Kronner v. United States, 40 T.C. 38 (1963)

The grant of an exclusive license to manufacture, use, and sell a patented article constitutes a sale of the patent rights for tax purposes, even when royalty payments are contingent on future sales, provided the patent is a capital asset and held for the required period.

Summary

The case concerns whether a license agreement between Kronner, a corporation, and its principal stockholder, constituted a sale of patent rights, qualifying the income as capital gains, or a mere licensing arrangement, resulting in ordinary income. Kronner granted Carroll an exclusive license to manufacture, use, and sell a patented device. The agreement stipulated royalties based on sales. The Tax Court held that the exclusive license constituted a sale of the patent rights, despite certain reserved rights like termination clauses and the licensor's control over sublicensing, entitling Kronner to treat the royalties as capital gains. The decision reaffirms the principle that transferring the exclusive rights to a patent can constitute a sale for tax purposes.

Facts

Kronner Corporation owned a patent for a track roller. It entered into a "License Agreement" with its principal stockholder, William Craig Carroll, granting him the exclusive right to manufacture, use, and sell the patented device within the United States. In exchange, Carroll agreed to pay a royalty of 1% of the wholesale price of each unit sold. The agreement included clauses addressing the licensor's rights to terminate for breach, limitations on sublicensing, and the licensor's ability to restrict assignments of the license. Kronner reported the royalties received as capital gains. The IRS argued the agreement was a licensing arrangement, and the payments were ordinary income, resulting in tax deficiencies.

Procedural History

The IRS determined tax deficiencies against Kronner, arguing the royalty income was not capital gains. Kronner petitioned the Tax Court for review of the deficiency determination. The Tax Court considered the case based on stipulated facts and legal arguments. The Tax Court ruled in favor of Kronner, holding that the license agreement constituted a sale of patent rights.

Issue(s)

1. Whether the "License Agreement" between Kronner and Carroll constituted a mere licensing arrangement or an assignment and sale of patent rights.

2. Whether the amounts received by Kronner under the "License Agreement" are taxable as capital gains or ordinary income.

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Holding

1. Yes, the “License Agreement” was an assignment and sale of the patent rights because it granted the exclusive right to make, use, and sell the patented invention.

2. Yes, the payments received under the agreement are taxable as capital gains because the transaction qualified as a sale of a capital asset, the patent.

Court’s Reasoning

The Tax Court relied on established precedent, particularly *Vincent A. Marco*, which held that granting the exclusive right to manufacture, use, and sell a patented article is a sale of the patent rights. The court rejected the IRS’s argument that certain clauses in the agreement, such as the right to receive royalties, limit Carroll’s right to sublicense, and the right to terminate, negated a sale. It held that these provisions were consistent with a sale and did not alter the fundamental nature of the agreement as a transfer of exclusive rights. The court noted the agreement’s clear language transferring all rights to Carroll and the fact that the patent was a capital asset. The court stated, “Where the language of the operative words effecting a transfer are clear and their meaning is plain any doubt as to whether the transfer has been restricted or conditioned by a subsequent clause will be resolved against the asserted restriction or condition.”

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