PERSPECTIVE

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# 'Kaepernicking' all the way to the bank

By Robert W. Wood

Colin Kaepernick and the San Francisco 49ers didn't make it to the Super Bowl this year, but they did come admirably close. And for a time it seemed that "Kaepernicking" was back in style. At a playoff win in Charlotte, the 49ers quarterback (along with Niner NaVarro Bowman) even expanded his move-set by copying Panther Cam Newton's celebratory Superman move.

Interestingly, the Panthers quarterback has never filed to trademark or copyright his touchdown dance. In contrast, Kaepernick has moved to protect his bicep-kissing celebration quickly known as "Kaepernicking." The U.S. Patent and Trademark Office shows six registration applications, including "use of the mark in commerce" for shirts and other articles of clothing.

But is this sort of thing really intellectual property? It depends. As we all know, "Kaepernicking" is really a surname turned into a verb. In most cases, an appropriate trademark use is an adjective, such as a "Kleenex® facial tissue" or a "Xerox® photocopier." Even so, a surname can work when it takes on a secondary meaning over time.

Take Tim Tebow's "Tebowing." It triggered a wave of filings until Tebow's own company successfully registered a trademark for "Tebowing" on shirts. And the similar use of Kaepernicking could be quite valuable. After all, Colin Kaepernick's No. 7 jersey remains one of the NFL's top sellers.

License deals could produce a stream of revenue, but for some holders of intellectual property, the bigger payday is to sell. One reason can be controversy. Often, holders of competing intellectual property — think Apple and Samsung — duke it out and spend big on legal fees.

Another reason can be the ordinary income tax rates that apply to licensing revenue. Licensing revenue is ordinary income, now taxed at a federal rate of 39.6 percent, versus the capital gain tax that can apply to a sale. In 2012, the top capital gain rate was only 15 percent, and now it's risen to 23.8 percent.

The latter is made up of the 20 percent capital gain rate plus the 3.8 percent Obamacare tax. For people regretting that they did not sell something while a 15 percent capital gain rate was in effect, 23.8 percent can be daunting. Yet it is still better than the 39.6 percent top rate on ordinary income.

Notably, some intellectual property sales are capital gain even if paid over time. The same is true for settlements of intellectual property legal disputes. Settling litigation can be done in different ways, but a transfer of anything less than ownership of the intellectual property is usually regarded as a license.

Most of the tax cases involve patents, but trademarks can also be sold. How could Kaepernick or another holder get capital gain? It's not likely on licensing revenue, but a sale of the trademark after a year could be a different story.

Some IP sales are capital gain even if paid over time. The same is true for settlements of IP legal disputes. A transfer of anything less than ownership is a license though, and that means ordinary income. Where rights are retained, a key question is whether they have substantial value.

It also helps if the payor calls the payment a purchase. A payment for "royalties paid" without mentioning a transfer of rights is likely to sound ordinary to the Internal Revenue Service. Only individuals and pass-through entities (S corporations, partnerships and limited liability companies) benefit from capital gain.

The professional or amateur status of an inventor is relevant, since professional inventors earn ordinary income. That leads to line-drawing. Thus, in *Lockhart v. Commissioner*, an inventor with 37 patents over 19 years was ruled a professional. See *Lockhart v. Commissioner of Internal Revenue*, 258 F.2d 343, (3d Cir. 1958). In contrast, in *Kucera v. Commissioner*, an inventor with 21 inventions and several patents was not a professional and was thus entitled to capital gain. See *Kucera v. Commissioner*, 10 T.C.M. (CCH) 303 (1951).

Patents and other intellectual property are of enormous importance to Americans and to global businesses. The Apple-Samsung legal battles and the prevalent news coverage worldwide brings the point home. From initial filing, licensing, litigation and sale, billions turn on these issues.

IP litigation involves enormous tax consequences, too. It is not merely an academic question whether an intellectual property recovery is ordinary income or capital gain. You'll care if one type of income is taxed at 39.6 percent and the other at 23.8 percent.

Surprisingly, a settlement in a case about stolen intellectual property can be either ordinary income or capital gain. The first way IP recoveries can be capital gain is under Section 1235 of the tax code. It expressly allows long term capital gain reporting for a transfer of all substantial rights to a patent (or an undivided interest) by any qualifying holder.

Amazingly, unlike capital gain rules for holding stock or real estate, the one year holding period is not required. Plus, payments can still qualify if made over time or made contingent on the productivity, use or disposition of the property. Thus, this capital gain treatment is extremely broad.

It can apply to payments for infringement and for settling infringement. However, a transfer of all rights means *all* rights. Even inadvertent wording glitches can prevent capital gain treatment.

That makes language in settlement agreements terribly important. Ideally, the settlement agreement will explicitly transfer all rights to the patent. If it does not, it may still be arguable that the settlement conveyed substantially all of the plaintiff's rights to the patent.

How the payor treats the payment is also relevant. If a payor treats the payment as made to purchase patent rights, it helps to support capital gain treatment. Conversely, if the payor treats (and reports) the payment as "royalties" without any mention of the transfer of patent rights, it sounds ordinary.

Even so, whether all substantial rights to a patent have been transferred is a factual question. The tax issues can be huge. The potential for intelligent planning or massive mistakes is too big to ignore.

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