.

E. A. Walen, (CA-1) 60-1 USTC ¶ 9128, 273 F. 2d 599.

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Prior law

.81 Employee.—Employees, having been found not to be professional inventors, derived capital gains from the transfer of their patents to their employers.

Edwin R. Evans v. Kavanagh, (DC) 49-2 USTC ¶ 9487, 86 F. Supp. 535.

Hofferbert v. Briggs, (CA-4) 50-1 USTC ¶ 9122, 178 F. 2d 743.

U. S. v. Borton, (DC) 50-1 USTC ¶ 9276.

Arthur N. Blum v. Com., (CA-3) 50-2 USTC ¶ 9375.

Stout v. Com., (CA-6) 51-1 USTC ¶ 9120, 185 F. 2d 854.

H. H. Lamar, (DC) 51-2 USTC ¶ 9386, 99 F. Supp. 17.

Robert D. Pike v. U. S., (DC) 51-2 USTC ¶ 9452, 101 F. Supp. 100.

Bukovsky v. U. S., (DC) 54-1 USTC ¶ 9193.

A. P. Waterson, (DC) 56-1 USTC ¶ 9348. Gov't appeal to CA-5 dismissed, July 13, 1956, on appellant's motion.

J. Becker, (DC) 58-1 USTC ¶ 9504, 161 F. Supp. 333.

Maurice B. Cooke, 4 TCM 204, Dec. 14,398(M).

Curtin, 6 TCM 457, Dec. 15,773(M).

Wm. M. Kelly, 6 TCM 646, Dec. 15,844(M).

Cope, 12 TCM 525, Dec. 19,680(M).

Herbert Allen, 11 TCM 1093, Dec. 19,293(M).

C. D. Beeth, (DC) 56-1 USTC ¶ 9244. Gov't appeal to CA-5 dismissed, July 11, 1956, on appellant's motion.

.83 Professional v. amateur inventors.—In the following cases, professional inventors were found to hold their patents for sale in the ordinary course of trade or business, so that gain therefrom was taxable as ordinary income.

Leo M. Harvey v. Com., (CA-9) 49-1 USTC ¶ 9124, 171 F. 2d 952.

Harold T. Avery, 47 BTA 538, Dec. 12,812.

Paul H. Smythe, Jr., BTA memo., Dec. 12,576-C.

M. L. Lockhart, (CA-3) 56-2 USTC ¶ 9715, 238 F. 2d 343.

.84 In the following cases, inventors were found not to be professional inventors. Their inventions, therefore, were capital assets, and gain derived from sale of the inventions was capital gain.

William O'Neill Kronner v. U. S., (Ct. Cls.) 53-1 USTC ¶ 9235, 110 F. Supp. 730.

Marvin R. Thompson v. Johnson, (DC) 50-2 USTC ¶ 9428.

Clarence E. Beach, (DC) 54-2 USTC ¶ 9657, 126 F. Supp. 771.

The First Nat. Bank of Princeton, (DC) 56-1 USTC ¶ 9203, 136 F. Supp. 818. Gov't appeal to CA-3 dismissed.

Lester P. Barlow, 2 TCM 133, Dec. 13,218(M).

Hogg, 3 TCM 212, Dec. 13,795(M).

Kucera, 10 TCM 303, Dec. 18,229(M).

Wilma M. Imm, 11 TCM 257, Dec. 18,863(M).

.85 Retroactive amendment.—The addition of Sec. 117(q) to the 1939 Code in 1956, retroactively according capital gains treatment to patent transfers, did not waive the statute of limitations on claims for refund.

A. Zacks, (Sup. Ct.) 63-2 USTC ¶ 9615, 375 U. S. 59.

K. J. Tobin, (CA-5) 59-1 USTC ¶ 9345, 264 F. 2d 845.

G. R. Dempster, (CA-6) 59-1 USTC ¶ 9421, 265 F. 2d 666. Cert. den., 361 U. S. 819.

S. P. Vaughn, (DC) 60-1 USTC ¶ 9361, 181 F. Supp. 386.

Tobin v. Tomlinson, (CA-5) 62-2 USTC ¶ 9827, 310 F. (2d) 501.

H. B. Smith, (CA-3) 62-2 USTC ¶ 9539, 304 F. 2d 267.

The decision in the *Zacks* case, above, has in effect overruled the decision in the *Lorenz* case.

A. Lorenz, (Ct. Cls.) 62-1 USTC ¶ 9107, 296 F. 2d 746.

Regulations under Section 117(q) were amended by T. D. 6324, adopted on October 10, 1958, 586 CCH ¶ 6740.

.86 For taxable years beginning before June 1, 1950, a patent had to be held for more than six months in order for payments to receive long-term capital gain treatment.

A. Touchett, 19 TCM 403, Dec. 24,137(M), TC Memo. 1960-76.

[¶ 4746] DEALERS IN SECURITIES

'54 Code

Sec. 1236 [1954 Code]. (a) CAPITAL GAINS.—Gain by a dealer in securities from the sale or exchange of any security shall in no event be considered as gain from the sale or exchange of a capital asset unless—

(1) the security was, before the expiration of the 30th day after the date of its acquisition, clearly identified in the dealer's records as a security held for investment or if acquired before October 20, 1951, was so identified before November 20, 1951; and

(2) the security was not, at any time after the expiration of such 30th day, held by such dealer primarily for sale to customers in the ordinary course of his trade or business.