28 T.C. 938 (1957)

Payments received for the transfer of all rights to an invention, even before a patent is obtained, can qualify for capital gains treatment if the invention is a capital asset and held for the required period.

Summary

In *Speicher v. Commissioner*, the Tax Court addressed whether payments received by an inventor for the assignment of his invention should be taxed as ordinary income (royalties) or as capital gains. Franklin Speicher had developed a machine for steel stamps and assigned all rights to it to a corporation. The IRS argued the payments were royalties, but the Tax Court held that the payments constituted capital gains because Speicher had transferred all rights to the invention, and the invention was a capital asset held for more than six months. The court also addressed penalties for failure to file a declaration of estimated tax.

Facts

Franklin S. Speicher developed a machine for manufacturing steel stamps and, in 1924, assigned all rights to the invention to M.E. Cunningham Company in exchange for a percentage of sales. Speicher also received a salary from the company. The IRS determined that payments received from the company based on sales were royalty income and taxed in full. The Commissioner also determined additions to tax for 1951 under Internal Revenue Code of 1939, Sec. 294 (d)(1)(A) and (d)(2). Speicher disputed the IRS's determination, arguing for capital gains treatment of the percentage payments, and contested the additions to tax.

Procedural History

The case was heard in the United States Tax Court. The Tax Court considered the IRS's determinations regarding the tax treatment of the payments received by Speicher from M.E. Cunningham Company, and the additions to tax that the IRS determined. The Tax Court ruled in favor of the taxpayer on the capital gains issue but sustained the additions to tax, subject to recalculation.

Issue(s)

1. Whether the percentage payments received by Franklin S. Speicher from M. E. Cunningham Company were taxable as ordinary income (royalties) or as capital gains from the sale of an invention?

2. Whether the petitioners were subject to additions to tax for failure to file a declaration of estimated tax for 1951 and for underestimation of their tax for 1951?

Holding

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1. Yes, because the payments were part of the purchase price for the invention, and Speicher assigned all rights to it.

2. Yes, because Speicher did not file a timely declaration of estimated tax.

Court’s Reasoning

The court relied on the general rule that the exclusive right to manufacture, use, and sell a patented article constitutes a sale of patent rights, taxable as long-term capital gain, provided the invention is a capital asset and held for the required period. The court determined that the 1924 agreement, though not using the words “manufacture, use and vend,” effectively transferred Speicher’s ownership of the invention. The court referenced testimony from Speicher affirming that he retained no rights to the invention. The court also noted the invention did not need to be patented to be a capital asset, as the conception was completed before the assignment. The court found that the invention was not held primarily for sale in the ordinary course of business, therefore qualifying for capital gains treatment. The court found that the invention was held for more than six months.

Regarding the additions to tax, the court sustained the IRS’s determination, because the declaration of estimated tax was not timely filed.

Practical Implications

This case clarifies that capital gains treatment can apply to transfers of inventions even without a formal patent, provided all ownership rights are transferred. The emphasis is on the substance of the agreement, not just the specific words used. The court’s analysis is useful for attorneys advising clients involved in the sale or transfer of inventions, particularly those who may not have yet secured a patent. This case illustrates that capital gains treatment is possible where the inventor has fully transferred their rights in the invention. This provides useful guidance on how to structure intellectual property transactions to take advantage of potentially lower capital gains tax rates. Subsequent cases must consider whether the inventor has transferred all rights to the invention.

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