6 T.C. 258 (1946)

An exclusive license to use, manufacture, and sell an invention constitutes a sale of a capital asset, eligible for capital gains treatment if held for the requisite period and not primarily for sale to customers in the ordinary course of business.

Summary

Edward Myers granted B.F. Goodrich an exclusive license to his rubber-covered flexible steel track invention, receiving annual payments characterized as royalties. Myers argued this was a sale of a capital asset held for over 24 months and should be taxed as a long-term capital gain. The Commissioner of Internal Revenue contended the payments were royalties taxable as ordinary income. The Tax Court held that the agreement constituted a sale, the invention was a capital asset held for more than 24 months, and it was not property held primarily for sale in the ordinary course of business, therefore taxable as a capital gain.

Facts

Myers invented a rubber-covered flexible steel track and completed the invention and drawings before January 1, 1930. He filed a patent application on January 25, 1932, which was granted on December 31, 1935. On January 9, 1932, Myers granted B.F. Goodrich an exclusive license to use, manufacture, and sell the invention in exchange for annual payments termed “royalties.” Myers was employed as an engineer and was not in the business of inventing and selling inventions.

Procedural History

Myers originally reported the income from Goodrich as royalties and ordinary income. He later filed claims for refund, arguing the payments were long-term capital gains. The Commissioner denied the refund claim, leading Myers to petition the Tax Court.

Issue(s)

1. Whether the agreement between Myers and Goodrich constituted a sale of the invention or a mere license for royalty payments.

2. Whether the invention was property held by Myers for more than 24 months before the sale.

3. Whether the invention was a capital asset or property held primarily for sale to customers in the ordinary course of Myers’s trade or business.

Holding

1. Yes, because the exclusive license granted to Goodrich transferred the essential

ownership rights in the invention, constituting a sale.

2. Yes, because Myers completed the conception and design of the invention, as evidenced by detailed drawings, before January 1, 1930, more than 24 months before the sale.

3. Yes, because Myers was not in the business of inventing and selling inventions, and this single transfer did not constitute holding the property primarily for sale to customers.

Court’s Reasoning

The court relied on *Waterman v. Mackenzie, 138 U.S. 252*, which established that the legal effect of a transfer agreement, not its label, determines whether it is a sale or a license. The court emphasized that the agreement gave Goodrich the exclusive rights to “make, use, and sell” the invention. The court distinguished this case from situations where the grantor retained significant rights or controls. Regarding the holding period, the court determined that Myers’s invention was complete before January 1, 1930, based on documented drawings. Citing *Samuel E. Diescher, 36 B.T.A. 732*, the court stated that property rights in an invention exist upon its reduction to actual practice, not just upon obtaining a patent. Finally, the court found that Myers was not in the business of selling inventions. The court distinguished *Harold T. Avery, 47 B.T.A. 538*, noting that Avery had developed and sold multiple inventions over many years, establishing a business. The court quoted *Samuel E. Diescher*, stating that by transferring his one and only invention, Myers was not transferring property held primarily for sale in any trade or business conducted by him.

Practical Implications

This case clarifies the conditions under which proceeds from the transfer of patent rights can qualify for capital gains treatment. It highlights that the substance of the transfer agreement, particularly the exclusivity of the rights granted, is paramount. The case also emphasizes that the holding period begins when the invention is sufficiently developed for practical application, not necessarily when a patent is granted. For inventors who are not in the business of inventing, a one-time or infrequent sale of patent rights is more likely to be treated as a capital gain. Later cases applying *Myers* have focused on the taxpayer’s business activities and the degree of control relinquished in the transfer agreement. Practitioners must carefully analyze these factors when advising clients on the tax implications of patent transfers.

