**8555. Are there any special rules that apply in determining whether the sale of a patent gives rise to capital gains treatment?**

Unlike typical asset sales, if the sale or exchange of a patent meets certain requirements, the sale will automatically qualify for long-term capital gains treatment regardless of the transferor’s holding period and whether or not the patent would have been classified as a capital asset in the hands of the holder who transfers the patent.[[1]](#footnote-1)

Sale of a patent will qualify for long-term capital gains treatment if the holder of the patent transfers either “all substantial rights” in the patent or an undivided interest in the patent.

The phrase “all substantial rights” is defined in the regulations to mean all rights in the patent that have value at the time the rights to the patent are transferred, whether or not the holder of the patent is the owner of those rights.[[2]](#footnote-2) The holder does *not* transfer all substantial rights in the patent if the rights to the patent are:

(1) limited geographically within the country;

(2) confined to a period of time that is less than the entire remaining life of the patent;

(3) limited to a grant of rights, in fields of use within trades or industries, which are less than all the rights covered by the patent that exist and have value at the time of the transfer; or

(4) limited to a grant of rights that does not give the transferee rights to all the claims and inventions covered by the patent that exist and have value at the time of sale.[[3]](#footnote-3)

Conversely, the holder does not lose long-term capital gain treatment by retaining rights that are not considered substantial. The regulations provide that, depending upon all of the facts and circumstances of the transaction as a whole, the holder may retain the right to prohibit sub-licensing or sub-assignment by the transferee and may also fail to convey the right to use or sell the property that is the *subject* of the patent.[[4]](#footnote-4)

The holder transfers an “undivided interest” in a patent when the holder transfers the same fractional share of every substantial right in the patent. A sale of the right to income from a patent, for example, does not constitute the sale of an undivided interest in the patent.[[5]](#footnote-5)

This treatment is not available to all patent holders, however. The term “holder” is defined in IRC Section 1235 to include only (1) the original inventor of the property subject to the patent and (2) an individual who obtained his rights in the patent in exchange for money or other property *before* the property subject to the patent was actually put to use *if* that individual is neither (i) the inventor’s employer or (ii) related to the inventor.[[6]](#footnote-6)

**Planning Point**:Due to the limited definition of “holder” under the patent laws, if an employer maintains the rights to patents on property invented by its employees, the employer will not be eligible for this special capital gains treatment upon sale of the patent.

1. . IRC Sec. 1235(a). [↑](#footnote-ref-1)
2. . Treas. Reg. §1.1235-2(b)(1). [↑](#footnote-ref-2)
3. . Treas. Reg. §1.1235-2(b)(2). [↑](#footnote-ref-3)
4. . Treas. Reg. §1.1235-2(b)(3). [↑](#footnote-ref-4)
5. . Treas. Reg. §1.1235-2(c). [↑](#footnote-ref-5)
6. . IRC Sec. 1235(b). [↑](#footnote-ref-6)