

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 155

January 7, 1958

PATENT ROYALTIES: SALE OR LICENSE

Syllabus:

Patent royalties received from the exclusive right to make, use, and sell under a patent are entitled to capital gain treatment. Patent royalties acquired by reason of the death of the patent owner are taxable to the person who receives the right to receive them under the provisions of Sections 17831 to 17837.

Prior to his death taxpayer's husband entered into an exclusive licensing agreement for a patented invention. Taxpayer inherited the right to receive the income produced from the agreement. Advice is requested whether the royalties received by the taxpayer should be treated as capital gains or ordinary income.

Notwithstanding Federal Rev. Rul. 55-58 and Mim. 6490, CB 1950-1, this office follows the rule laid down in U.S. v Carruthers, 219 F2d, 21, Meyers, 6 TC 258, and the principle of Waterman v Mac Kenzie, 138 US 252, which represent the prevailing judicial view on this question. Under this view, the grant of an exclusive right to make, use and sell is the sale of a patent regardless of the manner in which payment is to be made. Therefore, if the patent is a capital asset in the hands of the grantor, the consideration received from the sale is entitled to capital gains treatment regardless of the manner in which payment is received, if the transaction meets the following qualifications:

1. The patent must qualify for capital gains treatment in the hands of the grantor.
2. The contract must be a permanent and exclusive grant (at least within a defined area) of the right to make, use and vend the patented article; any lessor grant is a license.
3. There must be no inconsistent intent shown in the contract which would negate the passage of title, such as an option to buy all rights, title and interest at a future time.

The wife's rights to royalties stemmed from her decedent husband and were "income in respect of a decedent" and are treated as provided for in Sections 17831 to 17837. Since such income would have been capital gains to the husband, the wife is accorded the same treatment and may report the payments as capital gains.