

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:5
PLR-119807-16
Date:
October 05, 2016

In Re:

LEGEND

Year 1:

Year 2:

Date 1:

Date 2:

PRS:

LLC:

PR1:

PR2:

PR3:

PR4:

Rights:

Product:

Agreement 1:

Agreement 2:

\$a

\$b

Dear _____ :

This responds to a letter dated _____, together with subsequent correspondence, submitted on behalf of PRS by its authorized representative, requesting a ruling under § 1235 of the Internal Revenue Code (Code).

FACTS

PRS is a state law limited liability company classified as a partnership for Federal tax purposes. PR1, PR2, PR3, and PR4 are individuals within the meaning of § 1235, and the only partners in PRS.

On Date 1, PRS and LLC, an unrelated entity, entered into Agreement 1. Pursuant to Agreement 1, PRS transferred its Rights in Product to LLC in consideration for LLC's

payments, based on the sales of Product, to PRS. PRS represents that the transfer of its Rights in Product under Agreement 1 was a transfer of property consisting of all substantial rights to a patent within the meaning of § 1235. In Year 1 and Year 2, PRS and its partners reported the payments received from LLC as payments from the sale or exchange of a capital asset held for more than 1 year, under § 1235.

On Date 2, PRS and LLC entered into Agreement 2 by which they terminated Agreement 1, pending the acquisition of LLC by an unrelated third-party. Agreement 2 confirmed that PRS had transferred its Rights in Product to LLC pursuant to Agreement 1. Agreement 2 required that LLC pay PRS a termination payment in the amount of \$a, of which \$b was allocated as final payment for the termination of LLC's payment obligations under Agreement 1.

You have requested a ruling that the portion of the termination payment in the amount of \$b that was allocated as final payment for the termination of LLC's payment obligations under Agreement 1 qualifies as long-term capital gain under § 1235.

LAW AND ANALYSIS

Section 1235(a) of the Code generally provides that a transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 1 year, regardless of whether or not payments in consideration of the transfer are – (1) payable periodically over a period generally coterminous with the transferee's use of the patent, or (2) contingent on productivity, use, or disposition of the property transferred.

Section 1.1235-2(a) of the Income Tax Regulations provides that the term "patent" means a patent granted under the provisions of title 35 of the United States Code, or any foreign patent granting rights generally similar to those under a United States patent. It is not necessary that the patent or patent application for the invention be in existence if the requirements of § 1235 are otherwise met.

Section 1.1235-2(b)(1) provides that the term "all substantial rights to a patent" means all rights (whether or not then held by the grantor) which are of value at the time the rights to the patent (or an undivided interest therein) are transferred. The term "all substantial rights to a patent" does not include a grant of rights to a patent – (i) which is limited geographically within the country of issuance; (ii) which is limited in duration by the terms of the agreement to a period less than the remaining life of the patent; (iii) which grants rights to the grantee, in fields of use within trades or industries, which are less than all the rights covered by the patent, which exist and have value at the time of the grant; or (iv) which grants to the grantee less than all the claims or inventions covered by the patent which exist and have value at the time of the grant. The circumstances of the whole transaction, rather than the particular terminology used in

the instrument of transfer shall be considered in determining whether or not all substantial rights to a patent are transferred in a transaction.

Section 1235(b)(1) provides that for purposes of § 1235 the term “holder” means any individual whose efforts created the property. Section 1.1235-2(d)(1)(i) provides that the term “holder” means any individual whose efforts created the patent property and who would qualify as the “original and first” inventor, or joint inventor, within the meaning of title 35 of the United States Code.

Section 1.1235-2(d)(2) provides that although a partnership cannot be a holder, each member of a partnership who is an individual may qualify as a holder to his share of a patent owned by the partnership. For example, if an inventor who is a member of a partnership composed solely of individuals uses partnership property in the development of his invention with the understanding that the patent when issued will become partnership property, each of the inventor’s partners during this period would qualify as a holder. If, in this example, the partnership were not composed solely of individuals, nevertheless, each of the individual partner’s distributive shares of income attributable to the transfer of all substantial rights to the patent or an undivided interest therein, would be considered proceeds from the sale or exchange of a capital asset held for more than 1 year.

Based on the information submitted and the representations made, and provided that each individual partner qualifies as a holder, we conclude that the portion of the termination payment in the amount of \$b that was allocated as final payment for the termination of LLC’s payment obligations under Agreement 1 qualifies as long-term capital gain under § 1235 as to each individual partner’s distributive share of income attributable to the transfer.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied concerning whether PRS’s transfer of its Rights in Product under Agreement 1 was a transfer of property consisting of all substantial rights to a patent within the meaning of § 1235.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

This ruling is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Theresa M. Melchiorre
Acting Assistant to the Branch Chief
Branch 5
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (1)
Copy for § 6110 purposes

cc: