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Intellectual Property (Patents & Trademarks & Taxation)

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June 23, 2016

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Some Objectives

- patent sale system tax shelter of IRC sec 174 and 1235;
- the use of options (a) to incentivize others on start-up; (b) balance tax considerations with bankruptcy ipso facto clause possibilities; (c) delay sale until optimum time; and, (d) harvest more maximal ultimate cash flow.
- Eliminating liability in selection and adoption and segregation of trademark sales functions apart from asset ownership;

Some Objectives (cont'd)

- Seeking criticality in new, non-obvious computer methods
- use of insurance to promote deductibility of expenses & to supplement an affirmative enforcement budget
- tax-based selection of both domicile & business operating & sales locations
- personal liability for tax & how to structurally contain certain types of tax liability
- Leveraging by segregating capital gains stream from ordinary deductions

Overview of Intellectual Property

- ALL IP rights are NEGATIVE
- NO positive rights to manufacture/sell
- Some IP CAN qualify as asset that attracts CAPITAL GAINS tax treatment

PATENTS

COMMON MISCONCEPTIONS:

“A patent gives me the right to manufacture”
(NO it does not)

“I have to do a search”
(NO, but you should spend \$300K to be statistically
certain)

“Let’s send them a really nasty letter, if they don’t like
it, they can lump it!”
(WHOA! This can get you into big trouble...)

What is a Patent?

- Relates to (1) machine, (2) process, (3) article of manufacture, (4) composition of matter, (5) non-tuber plant
- Three kinds of patent:
 - Utility:
 - Covers function
 - 20 year potential
 - Design
 - Covers look of utilitarian item
 - 14 year potential
 - Plant: 20 year potential

Why File for a Utility Patent?

- Up to 39% U.S. Government subsidy (deductibility)
- Instant capital gain tax rate of 0%/15%/20%/23.8% based upon base income (no holding period)
- Makes the competition think twice
- Patent insurance to stop infringers is now available
- Great for advertising and marketing
- Utility = 1-year right to file foreign (design = 6 mo)

Why File for a Design Patent?

- Inexpensive (filing to issue w/o argument $\sim \leq$ \$2500)
- “Patent Pending” need not identify as design patent
- New look of old item qualifies!
- Low-tech protection
- NO maintenance fees
- Same capital gains tax treatment as utility patent!

Patent Related Tax Deductions

- RESEARCH & EXPERIMENTAL EXPENDITURES

IRC §174 allows deduction (ordinary) for:

- Research or experimental expenditures
- Paid or incurred during the taxable year
- “In connection with” trade or business
- (There should be some ordinary income {such as production or salary} to deduct against.)

What Else May be Deducted?

- PATENT ATTORNEY FEES!
- Non-marketing type research
- Equipment, testing, experiments
- Technical Performance Statistics

CASES OF INTEREST

For Taking Advantage of Patent Related Tax Benefits

- *Green v. Commissioner*, 83 T.C. 667 (1984)

NO DEDUCTION of project expenditures for “non-technically active” investment vehicles/partnerships, etc. (i.e. patent was already “tied up” and could not be freely sold.)

CASES OF INTEREST

For Taking Advantage of Patent Related Tax Benefits

- *Scoggins v. Commissioner*, 95-1 USTC 50061; 46 F3D 950 (9th Cir).

Where a partnership keeps the opportunity to enter business, sell the patent, control the technology; then money put into the partnership may be currently deductible.

THE CASES OF INTEREST

For Taking Advantage of the Tax Benefits

- *Associated Patentees, Inc.* 4 T.C. 979 (1945).

Where the payments are dependent upon the patent's use or production, the payments are related to "using up" the patent and thus should be deductible in the year paid or accrued.

What about Tax Credits?

- IRC §41 gives taxpayers, typically large corporate taxpayers, a tax credit
- Congress tinkers with this nearly every year, never really breaking forward towards anything that is of great help to inventive companies.
- A good example for comparison is Toronto's refundable tax credit that greatly helps in attracting the capital to form a company where this is necessary to start production.

Production Deduction §199

- Deduct a percentage of Qualified Domestic Production Activities Income. Generally 9% (but only 6% for oil related production)
- Tangible personal property is machines, printing presses, cooling equipment, vending machines, gas pump, film production, farming, construction, and more...which was manufactured, produced, grown or extracted.
- Must be substantial in nature with a 20% of the cost of goods sold as the safe harbor.

PATENT BANKRUPTCY RISK

- Licensee Bankruptcy:
 - Licensee may keep using and licensor may or may not be able to receive compensation.
 - Exclusive License may be more akin to ownership and may continue to be used by debtor licensee
 - Generally, non-exclusive licenses are not assignable in bankruptcy without the licensor's consent

PATENT BANKRUPTCY RISK

- Licensor Bankruptcy: (11 U.S.C. § 365)
 - Licensee can treat license as terminated and file claim
 - Licensee can elect to continue contract and cause Licensor to continue to service & continue to pay royalties

GENERAL LAW PRINCIPLES

- Asset purchase = capitalize & write-off over useful life
- Asset sale = giving up ~100% ownership rights
- Related entity sale: deductions & gains restricted
- Capital Asset sale: generally 1 year holding period for long-term capital gains treatment
- License = mere promise not to sue licensee

GENERAL TAX RATES

- Income relating to an activity:
 - Top ordinary Income tax rate – about 39%
 - Self Employment Tax – about 15%
 - Social Security Medical – 3% Forever
 - State Tax (Top California 13.3%)(Texas 0%)
 - Most states tax capital gains at ordinary rates (only one state which pivots from the overall federal rate has a concomitant reduction)

GENERAL TAX RATES

- Passive ordinary income:
 - Top ordinary Income rate – about 39.6%
 - State Tax (Top California 10%) (Texas 0%)
- Long Term Capital Gains income:
 - Capital Gains rates of 0%, 15%, 20% (plus Obama 3.8% surcharge)
 - State Tax (Top California 10%) (Texas 0%)

COST OF CAPITALIZATION

- Capitalization:
 - interest-free loan to the government
 - Amount of loan = tax imposed upon non-expensible portion of a purchase/investment
- Example:
 - \$1M used to build a building Jan 1, 2013;
 - \$1M rent collected by Dec 31, 2013 = single year cash break even

COST OF CAPITALIZATION

- Example (cont'd):
 - Disallowing expense forces 39.6% tax on the \$1M to build the improvement
 - TP recovers by depreciation over 27 years
 - Result: ~\$396K 27-year loan to government, 0% interest, AND you have to live long enough while earning ordinary income in order to benefit

COST OF RISK

- Outright purchase of patent = capitalization cost + HUGE risk:
 - Patent could become worthless overnight.
 - Patent could be invalidated.
 - Patent enforceability could be compromised.
- Costs of risk + capitalization LOWERS sales price!
- A prospective buyer might pay \$1M cash; or
 - \$1.10M if license if capitalization cost eliminated
 - Possibly \$3M with a pay-for-each-unit-produced arrangement

SALE OF PATENT

- Sale = surrender of “substantially” all owner rights
- A license can be a sale IF it transfers:
 - All rights to entire patent for an entire nation
 - All rights to 100% of the patent term
 - No substantial rights retained
- “Subject to right of payment” \neq retention of substantial interest (even if the payment increases over time)
(Other retained rights may cause denial of sale treatment!)

Instant Capital Gains

- TAX TREATMENT ON SALE OF A PATENT
- IRC §1235 treats a sale or exchange of a patent capital asset as if it were held for > 1 year:
 - A transfer (but not by gift, inheritance or devise)
 - Of ALL substantial patent rights (or undivided interest)
 - By any HOLDER
 - Regardless of whether payments are
 - Periodic and associated with use OR
 - Contingent on productivity, use, or disposition

Regular Capital Gains

- TAX TREATMENT ON SALE OF A PATENT
- Going outside of §1235 requires holding the asset for more than one year, but also eliminates the other restrictions and advantages of §1235:
 - Under §1235 Siblings again not related taxpayers
 - Restriction on summation of inventor interests (usually related) to 25% of a related entity.
 - Use of patents to compensate employees is forbidden.

Options now, Capital Gains Later

- A present short term license for nominal or no value can be granted with an option to purchase later on, say more than a year later.
 - The option grant fees and short term license will be taxed at ordinary rates.
 - The option exercise may attract capital gains rates
- If an older corporation exists (like a shell) and It can otherwise acquire the patent, the sale of the shares can attract capital gains for the share owners.

SELLER OBJECTIVES

- Maintain HOLDER status
 - Case law indicates that a partnership can preserve holder status
 - Holders include:
 - Inventors
 - Investors who invest in the invention before actual RTP
- Limited liability from holding a patent!
- NO reason to risk unproven forms of ownership (like LLC)

SELLER OBJECTIVES

- Keep patent in a position to enter business in all markets
 - Sacrificing all substantial rights precludes 174 expensing
 - Recall Green Case
 - Hold back some jurisdictions for potential patent filings there

PATENT: SELLER OBJECTIVES

- Capital Gains Treatment (0-15-20-23.8% Tax Rate)
- Avoid any other taxes
 - Reside in a state with no state income tax at the time of sale
 - Avoid mixed agreements (sale provisions & personal services)
 - Reasonably allocate bulk of sale to the items attracting lesser tax

PATENT: SELLER OBJECTIVES

- Control risk sharing
 - Require large initial payment that can be stated in terms of advance royalties against production.
 - Avoid selling on credit (even with UCC lien) as there may be a requirement of legal costs in order to foreclose the lien, or a lawsuit on the license contract.

PATENT: SELLER OBJECTIVES

Maintain control in the event of non-payment

- License/sell WITHOUT transfer of title
- State a clear non-payment time for forfeiture of patent equitable ownership and return of equitable title to licensor.

PATENT: SELLER OBJECTIVES

- Maximize royalty rate by sharing risk (\$/unit rate)
 - Keep mechanism to verify books of producer
 - Provide indicia inside the product to distinguish licensee cheating from infringing production
 - Avoid complicated formulas that include returns or take account of other deductions. (Make license so simple that its not subject to interpretation)
 - Remember that seller will be charged the tax rate in effect at the time of receipt of the sale royalties.

PATENT: SELLER OBJECTIVES

- Avoid characterization of inventing & research as a “business of inventing” with patent “inventory”
 - This can result in non-expensing of patent procurement costs
 - This can result in “ordinary income” for patent “inventory sold”
- Avoid investment or ownership of any interest in the buyer (not necessary because seller already gets capital gains tax treatment)

PATENT: SELLER OBJECTIVES

- Avoid Mixing Capital Gains Income with Ordinary Expenses
 - Expense items under §174 to offset ordinary income (capitalization is preferred only in extreme situations)
 - It is easily seen that where income is 100% capital gains money is the only money available to pay ordinary expenses, the differential (arbitrage) advantage that normally exists between ordinary expensing and separate but unrelated capital gains treatment – is damaged.

PATENT: SELLER OBJECTIVES

- Capture success of buyer
 - Consider progressive increasing royalty chart in the license/sale agreement providing for increases in per-unit royalty over the life of the patent. If too aggressive, it could cause the licensee to terminate the agreement & re-negotiate in future.
 - If licensee is making money, it will not risk lapse and termination where the licensor might license to someone else. If licensor doesn't set it high, not as much money will be earned.

PATENT: SELLER OBJECTIVES

- Consider the functional slope of the rate of increase. Might the function be: linear? Increasing in slope? Asymptotic rise?
- Jumpstart product/process/service
 - Insure business development activity is set up to allow:
 - Further sale of personal patent rights at capital gains rates.
 - Absolute deductibility of investment \$ put into the business entity

PATENT: SELLER OBJECTIVES

- Consider shape configured license to get licensee buyer moving (carrot or a stick):
 - Front-end royalty rate may cause buyer to hustle faster
 - No royalty up front & no royalty on the first X# of units may motivate buyer to open market
 - Reduced royalty rate for annual sales above certain amount may give buyer/licensee incentive to perform to reduce average royalty rate.

PATENT: SELLER OBJECTIVES

- Structure a requirement and mechanism that the buyer/licensee pay to prosecute infringers to maintain value of the patent or require the buyer/licensee to maintain patent insurance at a given coverage level
- Don't let the licensee put so little into the prosecution of infringers that the infringers invalidate the patent. Setting up a mechanism can be tricky.

PATENT: BUYER OBJECTIVES

- Deduction / Expensing of all royalty/sale money paid
- Avoid capitalization to the extent possible
 - Any advance royalties should be applied against production
 - Reasonable amounts for entering into contract should be administratively justified and minimized (consider payments from to sellers attorney targeted as a drafting expense)

PATENT: BUYER OBJECTIVES

- Don't mix Personal Services Contracts or Employment Contracts with the sale of capital, especially patent, assets
 - You may be unable to work with the licensor seller on a personal basis
 - You may want to terminate the license & allow the patent to return to the licensor seller while still working with the licensor seller
 - Separate contracts will result in generally more unassailable allocations

PATENT: BUYER OBJECTIVES

- If a Patent becomes uneconomic, maintain ability to:
 - Terminate & return ownership to Licensor/Seller
 - Re-negotiate patent (& repurchase) upon non-payment (but risking competing purchase by others)
 - Consider outright purchase along with filing a UCC financing statement if cash is lacking.
 - Generate a decisional yearly sales projection
- Maintain positive responsibility for patent litigation where the patent is valuable, but guard against a charge of deliberately euthanizing the patent to avoid paying royalty.

PATENT: BUYER OBJECTIVES

- If impractical for one licensee / purchaser to take on whole patent (and where seller would increase license fee from loss of cap gain on sale treatment:
 - Consider having an unrelated exploitation company set up to sublicense the patents on a non-sale basis while passing money back to the inventor (who gets cap gains) on a sale basis
 - §1235 exempts siblings from “related taxpayer status” and that a sibling-owned company would be “unrelated”.

PATENT: BUYER OBJECTIVES

- Be wary of sale-leaseback provisions:
 - Certain sales/lease transactions are IRS “listed transactions”
 - Ask for reduced royalty rate for unit sales exceeding high target

PATENT: BUYERS & SELLERS

- Tax law littered with dead bodies of “pretend inventors” with “pretend licenses”
 - If the invention is not real and the transaction is not reasonable, a real possibility exists that the IRS might re-write your deal to their liking, send a tax bill and possibly arrange for some R&R at “Club Fed”.

PATENT: BUYERS & SELLERS

- Avoid putting a patent in any corporation or LLC unless you are **ABSOLUTELY CERTAIN** you will not seek to sell it within a year.
- Consider carefully that even if the sale will occur beyond a year, the buyer may not want to buy your whole corporate organization.

PATENT: BUYERS & SELLERS

- Inventorship is an un-exciting topic, but can be just as damaging as a “no invention” tax maneuver. For a regular patent, & especially where there is more than one inventor, anyone who came into contact with the project should record their contribution. This will be needed in any event should the Examiner restrict inventions & their associated claims.
- A charge of deliberate wrongful naming of inventors will very likely be charged in any patent infringement where there are more than one inventor.

PATENT: BUYERS & SELLERS

- Use options where conditions are not right for an immediate sale or purchase.
- Keep short term gain (non-sale) licenses to a minimum
- Clearly address treatment of SUBSEQUENT inventions
 - Rules for determining relatedness
 - Rules for inclusion or exclusion with base license

EXAMPLE

- Seller invents Widget, moves to Las Vegas
- Seller licenses U.S. Buyer
 - whole patent for whole term all of U.S. & Japan
 - \$3 per unit, & advance royalty against unit rate)
 - Renew with advance each year by January 1

(Cap Gains to seller, deductibility to buyer, no capitalization)

EXAMPLE

- Seller can also apply for patent and sell same patent in China, New Zealand, Australia, etc., to other or same individuals who buy rights in whole countries (and capital gains result)
- This can be important where the main licensee is not active in some countries
- If any Licensee / buyer fails to pay, license lapses & Seller / Licensor can sell the patent again to someone else (as to each individual country).

PATENT TAX DREAM

- Top tax bracket (39%) Las Vegas Seller invents Widget on Friday, spends \$10K to build, improve & apply for patent, sells patent on Monday for \$10K
- How much did the seller make? (ignore 3.8% surtax)
 - \$10K investment written off against ordinary income (\$3.9K) (seller out of pocket is \$6.1K)
 - The \$10K sales price attracts capital gains rate of say 20%. (\$2.0K) (seller gets to keep \$8.0K)
 - Seller invested \$10K, received \$10K, but made 1.9k in the process!*
 - Successful inventors invest less & receive more!*

Comments on §1235

- Siblings are not treated as “related taxpayers”
- Cannot be used to compensate employees with capital gains
- This is an election to expense made in the 1st year of project
- Capitalization only make sense where the entity has carry forward offsetable losses

Comments on § 1235 (cont'd)

- May treat some investors as inventors
- Good candidates for investment may include
 - Projects costing greater than \$100K
 - Lead time of greater than one year
- The statute “REDUCES” percentage ownership for related taxpayers from 50% to 25%. This is likely the “inventive entity” much of the time. Co-inventors “CAN” tenants in common, but it would require an unusual fact pattern to achieve this status.

Trade Secrets

- Patents generally start out as ideas or trade secrets
- Generally same capital gains tax treatment as patents
- Sale of Trade Secret: sales agreement requires promise not to divulge/exploit to be considered a complete sale.
- May be used for inventions/contributions of lesser standard & sub-aspects of invention not in the patent application

Trade Secrets

- Criminal statute for Trade Secret thieves (In California Penal Code 499c. \$5,000.00 fine & felony sentence of 16 or 24 or 36 months where the value of the secret is \$950.00 or more (proposition 47 changed the threshold from \$450 to \$950))
- Various federal statutes prohibit industrial espionage

Reasons to Avoid Provisional Patents

- (1) force a double decision (file continuing application and file foreign application & increased cost at 1 year mark.
- (2) Waste of additional filing fee.
- (3) If conversion is sought, newly added claims may be rejected for new matter.
- (4) If conversion is sought, a petition fee is required in addition to the original filing fee.

Reasons to Avoid Provisional Patents

- (5) If conversion is sought, the USPTO may delay until past the point that foreign filing office requires priority document and additional motions requests and permissions (if possible) may be sought by the foreign office.
- (6) When a potential licensee sees that you have only filed a provisional, he will know that you have penuriousness and other bases for-based doubts about the viability of the invention.

Reasons to Avoid Provisional Patents

- (7) Article 4(A)2 of the Paris Convention states " Any filing that is equivalent to a REGULAR NATIONAL FILING under the domestic legislation of any country of the Union or under bilateral or multilateral treaties concluded between countries of the Union shall be recognized as giving rise to the right of priority." Is a provisional a "REGULAR NATIONAL FILING" Under the Paris Convention??? Will a foreign case be challenged on this ground???

Reasons to Avoid Provisional Patents

- (8) If the invention is completely developed, there is no need for a provisional.
- (9) If the invention is not completely developed, two a regular patent filings & a continuation-in-part can provide much more flexibility in deciding to use & keep sub-version patents and those sub-versions will have their associated dates and disclosures well and plainly established.

Reasons to Avoid Provisional Patents

- (10) Knowing that regular filings will be done helps to control the claims in order somewhat control the potential for (a) restriction (both technological & tax), (b) the need to have some inventions issue base solely upon the original filing (without trying to "subtract" text verbatim & lacking claims which would have been part of the disclosure.
- (11) Provisional filings delay ultimate issue of the patent by at least one year. As a practical matter any attempt to make up time with expedited examination is likely to result in narrower, weaker, claims.

Reasons to Avoid Provisional Patents

- (12) Perhaps the biggest statistical reason that provisionals are ineffective is that they contain less disclosure by a significant amount, whether or not you include the claims in counting for the omission.
- (13) Under First-To-File, factor (11) becomes doubly important as omissions in the provisional can't be later established as they might have otherwise been under First-To-Invent.

Reasons to Avoid Provisional Patents

- (14) An unethical firm might bait-&-switch a lower overall price based upon the \$500 lower provisional filing costs & charge additional & more at the 1-year conversion time, costing the client un-necessarily. In other words, inventors shopping for price may be led to go with the least cost firm based upon a lower “filing price” and not told of the hidden costs of an additional filing fee and two attorney filing action charges.

Reasons to Avoid Provisional Patents

- (15) The claim drafting requirement forces consideration of the scope of the invention & thus forces a drafter to think more completely about what needs to be included.
- (16) Because provisional dies at 12 months, inventors are placed into a position where inadvertent inattention can be fatal. A domestic deadline is usually curable by a petition to revive or a late fee. When an inventor has an inattention-producing occurrence in their life, the result with a provisional can be terminally fatal

Provisional Patents are Dangerous

- I know of only one situation where a provisional has an advantage: A French inventor who files a regular case in France can apply for U.S. FDA permission the next day & wait out his treaty year while the FDA is considering permission. Without a provisional, the U.S. inventor cannot mimic this action, & push the 20 year bracket one year forward. In both cases pushing an income realization series forward in time by one year makes sense only because the invention may not be used, sold or practiced at least during the first year of the FDA application. This is rare, however.

Provisional Patents are More Costly

- Additional costs at the one year time period include:
 - ~\$730 filing fee for follow-on filing in addition to the provisional filing fee paid a year earlier.
 - Potential costs where the follow on regular filing claims are rejected as being not enabled by the specification of the provisional.
 - Petition fee for back converting, where needed.

Provisional Patents are More Costly

- Additional costs at the one year time period include:
 - Any attorney fee for providing the re-filing services, having to again further prepare and file.
 - Additional attorney charges for adding to the provisional (which additions may likely not be able to derive priority from the provisional.)

SALE OF TRADE SECRET

- Sale of a trade secret requires at a minimum:
 - A promise never to practice the secret
 - A promise to never reveal the secret

SALE OF TRADE SECRET

- License with “failure to pay” clause can result in multiple licenses / sales
 - Licensor licenses all rights subject to payment of annual minimum royalties & per-product royalties , else equitable rights revert to licensor.
 - If Licensee does not pay, licensor has trade secret and can “sell” it again.
 - Other conditions that give the licensee rights to regain the patent may cause a failure of “sale” treatment.

Trademark

COMMON MISCONCEPTIONS:

“Other companies have descriptive TMs, why can’t I?”
(NO, if other companies jumped off a cliff would YOU?)

“If my name isn’t descriptive, how will anyone know what my product is?”
(NO, that’s not the purpose of TM)

Trademarks

- Most misunderstood form of Intellectual Property
- Patents are a “2-way” tax street, TM is a “1-way” tax street
- TM is an “ID code” for the SOURCE of the goods & services, NOT for the goods themselves.

Trademarks (cont'd)

- Purveyor motivated toward higher quality goods and services where public uses the TM to do more business with purveyor.
- Direct ownership of a trademark creates personal liability, even where no ownership of the trademarked goods.
- A sale of a naked trademark (no goods/services) is treated as an abandonment

Trademarks (cont'd)

- A trademark can last forever - no defined life term
- Infinite life means money spent to create or defend a TM must be capitalized
(Result: payment for TM with after-tax dollars! Not good.)
- Example: You spend \$1M defending a trademark.
 - It will cost you \$1.529M in CA
 - It will cost you \$1.396M in NV

Trademarks (cont'd)

- TM can help spin off separate lines of business
- TM attracts long-term capital gains tax treatment
- Being forced to change a TM mid-stream is essentially the same as having to “start over” in business
- Picking a weak mark can potentially cost you millions over the life of the business - ad dollars spent on a weak mark boost competitor sales!

Trademark Principles

- Self-created TMs are capitalized until sale.
- Any litigation to protect TM is capitalized.
- If common TM is chosen buyers will be confused.
- A common TM can increase sales for competitors
- Although a capital asset, TMs should not be owned personally (liability) but owned by a pass-thru entity.
 - Per se right to control
 - Per se right to specify nature & quality of goods
 - Owner liability may (very likely) result
- Goodwill is directly proportional to TM uniqueness

Trademark Strategy

- US TM Office grants weak marks EVERY DAY!
- The 5 Platinum Rules:
 - Following them helps to BUY LOW & SELL HIGH.
 - Breaking them helps to BUY HIGH & SELL LOW.
- 15 year write-off for TM of acquired businesses
- Purchaser of a TM business “becomes” the purchased entity

Trademark Strategy (cont'd)

- You do not really own a TM until FIVE YEARS after REGISTRATION
 - Incontestability at about 7 years post-application in reality
 - Until then the mark CAN BE TAKEN AWAY FROM YOU
- To cash-in at the end of the day you need BOTH
 - A TM that captures MAXIMUM GOODWILL \$\$
 - Decades of providing high quality goods & services.

Selecting a Trademark

- Objective is to MAXIMIZE goodwill value (especially when harvested at capital gains tax rates)
- Objective is to MINIMIZE litigation potential (buyers will not buy into potential litigation & problems!)
- Objective is to MAXIMIZE singular association of CLIENT business with the TM.
- RESIST the temptation to emulate others who chose poorly!

5 PLATINUM RULES

- NOT DESCRIPTIVE
- NOT IN THE DICTIONARY
- NOT A PERSON'S LAST NAME
- NOT A GEOGRAPHIC DESIGNATION
- NOT SCANDALOUS OR VULGAR

PATENT TRADEMARK BK RISK

- Trademarks are excluded from definition of Intellectual property at 11 U.S.C. § 101-35A
- Trademark Licensee Bankruptcy:
 - Because of 11 U.S.C. § 365 operates through 11 U.S.C. § 101-35A there are no special executory contract “accept / reject” rights for trademark and thus the licensee has no special license rights to retain. Licensees can be eliminated.

PATENT TRADEMARK BK RISK

- Trademark Licensor Bankruptcy: (11 U.S.C. § 365):
 - Licensee must still make license payments
 - Blanket contract for all licensor's trademark line may be limited to only those brands licensed at the time of relief.
- However, note that most cases have involved hybrid Patent and Trademark licensing and its difficult to tell which principle might predominate.

TRADEMARK DREAM

- Seller selects non-descriptive, non-dictionary word mark
- Seller applies for TM & TM passes easily due to uniqueness
- Seller works hard to maintain high quality product for 30 years, never has any TM lawsuits & generates extreme goodwill.

TRADEMARK DREAM

- TM capitalization account after 30 years includes:
 - Application cost (\$950)
 - Incontestability filing (\$750)
 - 3 renewals (\$950 each), totaling \$2,850.
- Seller moves to LV and sells his CA business
- Seller sells the business for cash, attracting the long term capital gains rate

SALE OF TM

- Sale of a TM requires at least a bare indicia of ability to maintain continuity of quality
 - TM theory: buyer may step into the shoes of the seller.
 - “Bare indicia of continuity” is a low threshold
 - Non-sale license of a TM requires that the TM owner continue to exercise some control over goods & services

TRADEMARK NIGHTMARE

- Seller adopts common, terrible, descriptive TM
- Seller makes \$10K profit. Seller spent \$10K defending a TM lawsuit to protect his worthless TM.
- Did seller break even? NO.
 - Cannot deduct the \$10K paid to his TM litigators
 - Must come up with additional \$3.9K for taxes on \$10K profit!
 - No deduction of money spent to protect TM.
 - \$10K of litigation cost \$13.9K

Copyright

COMMON MISCONCEPTIONS:

“I made this clothing by hand, I want to copyright it”
(NO, can't Copyright clothing)

I want to copyright my fuzzy idea!
(NO, there must be a tangible expression)

“I can sue and if I lose it won't cost me anything”

Copyright

- Minimum level of originality required
- Inexpensive Registration
- Can be fragmented and sold in parts
- Capital gains on sale of purchased CR held >1 year
- Long Term: life of the author + 75 years
- Minimum statutory damages of up to \$10K/copy
- Extended division of control of prohibited activities (copy, perform, distribute, display, etc.)
- Criminal Copyright statute helps deter copying

Copyright Problems

- Self-created CR NOT capital asset in hands of creator (except music— and only in past few years)
- Ordinary income on first sale from creator
- Litigation Rule - losers pays winner's attorney fees
- Author's decedents can take it back from owner

COPYRIGHT TAX

- CR (except for music very recently) is NOT asset in hands of the creator.
- Creation of non-music CRs are then:
 - Form of active self employment (unless hobby?)
 - No basis (creator's time worthless)
 - Activity in spare time - living expenses are not business expenses, they are personal expenses
- Sale of your CR results in:
 - Ordinary (employment?) income to Seller
 - Capital gains to Buyer who buys & holds it for a year

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- Buyer finds a starving writer, an orphan with no relatives (to reduce chance of claw-back)
- Buyer pays \$1K for purchase of the copyright in a novel Buyer knows will be a hit for TV & movies.
- Buyer holds CR, publishes book & makes \$1M in book royalties, ordinary, non-sale passive income.
- 3 years later, buyer sells MGM the movie rights \$1M attracting capital gains (using fragmentation principle.

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- Writer believes if he live in villa overlooking Pacific, he can write the novel of a lifetime.
- Writer borrows \$1M (food incl.) & rents villa for year
- At year-end, Buyer buys writer's book for \$1M
- Did writer break even? NO.
 - cannot deduct the \$1M cost of the villa
 - Owes fed & state tax on the \$1M income, ordinary rate, plus self-employment, medicare tax, etc.
 - Must come up with about \$350,000 to pay IRS.
 - Later, must earn & pay more income tax just to pay off the \$350,000 still owed on loan. (\$150,000)

Setting it up Right

- Tax implications should be considered BEFORE making IP decisions. Planning is key.
- Rewriting an IP deal years after it is done:
 - tax “badge of fraud”
 - Possibly no better tax treatment than the original deal
 - could attract the attention of the Criminal Investigation Division if the magnitude of difference between the two deals is big enough.

“Tax Avoidance” Defined

- “Tax avoidance” is not wrong or unlawful
 - “[o]ne who avoids tax does not conceal or misrepresent. He shapes events to reduce or eliminate tax liability and, upon the happening of the events, makes a complete disclosure.”
Internal Revenue Manual 9.1.3.3.2.1 (7/29/98)

“Bankruptcy & Taxation - Important Aspects”

- Creation of bankruptcy estate has tax effect; Pub. 908
- Discharge of Taxes in Bankruptcy is possible
- Bankruptcy Court can be a non-prepayment court
- Beware the “tolling” acts which affect discharge
- Beware the “barring” tax procedure remedies which can destroy bankruptcy court tax adjudication

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