Herbert Allen v. Commissioner, 9 T.C. 159 (1947)

When an employee is hired to invent, patents developed during that employment, using the employer’s resources and assistance, are the property of the employer, and payments to the employee are considered compensation, not capital gains from a sale.

Summary

Herbert Allen challenged the Commissioner’s determination that payments received from his employer, the company, were taxable as ordinary income rather than as capital gains from the sale of patents or from a joint venture. The Tax Court held that the patents developed by Allen during his employment were the property of the company based on the employment agreements. Allen was specifically hired to adapt a chain saw for the company and used company resources. Therefore, payments received were deemed compensation, not proceeds from a sale of capital assets. The court also allowed a deduction for legal fees related to advice on the employment contract but disallowed a deduction related to the alleged cost basis of patents he did not own.

Facts

Herbert Allen was employed by a company to work on developing and adapting a chain saw for commercial production.
Allen’s employment was governed by three agreements (March 31, 1933, January 25, 1939, and March 28, 1941), all of which mentioned the chain saw.
One agreement stated Allen would “develop claims and apply for patents” which would be assigned to the company without additional compensation.
Allen worked at the company’s plant with their resources and assistance.
Allen previously assigned other patent applications and patents to the company during his employment.
A chain saw embodying Allen’s inventions was finished and tested in September 1937 and sold in 1940.
Allen terminated his employment on December 31, 1941.

Procedural History

The Commissioner determined that payments to Allen were taxable as ordinary income.
Allen challenged this determination in Tax Court, arguing the payments were capital gains from the sale of patents or from a joint venture.
Allen also claimed deductions for legal fees and other expenses.</nThe Tax Court sustained the Commissioner's determination regarding the taxability of payments as ordinary income but allowed a deduction for certain legal fees.

Issue(s)

1. Whether payments made by the company to Allen were compensation taxable as ordinary income or consideration for the sale of patents taxable as long-term capital gains.
2. Whether Allen was entitled to deduct legal fees and other expenses incurred in connection with the employment contract and patent assignments.

Holding

1. No, because the patents developed during Allen's employment were the property of the company according to the employment agreements, thus payments were compensation.
2. Yes, in part. Allen was entitled to deduct legal fees for advice on his rights under the employment contract, but not expenses related to the alleged cost basis of patents he did not own, because there was no sale of patents by Allen.

Court's Reasoning

The court relied heavily on the employment agreements, finding them unambiguous and indicative of the parties' intent that the patents would belong to the company. The court cited *Standard Parts Co. v. Peck, 264 U.S. 52*, noting that when an employee is specifically hired to develop a particular device, the resulting invention belongs to the employer.
The court noted that the agreement of January 25, 1939 explicitly required Allen to assign any patents to the company without additional compensation beyond what was provided in the agreement. The court stated: "Should any patents be granted on any of these claims you agree that these will be assigned forthwith to this Company, without any other compensation to you than that provided under this agreement."
The court disregarded the company's internal accounting treatment of the patents and payments, finding that the employment contracts governed the parties' rights and obligations.
The court accepted Allen's testimony regarding the legal fees paid for advice on his contract rights, finding it established a prima facie case for deduction, as the respondent failed to offer contradictory evidence.
Regarding the claimed deduction of $1,861.33, the court found it was not properly deductible because it was allegedly part of the cost of patents, which the court already determined were owned by the company, and there was no sale by Allen. There was therefore no basis for a deduction.

Practical Implications

This case clarifies the ownership of patents developed during employment, particularly when an employee is specifically hired to invent. It emphasizes the importance of clear and unambiguous employment agreements that explicitly address patent rights.
This case underscores the principle that using the employer's resources and working within the scope of employment strongly suggests that resulting inventions belong

to the employer.
Attorneys drafting employment agreements should include clauses addressing the ownership of intellectual property created during the employment relationship. This prevents disputes over patent rights and clarifies the tax treatment of payments made to employees.
This case is often cited in disputes over intellectual property ownership between employers and employees. Later cases distinguish *Allen* based on the specific language of the employment agreement and the extent to which the employee used the employer’s resources.

