***General Aniline & Film Corp. v. Commissioner, 3 T.C. 104 (1944)***

A transfer of all substantial rights in a patent constitutes a sale, not a mere license, even if payments are based on production or profits, and such payments are not subject to withholding tax applicable to nonresident aliens.

**Summary**

General Aniline argued that payments to nonresident aliens under several agreements were for the purchase of patents (capital gains, not subject to withholding), or compensation for services performed outside the U.S. The IRS argued the payments were royalties (ordinary income subject to withholding). The Tax Court held that agreements transferring all substantial rights in a patent constituted sales, not licenses. However, one agreement that did not transfer all substantial rights was deemed a license, and payments under it were subject to withholding. The court emphasized the importance of evaluating the substance of the agreements, not merely their titles.

**Facts**

General Aniline & Film Corp. (petitioner) entered into several agreements with nonresident aliens (Dichter, Favre, and Meyer). These agreements concerned patents and patent applications. Some agreements were titled “licenses,” while others involved outright assignments. Payments to the nonresident aliens were structured in various ways, including fixed sums and amounts based on production or profits. The IRS determined that these payments were “royalties” subject to withholding tax under Section 143(b) of the Internal Revenue Code.

**Procedural History**

The Commissioner of Internal Revenue assessed deficiencies against General Aniline for failure to withhold tax on payments made to nonresident aliens. General Aniline petitioned the Tax Court for a redetermination of these deficiencies. The case was heard by the Tax Court, which issued its opinion determining the nature of the payments and the applicability of withholding requirements.

**Issue(s)**

1. Whether the agreements between General Aniline and the nonresident aliens constituted sales of patents or mere licenses.
2. Whether payments made under these agreements were subject to withholding tax under Section 143(b) of the Internal Revenue Code.

**Holding**

1. For the Dichter, Favre, and the June 2, 1933 Meyer agreements: No, because the agreements transferred all substantial rights in the patents, constituting sales.

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2. For the September 17, 1925 Meyer agreement: Yes, because this agreement did not transfer all substantial rights, constituting a mere license. Therefore payments made under this contract were subject to withholding.

**Court's Reasoning**

The court reasoned that the substance of the agreements, not merely their titles, determined whether they constituted sales or licenses. Quoting *Waterman v. Mackenzie, 138 U. S. 252*, the court stated that when a patentee transfers all rights to make, use, and vend an invention, the transfer amounts to a sale, even if called a license. The court distinguished agreements that conveyed all substantial rights from those that did not. For example, the court noted, "Unlike the Dichter and Favre agreements, this contract did not convey to petitioner all three of the exclusive patent rights, i. e., to make, to use, and to vend. Only the rights to manufacture and to sell are mentioned. Under the rule of the Waterman case, the agreement therefore appears to be a mere license."
The court also held that the form of payment (fixed sums vs. percentage of profits) was not determinative. Percentage payments, though similar to royalties, could still constitute payments of purchase price. The court distinguished its holding from cases cited by the IRS, emphasizing that the seller's continued "economic" interest in the patent's exploitation did not automatically make the payments subject to withholding.

**Practical Implications**

This case clarifies the distinction between a sale and a license of a patent for tax purposes. It emphasizes the importance of transferring all substantial rights in a patent to achieve sale treatment. The ruling impacts how cross-border transactions involving patents are structured, especially concerning withholding tax obligations. It shows attorneys should carefully draft patent transfer agreements to ensure the intended tax consequences are achieved. Later cases have cited *General Aniline* for its analysis of what constitutes a transfer of "all substantial rights" and the factors considered when determining if a transaction is a sale or a license for tax purposes.

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