

# Tax Relief for Patent Holders

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Anyone who owns a patent, or advises those who do, should take note of the tax implications of assigning or licensing patent rights. Do it right, and the inventor can treat this income as a long-term capital gain. Do it wrong, and the inventor may have to treat the income as ordinary income.

Internal Revenue Code §1235 was enacted to ensure that inventors received favorable long-term capital gains treatment for the sale or exclusive license of their patents. Under Section 1235, any sale by a "holder" of "property" that consists of "all substantial rights" to a patent, or undivided interest therein, is treated as a long term capital transfer regardless of the holding period. A holder is defined as (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)).

As can be seen, Section 1235 specifically excludes assignments by employees to their employers. An interesting exception: when professors share in royalty payments received by their University employer, the IRS has ruled that the payment should be treated as long-term capital gain under IRC 1235. Technical Advice Memorandum (TAM) 200249002 (dated August 8, 2002, released December 6, 2002).

If you or a client intend to assign or license any patent rights, look into the tax implications as early as possible.

