Blake v. Commissioner, 67 T. C. 7, 1976 U. S. Tax Ct. LEXIS 40, 192 U. S. P. Q. (BNA) 45 (1976)

A transfer of all substantial rights to a patent qualifies for capital gains treatment under Section 1235, even if made through multiple exclusive licenses, provided no valuable rights are retained by the transferor.

Summary

David R. Blake, the patent holder of a leveling device, granted exclusive licenses to American Seating Co. for public seating and Ever-Level Glides, Inc. for the restaurant field. The Tax Court held that royalties from the American license were ordinary income, as Blake retained valuable rights at the time of that license. However, the Ever-Level license transferred all remaining substantial rights, entitling Blake to capital gains treatment under Section 1235 for royalties and infringement damages from that license. The court also ruled that infringement damages could not be accrued until 1970 when they were reasonably calculable, and Blake was not entitled to a deduction for surrendering certain royalty rights in 1969.

Facts

David R. Blake patented a leveling device and granted an exclusive license to American Seating Co. in 1954 for use in public seating, excluding restaurants. In 1960, he granted an exclusive license to Ever-Level Glides, Inc. for the restaurant field. Both licenses included royalties and provisions for infringement suits. Blake also received infringement damages from Stewart-Warner in 1970 after a successful lawsuit. In 1969, Blake and Ever-Level settled their disputes, with Blake releasing claims to additional royalties under the 1954 agreement.

Procedural History

Blake filed tax returns treating royalties and infringement damages as capital gains under Section 1235. The IRS challenged this, asserting the income should be treated as ordinary. The case was heard by the U. S. Tax Court, which issued its opinion on October 6, 1976.

Issue(s)

1. Whether amounts received from the American and Ever-Level licenses qualified for long-term capital gain treatment under Section 1235.
2. Whether infringement damages from Stewart-Warner should have been accrued as income in 1968.
3. Whether Blake was entitled to a deduction or addition to cost for surrendering royalty rights in 1969.

Holding

1. No, because Blake retained valuable rights at the time of the American license; Yes, because the Ever-Level license transferred all remaining substantial rights.
2. No, because the amount of damages could not be determined with reasonable accuracy until 1970.
3. No, because Blake did not establish a legal or factual basis for the asserted deduction.

Court's Reasoning

The court applied Section 1235, which provides for capital gains treatment when all substantial rights to a patent are transferred. The American license did not qualify because Blake retained valuable rights outside the public seating field. However, after granting the Ever-Level license, Blake retained no valuable rights, thus qualifying the royalties and infringement damages from that license for capital gains treatment. The court distinguished this case from Fawick v. Commissioner, which involved field-of-use licenses where valuable rights were retained. The court also followed the Sixth Circuit's ruling in Fawick for the American license but disagreed with the IRS's interpretation that Section 1235 required a single transferee. For infringement damages, the court held that they could not be accrued until 1970 when the amount was reasonably calculable. Finally, Blake's claim for a deduction related to surrendered royalties was rejected due to lack of proof of loss or legal basis.

Practical Implications

This decision clarifies that a patent holder can qualify for capital gains treatment under Section 1235 even through multiple exclusive licenses, as long as no valuable rights are retained after the final transfer. Practitioners should carefully evaluate the scope of rights retained after each license to determine the tax treatment of subsequent income. The ruling also emphasizes the importance of the ability to reasonably calculate infringement damages before they can be accrued for tax purposes. This case has been influential in later decisions involving the tax treatment of patent licensing income and has helped shape IRS regulations and guidance in this area.

