

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 022

June 24, 1958

LIQUIDATION PAYMENTS: CHARACTER OF ROYALTY PAYMENTS TO STOCKHOLDERS

Syllabus:

Royalty payments from an undivided interest in a patent license agreement received on liquidation are to be treated as payments received in exchange for stock and taxed as capital gains.

A Inc. owned a patent which it licensed to B Company for the life of the patent in consideration of a percentage royalty on sales. In 1942 A Incorporated was liquidated and the assets, with the exception of the license agreement, were turned into cash and distributed to the stockholders. Each stockholder also received an individual interest in the license agreement. Advice is requested whether the royalty payments should be treated as ordinary income produced by capital assets received in liquidation or as payments received in exchange for their stock and, as such, receive capital gain treatment.

In Westover v Smith, 173 Fed. 2d 90, it was held that where one of the assets distributed on dissolution was a royalty contract, the full market value of which was unascertainable, royalty payments thereafter received were to be taxable as payments in exchange for stock and taxed as capital gains. In the instant case the license had no ascertainable market value at the time of liquidation and, therefore, a capital gain could not be computed at that time. Under the rule of Burnet v Logan, 283 U.S.404, the transaction remains open until all payments are received and all payments in excess of the taxpayers basis are capital gains. Therefore, the royalty payments are taxable as payments in exchange for stock and taxed as capital gains.