9 T.C. 183 (1947)

Payments for the exclusive right to make, use, and sell a patented invention constitute the purchase price of the patent (a sale), not royalties from a license, and are thus not subject to tax withholding for nonresident aliens, unless the agreement only transfers some, but not all, of those rights.

Summary

Kimble Glass Co. made payments to three nonresident aliens under various contracts related to patents. The IRS determined these payments were royalties subject to withholding tax. Kimble argued the payments were either the purchase price for patents or compensation for services performed outside the U.S., neither of which are subject to withholding. The Tax Court held that most of the contracts constituted sales of patents, except for one that only transferred some of the patent rights, and thus only payments under that specific contract were subject to withholding.

Facts

Kimble Glass Co. contracted with Felix Meyer, Jakob Dichter, and Pierre A. Favre, all nonresident aliens, for rights related to glass manufacturing patents. The contracts involved fixed payments and payments based on production or sales. The specific terms varied, including assignments of patents and exclusive licenses to make, use, and sell inventions. Kimble initially did not withhold taxes on these payments, relying later on an attorney's advice. Some payments were also for services performed by Meyer in Europe.

Procedural History

The IRS assessed deficiencies and penalties against Kimble for failing to withhold income taxes on payments made to the nonresident aliens. Kimble petitioned the Tax Court, contesting the deficiencies and claiming overpayment for certain years. Kimble filed delinquent returns for some years after an investigation by the Alien Property Custodian.

Issue(s)

1. Whether payments made by Kimble to Meyer, Dichter, and Favre constituted royalties for the use of patents, subject to withholding tax under Section 143(b) of the Internal Revenue Code.
2. Whether the penalties for failure to file timely returns should be imposed.

Holding

1. No, for the Dichter and Favre agreements and the June 2, 1933, Meyer agreement; Yes, for the September 17, 1925, Meyer agreement because those

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agreements transferred the exclusive rights to make, use, and sell the inventions, constituting a sale of the patent, while the 1925 Meyer agreement was only a license.
2. Yes, for the payments under the 1925 Meyer contract because Kimble did not demonstrate reasonable cause for failing to file returns before 1936.

Court's Reasoning

The court distinguished between a sale of a patent (transferring all rights to make, use, and vend) and a mere license. Citing *Waterman v. Mackenzie, 138 U.S. 252*, the court stated that "when the patentee transfers all of these rights exclusively to another…he transfers all that he has by virtue of the patent and the transfer amounts to a sale of the patent. Where he transfers less than all three rights to make, use, and vend for the term of the patent…the transfer is a mere license." The Dichter and Favre agreements and the June 2, 1933 Meyer agreement granted Kimble the exclusive right to make, use, and sell, thus constituting a sale. The September 17, 1925 Meyer agreement, however, only conveyed the rights to manufacture and sell, not to use, and was deemed a license. The court also noted that the fact percentage payments were included did not negate the sales. The court relied on *Commissioner v. Celanese Corporation, 140 Fed. (2d) 339* to reject the argument that periodic payments are subject to withholding if the seller retains an economic interest. Penalties were upheld for pre-1936 failures to file regarding the 1925 Meyer agreement, as Kimble did not demonstrate reasonable cause.

Practical Implications

This case clarifies the distinction between a sale of a patent and a mere license for tax withholding purposes. It emphasizes that the substance of the agreement, not its label, controls. Attorneys drafting patent agreements should be aware that transferring all three rights (make, use, and vend) constitutes a sale, exempting payments from withholding tax for nonresident aliens. Retaining even one of these rights suggests a license, which triggers withholding obligations. This case is relevant in structuring international patent transactions to minimize tax burdens. Later cases have cited *Kimble Glass* for its clear exposition of the *Waterman v. Mackenzie* rule regarding patent assignments versus licenses.

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