***28 T.C. 1189 (1957)***

The assignment of a patent by an inventor to a corporation in which she and her husband owned all of the stock qualified as a "sale or exchange" of a capital asset, entitling the inventor to capital gains treatment on payments received, despite the fact that the payments were contingent on the corporation's sales of the patented product.

**Summary**

In this case, the United States Tax Court addressed whether payments received for the assignment of a patent were to be treated as ordinary income or capital gain. Raye Coplan, the inventor of a device, assigned her patent to a corporation jointly owned by her and her husband, Leonard Coplan. The agreement provided for payments based on a percentage of net sales. The Commissioner of Internal Revenue argued that these payments should be taxed as ordinary income. The Tax Court, however, followed established precedent and held that the assignment constituted a "sale or exchange," entitling the Coplans to capital gains treatment on the payments received. The Court found that the transfer was not a sham and met the requirements of a sale, even though the Coplans owned the corporation.

**Facts**

Raye Coplan invented a device for simplified marionette operation and obtained a patent on May 23, 1950. Peter Puppet Playthings, Inc., a New York corporation, was formed in 1947, with Raye and Leonard Coplan each initially owning 25% of the shares. By 1949, the Coplans owned 50% each. On May 23, 1950, Raye assigned the patent to the corporation in exchange for $25,000 and a 5% royalty on net sales. The agreement also included a clause for reassignment of the patent to Raye if the corporation became bankrupt or failed to meet minimum royalty payments. In 1953, the parties clarified the agreement to specify the 5% royalty based on net sales with a $1,000 minimum annual guarantee. For the years 1951, 1952, and 1953, the corporation paid Raye Coplan substantial sums based on sales of the patented device. The Coplans reported the payments as capital gains on their tax returns, but the Commissioner determined they were taxable as ordinary income.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in the Coplans' income tax for the years 1951, 1952, and 1953, arguing that the payments received from the corporation were ordinary income, not capital gains. The Coplans filed a petition in the United States Tax Court to challenge the Commissioner's decision. The Tax Court considered the case based on stipulated facts. The Tax Court held in favor of the Coplans, allowing them to treat the payments as capital gains.

**Issue(s)**

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Whether the payments received by Raye Coplan from Peter Puppet Playthings, Inc. for the assignment of the patent constitute ordinary income or capital gain.

## Holding

Yes, the payments received by Raye Coplan from Peter Puppet Playthings, Inc. for the assignment of the patent constitute capital gain because the assignment of the patent was a "sale or exchange" of a capital asset, despite her ownership of the corporation.

## Court's Reasoning

The Court found that the transfer of the patent to the corporation constituted a "sale or exchange," as the inventor assigned all rights to the patent in exchange for payments. The court relied on the established case law, specifically citing *Edward C. Myers*, which had previously established that such transfers qualify for capital gains treatment. The Court noted that the Commissioner had, at various times, either accepted or rejected the precedent, leading to legislative action clarifying the issue. While a new tax code provision (1954 Code section 1235) and an amendment to the 1939 Code existed, the court found that the transfers were still a "sale or exchange" and were not a sham. The court found no issues with Raye's ownership in the company. The court stated, "Since the years before us, 1951-1953, fall within the period covered by the new legislation, it is apparent that petitioners would prevail if the conditions of the new subsection (q) were met." The court made it clear it was not revisiting the case, which had been followed in prior cases.

## Practical Implications

This case provides guidance on how to structure the transfer of patent rights and the tax implications of such transfers. This case reinforces the importance of establishing a genuine sale or exchange, rather than a mere licensing agreement. The case demonstrates the potential for inventors to receive capital gains treatment on the sale of their patents, even to corporations they own. The key takeaway for attorneys is to structure transactions to ensure the transfer meets the requirements for a "sale or exchange". This case is also relevant for cases where the inventor owns a corporation, and the terms of the assignment and ongoing payments must clearly indicate a sale. This case highlights the importance of examining the entire economic substance of the transaction to determine its characterization for tax purposes.

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