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Ninth Circuit: No capital gains treatment of royalties, “all substantial rights” in patents not transferred

The U.S. Court of Appeals for the Ninth Circuit today affirmed a decision of the U.S. Tax Court that found the taxpayer was not entitled to capital gains treatment of patent-generated royalties because the taxpayer had not transferred “all substantial rights” in the patent so as to warrant capital gains treatment of the royalties.

The case is: *Cooper v. Commissioner*, No. 15-70863 (9th Cir. December 15, 2017). Read the Ninth Circuit’s [decision](#) [PDF 146 KB] that includes a partial dissent and partial concurrence.

Summary

The taxpayer held patents that generated significant royalties. He and his wife incorporated and transferred their rights to the patents to an entity that was formed by the taxpayer and two other individuals. A patent holder that has effective control of a corporation is determined to retain the right to retrieve ownership of the patent at will. In such instances, there has not been a transfer of “all substantial rights” to the patent as required for capital gains treatment of the patent-generated royalties.

In this case, the Ninth Circuit affirmed the Tax Court’s conclusion that the taxpayer had not transferred all substantial rights to the patents to the corporation because the other two individuals acted at the taxpayer’s direction, did not exercise independent judgment, and returned the patents to the taxpayer when requested, for no consideration.

Other issues in this case concerned a denied deduction for a nonbusiness bad debt and an accuracy-related penalty.

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