Rose Marie Reid v. Commissioner, 26 T.C. 622 (1956)

Payments received for the exclusive and perpetual transfer of a trade name and patents, even if structured as a percentage of sales, are considered capital gains, not ordinary income, for tax purposes, provided the assets are capital assets and were not held for sale in the ordinary course of business.

Summary

The U.S. Tax Court ruled in favor of Rose Marie Reid, determining that payments she received from a corporation for the use of her trade name and patents were taxable as capital gains rather than ordinary income. Reid had transferred her trade name and patents to a swimsuit manufacturing corporation, and as part of a settlement agreement, the corporation agreed to pay her a percentage of its net sales. The court held that this arrangement constituted a sale of capital assets, as the transfer was exclusive, perpetual, and not related to personal services. The decision clarified that the form of payment (percentage of sales) does not preclude capital gains treatment and highlighted the importance of the parties' intent in determining the nature of the transaction.

Facts

Rose Marie Reid, a swimsuit designer, developed valuable patents and a strong trade name associated with her designs. In 1946, she and Jack Kessler agreed to form a corporation (Californian) to manufacture and sell swimsuits. Reid was to transfer her trade name, patents, and patent applications to Californian in exchange for stock, while Kessler was to contribute cash and manage the business. A dispute arose over the terms of the agreement. Reid subsequently entered into a settlement agreement with Californian in 1949. The agreement granted Californian the exclusive right to use her name and patents in exchange for one percent of net sales. Reid also received employment compensation as a designer. The Commissioner of Internal Revenue determined that the payments were taxable as ordinary income. Reid contended that the payments from the agreement should be treated as capital gains.

Procedural History

The Commissioner of Internal Revenue determined deficiencies and additions to tax in Reid's income tax returns for the years 1948, 1949, and 1950, treating the payments from the corporation as ordinary income. Reid petitioned the United States Tax Court, arguing for capital gains treatment. The Tax Court considered the case and ruled in favor of Reid, determining that the payments were indeed capital gains. Decision was entered under Rule 50.

Issue(s)

1. Whether the payments to Reid, based on a percentage of the corporation's net

© 2025 SCOTUSreports.com. All rights reserved.

sales, were made in respect of her trade name and patents or for personal services.

2. Whether, assuming the payments were made in respect of the trade name and patents, the transaction constituted a “sale or exchange” of capital assets, thus entitling Reid to capital gains treatment.

Holding

1. Yes, because the court found that the payments were received as consideration for Reid’s trade name and patents.

2. Yes, because the court held that the agreement constituted a “sale or exchange” of capital assets.

Court’s Reasoning

The court analyzed the substance of the 1949 agreement and determined that the payments in question were separate from Reid’s compensation as a designer and were directly tied to the transfer of her trade name and patents. The court referenced the agreement between Reid and the corporation, which explicitly stated the payments were for the use of her name and patents. Moreover, the court considered that Reid possessed valuable rights and could have sought legal remedies to prevent the corporation from using these assets, which indicated a transfer of ownership. The court found that the agreement represented a “sale or exchange” of capital assets, entitling her to capital gains treatment under Section 117 of the Internal Revenue Code of 1939. The court cited that the trade name and patents were not held for sale in the ordinary course of business, and therefore were capital assets. “An exclusive perpetual grant of the use of a trade name, even within narrower territorial limits than the entire United States, is a disposition of such trade name falling within the “sale or exchange” requirements of the capital gains provisions of the 1939 Code.” The court emphasized that the form of payment (percentage of sales) did not preclude capital gains treatment; the key was the intent to transfer ownership of capital assets.

Practical Implications

This case establishes that when a business owner transfers a trade name or patents to another entity, and the transfer is exclusive and perpetual, payments received for the transfer are likely to qualify as capital gains. Attorneys should: 1) carefully draft agreements to reflect a clear intent to transfer ownership. 2) Assess whether the trade name/patents are held for business (ordinary income) versus personal use (capital asset). 3) Recognize that the method of payment (e.g., royalties or a percentage of sales) does not automatically determine the tax treatment. The case reinforces the importance of distinguishing between payments for the transfer of assets and compensation for services, as well as how to characterize the transaction as a sale. It highlights that even if a dispute exists over ownership, the resolution of

© 2025 SCOTUSreports.com. All rights reserved.

that dispute can result in a sale or exchange of a capital asset. Future cases involving intellectual property transfers can cite this case for the principle of capital gains treatment for qualifying transfers of intangible assets. The principles in this case would be relevant to modern tax law, where capital gains are generally taxed at a lower rate than ordinary income.

© 2025 SCOTUSreports.com. All rights reserved.