BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of)	S U P P L E M E N T A L D E T E R M I N A T I O N
. . .	No. 85-97A Registration No. . . . Tax Assessment No. . . .

[1] RULE 106 AND RULE 194: B&O TAX -- SALE OR LEASE -- TRANSFER OF PATENT RIGHTS. A transfer of patent rights constitutes a sale (assignment) instead of a lease, where the assignee received all substantial patent rights, has the right to assign and license the patent to others, and the right to sue for infringement of the patent. Neither the terms used in the agreement, the right of the assignee to terminate the agreement, nor the fact the agreement is not recorded is dispositive.

[2] RULE 106 AND RULE 194: B&O TAX -- CASUAL OR ISOLATED SALE -- TYPE OF PROPERTY -- PATENT RIGHTS. One-time assignment (sale) of patent rights by a taxpayer-manufacturer to its subsidiary, when the taxpayer was not in the business of developing or selling patents, held to be a casual and isolated sale since the patent was not the "type of property" which the taxpayer held himself out as selling, and such sales were not "routine and continuous."

These headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Taxpayer represented by: . . .
. . .
. . .

NATURE OF ACTION:

Petition for cancellation of assessment of Service (B&O) tax on royalties.

FACTS:

Bauer, A.L.J. -- The Washington corporate taxpayer is a manufacturer of small bag closure devices. It entered into a "licensing agreement" with its wholly-owned Indiana subsidiary (hereinafter, "subsidiary") granting it the patent rights for two of the devices. The taxpayer's business activities were audited by the Department of Revenue for the period January 1, 1979 through September 31, 1983, and Assessment No. . . . was issued on August 30, 1984 for excise tax liability and interest. The taxpayer appealed. Determination No. 85-97 upheld the assessment of the Service and Other Activities classification of the business and occupation tax upon gross "royalty income" received from the patent rights.

The taxpayer then appealed to the Board of Tax Appeals, claiming (1) the transfer of patent/licensing rights was a "casual or isolated sale" within the meaning of RCW 82.04.040 and WAC 458-20-106, and therefore not subject to the business and occupation tax, (2) the transfer was not in the conduct of "business" as defined under RCW 82.04.140, and therefore not subject to the business and occupation tax, or (3) any excise tax upheld should be apportioned between the taxpayer and its out-of-state subsidiary pursuant to RCW 82.04.460. The taxpayer requested a refund of the service tax paid, plus interest.

Because the Department had not previously heard arguments on these issues, the Board of Tax Appeals, with agreement of the parties, remanded the case to the Department for further consideration.

The essential facts are as follows:

1. On February 6, 1969, a trust offered to assign (sell) two bag closure device patents to the taxpayer for a total of $5 million dollars, payable in equal monthly installments during the period from the date of sale to the expiration date of the patents (due to expire September 5, 1983).

2. On February 7, 1969, the taxpayer's Board of Directors met to consider the offer. It was resolved that the patents should be purchased, provided that the taxpayer's subsidiary would agree to be "licensed, under said patents, to produce and market the articles covered by said patents ... [in its

normal geographical market area], and ... remit royalty payments to [the taxpayer]."

3. On February 21, 1969, the patents were acquired by the taxpayer for $5 million dollars, payable in 172 successive monthly installments of $28,901 commencing April 5, 1969, plus a final payment of $29,028 due on August 5, 1983. There was no interest charge applied to the deferred payments in this agreement.

4. On February 21, 1969, the taxpayer ("LICENSOR") entered into a "License Agreement" with its subsidiary ["LICENSEE"]. This agreement granted the subsidiary the following rights for the life of the patents:

A. To perform the methods covered by said patents;

B. To manufacture, use, lease and sell devices covered by said patents including devices embodying any improvements invented by LICENSOR and embraced by any of the claims of said patents.

5. Pursuant to the "licensing agreement," the taxpayer relinquished all patent rights in its subsidiary's geographical market area, but retained full patent rights in its own market area. Payments by the subsidiary equalled two-thirds of the taxpayer's payments under the original purchase agreement. This fractional share was based on the projection that the subsidiary would market approximately two-thirds of the patented products sold in the U.S.

6. The agreement additionally gave the subsidiary

the right to institute in its own behalf and in the name of the LICENSOR, suits designed to protect from infringement, the patent rights, embraced by this agreement. These suits shall be conducted at the expense of LICENSEE, and LICENSEE shall have full control of the litigation and all recoveries therefrom shall belong to LICENSEE.

7. The agreement provided that the subsidiary could cancel the agreement with 90 days' notice to the taxpayer, and that the taxpayer could cancel the agreement 90 days after the subsidiary's breach of contract or bankruptcy.

8. The agreement additionally provided that its provisions would be binding on both parties and their respective "successors, heirs, and assigns." This clause thus implied

that the subsidiary had the right to further assign the patents.

9. The basic agreement was amended on July 23, 1970 to provide for 4 percent simple interest on the monthly payments. This amendment was executed because the IRS imputed interest on the payments.

10. The agreement between the taxpayer and the subsidiary was not registered with the U.S. Patent Office.

11. The IRS treats the "licensing agreement" as an assignment (sale).

12. The taxpayer has not assigned (sold) any other patents or entered into any other licensing agreements since this transaction in 1969.

ISSUES:

The taxpayer has raised the following issues for consideration:

1. Whether the "Licensing Agreement" is an assignment (sale) regardless of its label, and, if so, whether such assignment qualifies as a tax-free "casual and isolated sale" under WAC 458-20-106, or

2. Whether the taxpayer, in entering into "licensing agreement" with its subsidiary, was "engaging in business" pursuant to RCW 82.04.140, or was merely engaging in a tax-free cost-sharing arrangement with its subsidiary.

3. In the alternative, whether any tax which is held to be due should be apportioned between the taxpayer and its Indiana subsidiary pursuant to RCW 82.04.460.

DISCUSSION:

[1] Title to a patent passes only by assignment. An assignment [sale] of a patent is a transfer of the exclusive right under the patent, or of an undivided part thereof, to make, use and vend the invention throughout a specified part of the United States. ANTHONY WILLIAM DELLER, DELLER'S WALKER ON PATENTS § 345 (1965).
For a transfer to constitute a sale, there must be a grant of all substantial rights of value in the patent; transfer of anything less is a license which conveys no proprietary interest to the licensee. Whether a transfer constitutes a

sale or license is determined by the substance of the transaction and a transfer will suffice as a sale if it appears from the agreement and surrounding circumstances that the parties intended that the patentee surrender all his substantial rights to the invention. The question does not depend upon the labels or the terminology used in the agreement. Hence, the fact that an agreement is termed a license and that the parties are referred to as licensor and licensee is not decisive. The fact, too, that the grantee has the right to terminate the agreement at will does not defeat a sale. Bell Intercontinental Corporation v. United States, 152 USPQ 182 (1966); Newton Insert Co. v. Comm'r. Internal Revenue, 181 USPQ 765 (1974).

The fundamental distinction between an assignment of a patent and a license arrangement under a patent relates to the rights and liabilities of an assignee or licensee to sue or be sued for infringement of the patent. An assignee of a patent has the right to maintain suit for infringement and to be sued regarding the validity of the patent. A licensee only gains immunity from suit for infringement. TWM Mfg. Co. v. Dura Corp., 189 USPQ 518 (1975).

Moreover, the implication in the agreement that the transferee has the right to assign and license the patents transferred to other is another indication of a sale. Hooker Chemicals and Plastics Corp. v. United States, 199 USPQ 549 (1978).

Finally, the recording of an assignment of a patent is not necessary to its validity as between the parties to the agreement, infringers of the patent, innocent purchasers for valuable consideration without notice within three months after the date of the prior unrecorded assignment, any subsequent purchasers who had notice or paid no consideration. (citations omitted). DELLER'S WALKER ON PATENTS, supra., §341.

In this case, it is clear that an assignment (sale) occurred.

In granting its subsidiary the right "to manufacture, use, lease and sell devices covered by said patents" for the life of the patent, the taxpayer surrendered all its substantial rights in those patents as to a specified market area of the United States.
The use of the terms "licensor" and "licensee" in the agreement, the fact that the subsidiary was given the right to cancel the agreement, and the fact that the agreement was not recorded, do not defeat an assignment.

Further, the subsidiary was granted not only the right to sue for infringement of the patent, but also all of the beneficial interests relating to such suits.

Finally, the agreement's reference to the parties' "successors, heirs, and assigns" implied that the transferee had the right to assign and license the patents to others.

Accordingly, we hold that the transfer of patent rights by the taxpayer was a sale.

[2] RCW 82.04.040 defines "casual or isolated sale" to mean ...a sale made by a person who is not engaged in the business of selling the type of property involved. (Emphasis supplied.)

WAC 458-20-106 (Rule 106) implements RCW 82.04.040 and in pertinent part states

> A casual or isolated sale is defined by RCW 82.04.040 as a sale made by a person who is not engaged in the business of selling the type of property involved. Any sales which are routine and continuous must be considered to be an integral part of the business operation and are not casual or isolated sales.
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> Furthermore, persons who hold themselves out to the public as making sales at retail or wholesale are deemed to be engaged in the business of selling, and sales made by them of the type of property which they hold themselves out as selling, are not casual or isolated sales even though such sales are not made frequently.
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> In addition the sale at retail by a manufacturer or wholesaler of an article of merchandise manufactured or wholesaled by him is not a casual or isolated sale, even though he may make but one such retail sale.
>
> BUSINESS AND OCCUPATION TAX
>
> The business and occupation tax does not apply to casual or isolated sales. (Emphasis supplied.)

The taxpayer is a manufacturer of articles of bag closures, and holds itself out to the public as making sales of these

items at wholesale. Therefore, it is deemed to be engaged in the business of selling.

The crucial question, then, is whether the patent rights sold are the type of property which the taxpayer holds itself out as selling; that is, whether a patent for the manufacture of bag closures is the same type of property as the bag closures themselves. We think not.

The assignment of the patent rights at issue was an isolated transaction in 1969 which has not been repeated. The taxpayer has never been in the business of developing or selling patents. We therefore hold the sale to have been a "casual and isolated sale," since patents are not the "type of property" which the taxpayer held itself out to be selling, and such sales were not "routine and continuous."

Payments on the sale then, including the interest portion, are thus exempt from the business and occupation tax.

Because relief will be granted on this issue, the other issues will not be addressed.

DECISION AND DISPOSITION:

The taxpayer's petition is granted. A refund, plus interest, will be issued by the Department in due course.

DATED this 24th day of May 1989.