

TAX ISSUES FOR PATENT ATTORNEYS

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PATENT ISSUES

1. Section 1235 Capital Gains
2. R&D Partnerships
3. The *Associated Patentees* Structure
4. Partnerships with Lawyers

CAPITAL GAIN UNDER SECTION 1235

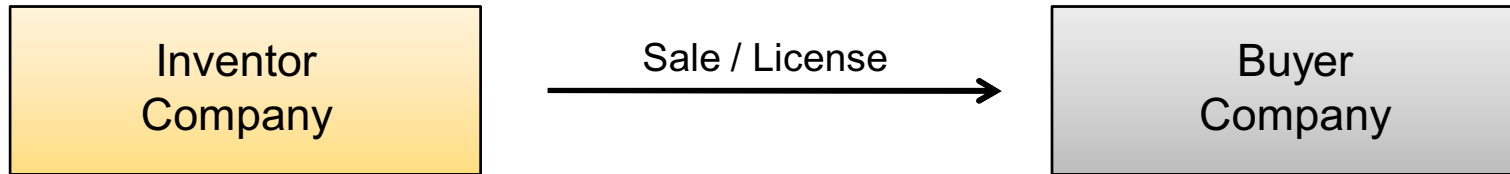
Allows patent “holder” to obtain long-term capital gains treatment regardless of holding period, the method of payment, and the status of the inventor as a professional; could potentially apply to trade secrets or other patentable know-how

Requirements

- Available to “holders” – meaning either the individual who (1) created the patent or (2) acquired an interest therein prior to reduction to practice; look-through for LLC ownership
- Must transfer “all substantial rights”
- “Patent” means a patent granted under domestic law, or any foreign patent granting rights generally similar to those under a United States patent; not necessary that patent or application be filed
- Not available in (1) transfers to “related parties” (25% threshold) or (2) “hired to invent” scenarios

CAPITAL GAIN UNDER SECTION 1235

“ALL SUBSTANTIAL RIGHTS”



Transfer of All Substantial Rights?

- Use of the patent limited geographically within the country of issuance
- Time period of less than the remaining life of the patent
- Limited to specific trades or industries
- Rights that are less than all the rights covered by the patent (prior transfers)
- Limit on further sublicensing
- Grant of less than all the claims or inventions covered by the patent
- Retention of a right to terminate the transfer at will or on condition subsequent
- Can retain right to use the invention and hold the legal title to the patent for purposes of securing the obligations of the purchaser

R&D PARTNERSHIPS

- **LDL Research & Development II, Ltd.**
 - Partnership had no real prospect of exploiting technology
 - Developer relied on to conduct technology business
 - Only possibility that partnership would ever act
- **Kantor v. CIR**
 - Partnership must have realistic possibility of entering its own business
 - Prospect of entering business must be shown at time of expenditure
 - Option to acquire exclusive rights for nominal sum
 - Lack of Capability to enter business
- **Scoggins v. CIR**
 - Developer had significant cost option to acquire IP
 - Partnership was capable of developing business if developer did not

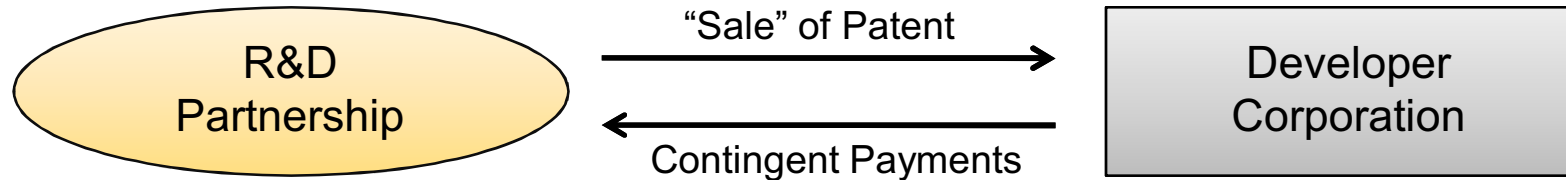
R&D PARTNERSHIPS

SCOGGINS PARTNERSHIP



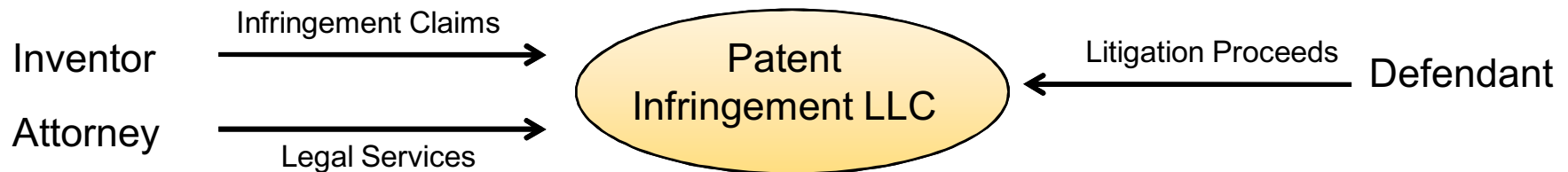
- Tax Advantaged Structure
 - R&D Deductions
 - Capital Gain Treatment
- Bankruptcy Remote Partnership
- Liability Protection

ASSOCIATED *PATENTEES* CHARACTER CONVERTER



Associated Patentees, Inc.: current deduction for payments based on patent's use or production

CLIENT PARTNERSHIP WITH ATTORNEY



- Generally, legal expense deduction limited by (1) 2% floor on AGI, (2) alternative minimum tax and (3) itemized deduction phase out
- Structuring the relationship as a client-attorney partnership may eliminate the client's tax on the portion paid to the attorney; in a partnership, the client's gross income will not include legal expenses
- Can be useful in prosecution of patent infringement claims

CLIENT PARTNERSHIP WITH ATTORNEY

Partnership Formalities

- An Agreement;
- Conduct of the parties in execution of its provisions;
- Statements of the parties;
- Testimony of disinterested persons;
- Relationship of the parties;
- Respective abilities and capital contributions of the parties;
- Actual control of income and purposes for which it is used; and
- Other facts showing the true intent of the parties (file partnership return).

Other Issues

- Federal tax law determines existence of partnership (not State)
- State rules of professional conduct (conflicts, partnership with non-attorney)
- Control of the case