

Internal Revenue Code of 1954 applies, or in a year prior thereto, are subject to the provisions of section 1235.

(f) *Nonresident aliens.* For the special rule relating to nonresident aliens who have gains arising from a transfer to which section 1235 applies, see section 871 and the regulations thereunder. For withholding of tax from income of nonresident aliens, see section 1441 and the regulations thereunder.

[T.D. 6500, 25 FR 12014, Nov. 26, 1960, as amended by T.D. 6885, 31 FR 7803, June 2, 1966; T.D. 7728, 45 FR 72650, Nov. 3, 1980]

#### § 1.1235-2 Definition of terms.

For the purposes of section 1235 and § 1.1235-1:

(a) *Patent.* The term *patent* means a patent granted under the provisions of title 35 of the United States Code, or any foreign patent granting rights generally similar to those under a United States patent. It is not necessary that the patent or patent application for the invention be in existence if the requirements of section 1235 are otherwise met.

(b) *All substantial rights to a patent.* (1) The term *all substantial rights to a patent* means all rights (whether or not then held by the grantor) which are of value at the time the rights to the patent (or an undivided interest therein) are transferred. The term *all substantial rights to a patent* does not include a grant of rights to a patent:

(i) Which is limited geographically within the country of issuance;

(ii) Which is limited in duration by the terms of the agreement to a period less than the remaining life of the patent;

(iii) Which grants rights to the grantee, in fields of use within trades or industries, which are less than all the rights covered by the patent, which exist and have value at the time of the grant; or

(iv) Which grants to the grantee less than all the claims or inventions covered by the patent which exist and have value at the time of the grant.

The circumstances of the whole transaction, rather than the particular terminology used in the instrument of transfer, shall be considered in determining whether or not all substantial

rights to a patent are transferred in a transaction.

(2) Rights which are not considered substantial for purposes of section 1235 may be retained by the holder. Examples of such rights are:

(i) The retention by the transferor of legal title for the purpose of securing performance or payment by the transferee in a transaction involving transfer of an exclusive license to manufacture, use, and sell for the life of the patent;

(ii) The retention by the transferor of rights in the property which are not inconsistent with the passage of ownership, such as the retention of a security interest (such as a vendor's lien), or a reservation in the nature of a condition subsequent (such as a provision for forfeiture on account of non-performance).

(3) Examples of rights which may or may not be substantial, depending upon the circumstances of the whole transaction in which rights to a patent are transferred, are:

(i) The retention by the transferor of an absolute right to prohibit sub-licensing or subassignment by the transferee;

(ii) The failure to convey to the transferee the right to use or to sell the patent property.

(4) The retention of a right to terminate the transfer at will is the retention of a substantial right for the purposes of section 1235.

(c) *Undivided interest.* A person owns an *undivided interest* in all substantial rights to a patent when he owns the same fractional share of each and every substantial right to the patent. It does not include, for example, a right to the income from a patent, or a license limited geographically, or a license which covers some, but not all, of the valuable claims or uses covered by the patent. A transfer limited in duration by the terms of the instrument to a period less than the remaining life of the patent is not a transfer of an undivided interest in all substantial rights to a patent.

(d) *Holder.* (1) The term *holder* means any individual:

(i) 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 U.S.C., or

(ii) Who has acquired his interest in the patent property in exchange for a consideration paid to the inventor in money or money's worth prior to the actual reduction of the invention to practice (see paragraph (e) of this section), provided that such individual was neither the employer of the inventor nor related to him (see paragraph (f) of this section). The requirement that such individual is neither the employer of the inventor nor related to him must be satisfied at the time when the substantive rights as to the interest to be acquired are determined, and at the time when the consideration in money or money's worth to be paid is definitely fixed. For example, if prior to the actual reduction to practice of an invention an individual who is neither the employer of the inventor nor related to him agrees to pay the inventor a sum of money definitely fixed as to amount in return for an undivided one-half interest in rights to a patent and at a later date, when such individual has become the employer of the inventor, he pays the definitely fixed sum of money pursuant to the earlier agreement, such individual will not be denied the status of a holder because of such employment relationship.

(2) Although a partnership cannot be a holder, each member of a 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).

(3) An individual may qualify as a holder whether or not he is in the business of making inventions or in the business of buying and selling patents.

(e) *Actual reduction to practice.* For the purposes of determining whether an individual is a holder under paragraph (d) of this section, the term *actual reduction to practice* has the same meaning as it does under section 102(g) of title 35 of the United States Code. Generally, an invention is reduced to actual practice when it has been tested and operated successfully under operating conditions. This may occur either before or after application for a patent but cannot occur later than the earliest time that commercial exploitation of the invention occurs.

(f) *Related person.* (1) The term *related person* means one whose relationship to another person at the time of the transfer is described in section 267(b), except that the term does not include a brother or sister, whether of the whole or the half blood. Thus, if a holder transfers all his substantial rights to a patent to his brother or sister, or both, such transfer is not to a related person.

(2) If, prior to September 3, 1958, a holder transferred all his substantial rights to a patent to a corporation in which he owned more than 50 percent in value of the outstanding stock, he is considered as having transferred such rights to a related person for the purpose of section 1235. On the other hand, if a holder, prior to September 3, 1958, transferred all his substantial rights to a patent to a corporation in which he owned 50 percent or less in value of the outstanding stock and his brother owned the remaining stock, he is not considered as having transferred such rights to a related person since the brother relationship is to be disregarded for purposes of section 1235.

(3) If, subsequent to September 2, 1958, a holder transfers all his substantial rights to a patent to a corporation in which he owns 25 percent or more in value of the outstanding stock, he is considered as transferring such rights to a related person for the purpose of section 1235. On the other hand if a holder, subsequent to September 2, 1958, transfers all his substantial rights

to a patent to a corporation in which he owns less than 25 percent in value of the outstanding stock and his brother owns the remaining stock, he is not considered as transferring such rights to a related person since the brother relationship is to be disregarded for purposes of section 1235.

(4) If a relationship described in section 267(b) exists independently of family status, the brother-sister exception, described in subparagraphs (1), (2), and (3) of this paragraph, does not apply. Thus, if a holder transfers all his substantial rights to a patent to the fiduciary of a trust of which the holder is the grantor, the holder and the fiduciary are related persons for purposes of section 1235(d). (See section 267(b)(4).) The transfer, therefore, would not qualify under section 1235(a). This result obtains whether or not the fiduciary is the brother or sister of the holder since the disqualifying relationship exists because of the grantor-fiduciary status and not because of family status.

[T.D. 6500, 25 FR 12014, Nov. 26, 1960, as amended by T.D. 6852, 30 FR 12730, Oct. 6, 1965; T.D. 7728, 45 FR 72650, Nov. 3, 1980]

#### § 1.1236-1 Dealers in securities.

(a) *Capital gains.* Section 1236(a) provides that gain realized by a dealer in securities from the sale or exchange of a security (as defined in paragraph (c) of this section) shall not be considered as gain from the sale or exchange of a capital asset unless:

(1) The security is, before the expiration of the thirtieth day after the date of its acquisition, clearly identified in the dealer's records as a security held for investment or, if acquired before October 20, 1951, was so identified before November 20, 1951; and

(2) The security is not held by the dealer primarily for sale to customers in the ordinary course of his trade or business at any time after the identification referred to in subparagraph (1) of this paragraph has been made.

Unless both of these requirements are met, the gain is considered as gain from the sale of assets held by the dealer primarily for sale to customers in the course of his business.

(b) *Ordinary losses.* Section 1236(b) provides that a loss sustained by a

dealer in securities from the sale or exchange of a security shall not be considered a loss from the sale or exchange of property which is not a capital asset if at any time after November 19, 1951, the security has been clearly identified in the dealer's records as a security held for investment. Once a security has been identified after November 19, 1951, as being held by the dealer for investment, it shall retain that character for purposes of determining loss on its ultimate disposition, even though at the time of its disposition the dealer holds it primarily for sale to his customers in the ordinary course of his business. However, section 1236 has no application to the extent that section 582(c) applies to losses of banks.

(c) *Definitions*—(1) *Security.* For the purposes of this section, the term *security* means any share of stock in any corporation, any certificate of stock or interest in any corporation, any note, bond, debenture, or other evidence of indebtedness, or any evidence of any interest in, or right to subscribe to or purchase, any of the foregoing.

(2) *Dealer in securities.* For definition of a *dealer in securities*, see the regulations under section 471.

(d) *Identification of security in dealer's records.* (1) A security is clearly identified in the dealer's records as a security held for investment when there is an accounting separation of the security from other securities, as by making appropriate entries in the dealer's books of account to distinguish the security from inventories and to designate it as an investment and by (i) indicating with such entries, to the extent feasible, the individual serial number of, or other characteristic symbol imprinted upon, the individual security, or (ii) adopting any other method of identification satisfactory to the Commissioner.

(2) In computing the 30-day period prescribed by section 1236(a), the first day of the period is the day following the date of acquisition. Thus, in the case of a security acquired on March 18, 1957, the 30-day period expires at midnight on April 17, 1957.

[T.D. 6500, 25 FR 12015, Nov. 26, 1960, as amended by T.D. 6726, 29 FR 5667, Apr. 29, 1964]