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**Internal Revenue Service**

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Department of the Treasury  
Washington, DC 20224

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:PSI:B07 – PLR-163836-03

Date:  
October 20, 2004

Legend:

Product:

A:

B:

C:

X:

Y:

Z:

Dear :

We received a letter from your authorized representative requesting a ruling under § 1235 of the Internal Revenue Code. This letter responds to that request.

A, B, and C are independent inventors who have been developing Product. A, B, and C filed several patent applications in the United States relating to Product. The patent filings were made as co-inventors and a joint owner's agreement was executed between A, B, and C. A, B, and C are contemplating filing additional U.S. patent applications and foreign patent applications relating to Product. The Product related patents, patent applications, and contemplated patent applications are referred to collectively hereinafter as the "Patents."

A, B, and C represent that, in a transaction qualifying under § 721 of the Code, they will transfer their respective interests in Product, including, without limitation, all of their interest in the Patents and trade secrets, know how and other intellectual property associated with Product, to a newly formed limited liability company ("LLC") in exchange for membership interests in LLC. The sole members of LLC would be A, who would have a x% interest in both capital and profits, and B and C who would have y% and z% interests, respectively, in both capital and profits. LLC will be manager-managed with B as the manager.

A has requested two rulings: (1) following the transfer of A's interest in the Patents to LLC, A will retain A's status as a "holder" for purposes of § 1235 of the Code, and (2) assuming the other requirements of § 1235 are satisfied, A's share of any gain recognized by LLC on disposition of all substantial rights in the Patents will qualify under § 1235 as long term capital gain.

Section 1235(a) 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 1235(b) provides that, for purposes of § 1235, the term "holder" means any individual whose efforts created the property.

Section 1.1235-2(d)(1)(i) of the Income Tax Regulations 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 the partnership who is an individual may qualify as a holder as 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 partners' 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 (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977).

Section 301.7701-3(b)(1)(i) of the Procedure and Administration Regulations provides that a domestic eligible entity (a business organization not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8)) with two or more members is treated as a partnership for federal tax purposes unless the entity elects to be treated as a corporation.

In the present case, the LLC formed by A, B, and C would be treated as a partnership for federal tax purposes under § 301.7701-3. Consequently, LLC would be classified as any other partnership and each member of LLC would be treated as a partner for purposes of § 1235 and the regulations under § 1235.

Based on the information submitted and the representations made, we conclude that: (1) following the transfer of A's interests in the Patents to LLC, A will retain A's status as a "holder" for purposes of § 1235; and (2) provided the other requirements of § 1235 are satisfied, A's shares of any gain recognized by LLC on a disposition of an interest in the Patents will qualify under § 1235 as long term capital gain.

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. In particular, we express or imply no opinion concerning (a) A's status as a holder before the transfer of the Patents to LLC; (b) the application of § 1235 to any persons other than A; or (c) the tax consequences of forming LLC.

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.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

The rulings contained in this letter are 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.

Sincerely,

*/s/*

Joseph H. Makurath  
Senior Technician Reviewer, Branch 7  
Office of the Associate Chief Counsel

(Passthroughs and Special Industries)

cc: