6 T.C. 856 (1946)

The grant of an exclusive and perpetual right to use a trademark in a limited territory, in exchange for a lump-sum payment, constitutes a sale of a capital asset rather than a license, precluding the deduction of the payment as a business expense.

Summary

Seattle Brewing & Malting Co. sought to deduct payments made to Rainier Brewing Co. for the use of the "Rainier" and "Tacoma" trademarks. Initially, the agreement was structured as a license with royalty payments based on production. However, Seattle Brewing exercised an option to make a lump-sum payment of $1,000,000 to acquire the perpetual and exclusive right to use the trademarks in Washington and Alaska. The Tax Court held that this transaction constituted a sale of a capital asset, not a license, and therefore the lump-sum payment was not deductible as a business expense. The court emphasized the perpetual and exclusive nature of the rights transferred.

Facts

– Seattle Brewing & Malting Co. (petitioner) entered into a contract with Rainier Brewing Co. granting it the exclusive right to manufacture and sell alcoholic malt beverages under the "Rainier" and "Tacoma" trademarks in Washington and Alaska.
– Initially, the agreement required royalty payments based on barrel production, with a minimum annual royalty.
– The contract included an option allowing Seattle Brewing to terminate royalty payments by making a lump-sum payment of $1,000,000.
– Seattle Brewing exercised this option and argued that the lump-sum payment should be deductible as a royalty expense.
– After exercising the option, Rainier released its security interest in Seattle Brewing's property and modified the malt purchase requirements.

Procedural History

– The Commissioner of Internal Revenue disallowed Seattle Brewing's deduction of the $1,000,000 payment as a royalty expense.
– Seattle Brewing petitioned the Tax Court for review.
– The Tax Court upheld the Commissioner's determination, finding that the transaction was a sale of a capital asset.

Issue(s)

Whether the lump-sum payment made by Seattle Brewing to acquire the perpetual and exclusive right to use the "Rainier" and "Tacoma" trademarks constituted the purchase of a capital asset or a deductible royalty expense.

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Holding

No, because the grant of an exclusive and permanent right in a limited territory was an assignment of such right, the taxpayer acquired a capital asset, and the transaction was a sale and not a license.

Court’s Reasoning

– The Tax Court reasoned that the key factor was the nature of the rights transferred. The initial agreement was a license. However, after Seattle Brewing exercised the option and made the lump-sum payment, it acquired a perpetual and exclusive right to use the trademarks.
– The court distinguished this situation from cases involving licenses for limited terms or where the grantor retained significant control over the trademark.
– The Tax Court emphasized the

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