

A Survey of Intellectual Property Tax Issues

Connecticut Intellectual Property Law Association
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Introduction

- Background
- IP Development
- IP Acquisitions
- IP Transfers
- IP Litigation
- International IP Transactions
- Conclusion

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Background

- Application of tax principles to intellectual property transactions
 - IP life cycle
 - Sources of law
 - Policy decisions
- Value add
 - Early intervention
 - Efficacy of tax position
 - Strategy

Intellectual Property Development

- Immediate Deduction
 - “expense” vs. “capitalize”
 - Separate and distinct asset
 - Useful life in excess of 1 year
 - Section 174 deduction
 - Revenue Procedure 2000-50
- Amortization
 - Deduct capitalized costs over useful life
 - Recapture
- Section 41 R&D tax credit

Intellectual Property Acquisitions

- Capitalize cost
- Acquisition by assignment – amortization
 - Section 197
 - Section 167
 - Treas. Reg. s. 1.167(a)-3.
- Acquisition by license – deduct or amortize
 - In connection with acquisition of trade or business
 - Not in connection with acquisition of trade or business

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Intellectual Property Transfers

- Capital gain vs. ordinary income
 - 15% (20%) vs. 35% (39.6%)
 - Recovery of basis
 - Capital losses offset capital gains
 - 1 year holding period (except for Section 1235)
- Tension between transferor and transferee
 - “Assignment” usually capital gain to transferor and amortization deductions to transferee
 - “License” usually ordinary income to transferor and deductible to transferee

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Intellectual Property Transfers (cont'd 1)

- Section 1235 – transfer of all substantial rights to a patent (or undivided interest) by a holder to an unrelated person creates long term capital gain – regardless of holding period or whether patent would be considered inventory
 - Must transfer right to make, use and sell in all geographic regions and fields of use for entire life of patent
 - Transferor must be individual whose personal efforts created the patent or any other individual (other than an employer or relative of the inventor) who acquired an interest in the patent before reduction to practice

Intellectual Property Transfers (cont'd 2)

- Sections 1222/1231 – long term capital gain from
 - sale or exchange
 - capital asset
 - held for more than one year
- Sale or exchange - “assignment” for tax purposes
- Capital asset – property other than inventory and self-created copyrights

Intellectual Property Litigation

- Origin of the claim
 - In lieu of what were damages awarded?
 - Underlying law, causes of action, allegations, opinion, settlement agreement, etc.
- Costs of litigation/legal fees
 - Deduct as incurred or add to basis?
 - Patent/copyright: ownership vs. infringement
 - Trademark: generally viewed as capital in nature
- Proceeds of litigation
 - Ordinary income or capital gain?
 - Patent/copyright: lost profits
 - Trademark: damage to capital asset

International IP Tax Issues

- Inbound – Unless otherwise provided by treaty, non-US persons are subject to US tax on certain income from US sources, including royalties and payments based on productivity of IP in the US
- Outbound – US persons subject to US tax on worldwide income. Transfer of IP to a foreign corporation can result in “super royalty” deemed paid to US transferor.
- Cost-Sharing – Make sure intangibles for use outside the US are developed by a non-US person

Questions

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