



Charitable Contributions Of Intellectual Property¹

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Corporations are constantly seeking to understand and analyze the federal income regulations so as to minimize their tax burden. Individuals have long known that an old suit or unwanted chair can be donated to a charitable organization and, if properly documented, the value can be deducted from income in the calculation of personal income tax. In the past, corporations' charitable contributions have tended to be cash rather than assets.

In recent years, the world's corporations have come to recognize the value of the intangible assets that are not reflected on their balance sheets. Among these assets are intellectual properties, such as patents, copyrights and proprietary technology. More and more companies have departments who have responsibility to identify, protect and manage these IP assets in order to enhance profitability. Managing these assets includes the identification of those that are critical to the present and future business as well as those that are outside the mainstream of the corporation's business. Those not in the mainstream are available for exploitation outside of the company and this has commonly meant by sale or license. Corporations have begun to recognize the exploitation opportunity represented by a charitable donation of IP for the associated tax benefit.

The possibility of making a charitable donation of intellectual property has been known for some time but used extensively only in recent years. In Revenue Ruling 58-260, the Internal Revenue Service (IRS) recognized that the fair market value of an undivided interest in a patent contributed to an appropriate organization is an allowable deduction as a charitable contribution. An "appropriate organization," is described in the Internal Revenue Code² as:

- A state, possession of the United States or political subdivision of each, or the United States or the District of Columbia if the contribution or gift is made for "exclusively public purposes:
- A corporation, trust, or community chest, fund or foundation organized in the United States and operated exclusively for religious, charitable, scientific, literary, or educational purposes, to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals³.
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Revenue Ruling 58-260 also noted that when a contribution is made in property other than money, the amount of the deduction is determined by the fair market value of the property at the time of the contribution. Taxpayers are responsible for the development of the fair market value reported on their tax returns. They may make this appraisal themselves or with the help of experts in the field. The IRS defines fair market value as:

"Fair market value (FMV) is the price the property would sell for on the open market. It is the price that would be agreed on between a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of the relevant facts."⁴

An alternative definition of fair market value is: "The present value of the future economic benefits of ownership."

This alternative definition is not really at odds with that of that of the IRS (which is commonly in use), since intellectual property derives its value from the financial benefits of exploiting it. In the case of intellectual property which is the subject of a charitable donation, it is useful to think in terms of the second fair market value definition. Implicit in that definition is the concept that, in order to have value (and therefore constitute a meaningful tax deduction), the donated intellectual property must be exploitable by the donee. This does not necessarily mean that the donee must directly exploit it (i.e., use the patent in a product or service), but could also license the IP to others who will utilize it in products or services. However this is accomplished, the reasonable expectation of future exploitation of the contributed IP is essential to its present day value.

As we have witnessed many times in the past, when taxpayers (and their advisors) discover a tax reduction strategy, the word gets around rapidly. Some taxpayers attempt to employ the strategy without incurring the costs of doing it right, and others want to challenge the boundaries⁵. When this happens, the IRS understandably allocates resources to rigorously examine this aspect of tax returns. This has already happened relative to charitable donations of IP⁶. Probably the most common donee for corporate IP is a university or foundation. In recent years, these organizations have become much more sophisticated recipients of IP. As an example, the administrative regulations of North Carolina State University contain a section on donations of intellectual property:

"More and more major corporations are seeking opportunities to donate patents and related assets to universities. Donations of intellectual property, often packaged with cash, equipment and expertise, are becoming a popular form of philanthropy for some leading U.S. companies. Indeed, many of the largest contributions that corporations have made to higher-education institutions in the past year have been in the form of patents for technologies, most of them valued as tens of millions of dollars. Companies began giving

patents and associated IP to universities some years ago, but the number and scale of such donations have increased markedly...."⁷

This document further notes that the University's Office of Technology Transfer will evaluate a proposed gift based on a number of criteria and may, in fact, inform the prospective donor that the university is not interested in accepting the gift. The criteria clearly recognize the importance of potential economic benefit to the university:

- The availability of financial support for further research and development of the donated IP.
- Availability of resources to maintain the patents.
- The opportunity for immediate license or other arrangements with a business partner or to create a start-up company likely to attract venture capital.
- The potential for revenue from exploitation.

Potential donees are also recognizing that there should be a good "fit" between the donated IP and research programs and resources at the institution. As an example, NC State University criteria include a consideration of:

- The relevance and fit of the donated IP with an ongoing research program.
- The willingness of the relevant researchers to carry out further research involving the donated IP.
- The relevance and fit of the donated IP with current patent portfolios held by the University.
- The possibility of a parallel donation of related research equipment, cash, and know-how.

Corporate donors as well (perhaps spurred on by the increasingly intense examinations of IP valuations by the IRS) have also become more sophisticated in their giving. At the Annual meeting of the Licensing Executives Society in September, there were several workshops presented by members including consultants, corporate licensing executives, and the IRS. It was obvious from the content of these workshops that corporate donors have come to understand that a successful charitable donation involves much more than the legal assignment of some patents and a little "handing over" ceremony for the benefit of the local paper.

The presentations clearly emphasized the importance of making an IP charitable contribution an economic success for the donee. In doing so, the donor gains support for the valuation, which clearly must be based on the results of economic exploitation. The donor has a large stake, therefore, in doing whatever is reasonable and possible to ensure that the economic benefits materialize for the donee. Those efforts were illustrated to be some of the very criteria that NC State University noted:

- Providing know-how and show-how to the donee.
- Providing cash to the donee for ongoing research and patent maintenance fees, or funding a start-up company.

When an appropriate donor-donee relationship is found and established, realistic valuations and proper documentation can lead to a successful transaction for both parties. Those taxpayers who view the process as similar to leaving excess zucchini on a neighbor's doorstep in the dead of night will likely face an unhappy scrutiny.

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² Section 170(c).

³ This is not an exhaustive description of the organizations listed in Section 170(c), but it gives the reader a general idea of the type of organization to which a contribution or gift is considered to be a charitable contribution for tax purposes. A helpful description of these organizations is also contained in the IRS Publication 526.

⁴ IRS Publication 561.

⁵ Readers may remember the Section 38 - Investment Tax Credit provisions when they were part of the Tax Code. An aggressive taxpayer labeled the fountain in front of the headquarters building as part of the air conditioning system and therefore deductible as a tax credit. Section 38 is no longer part of the Tax Code.

⁶ See, Bryan-Low, Cassell, "Deductions for Patent Donations Draw Deeper Scrutiny From IRS", The Wall Street Journal, October 9, 2003. This article cites the possibility of "potentially overvalued patent donations", and the attention of Congress that may result in changing the law in order to limit the tax-deductibility of such donations.

⁷ Found at <http://www.ncsu.edu/policies/research/REG10.00.1.php>

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