

(d) *Nonapplicability to compensatory options.* Section 1234 does not apply to options to purchase stock or other property which are issued as compensation for services, as described in sections 61, 83, and 421 and the regulations thereunder.

(e) *Premium allocation for simultaneously granted options.* The allocation of a premium received for a straddle or multiple option between or among the component options thereof shall be made on the basis of the relative market value of the component options at the time of their issuance or on any other reasonable and consistently applied basis which is acceptable to the Commissioner.

(f) *Effective date.* This section, relating to special rules for the treatment of grantors of certain options, shall apply to options granted after September 1, 1976.

[T.D. 7652, 44 FR 62282, Oct. 30, 1979; 44 FR 67657, Nov. 27, 1979]

#### § 1.1234-4 Hedging transactions.

The character of gain or loss on an acquired or a written option that is (or is identified as being) part of a hedging transaction is determined under the rules of § 1.1221-2.

[T.D. 8555, 59 FR 36367, July 18, 1994]

#### § 1.1235-1 Sale or exchange of patents.

(a) *General rule.* Section 1235 provides that a transfer (other than by gift, inheritance, or devise) of all substantial rights to a patent, or of an undivided interest in all such rights to a patent, by a holder to a person other than a related person constitutes 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), whether or not payments therefor are:

(1) Payable periodically over a period generally coterminous with the transferee's use of the patent, or

(2) Contingent on the productivity, use, or disposition of the property transferred.

(b) *Scope of section 1235.* If a transfer is not one described in paragraph (a) of this section, section 1235 shall be disregarded in determining whether or not such transfer is the sale or exchange of

a capital asset. For example, a transfer by a person other than a holder or a transfer by a holder to a related person is not governed by section 1235. The tax consequences of such transfers shall be determined under other provisions of the internal revenue laws.

(c) *Special rules—(1) Payments for infringement.* If section 1235 applies to the transfer of all substantial rights to a patent (or an undivided interest therein), amounts received in settlement of, or as the award of damages in, a suit for compensatory damages for infringement of the patent shall be considered payments attributable to a transfer to which section 1235 applies to the extent that such amounts relate to the interest transferred. For taxable years beginning before January 1, 1964, see section 1304, as in effect before such date, and § 1.1304A-1 for treatment of compensatory damages for patent infringement.

(2) *Payments to an employee.* Payments received by an employee as compensation for services rendered as an employee under an employment contract requiring the employee to transfer to the employer the rights to any invention by such employee are not attributable to a transfer to which section 1235 applies. However, whether payments received by an employee from his employer (under an employment contract or otherwise) are attributable to the transfer by the employee of all substantial rights to a patent (or an undivided interest therein) or are compensation for services rendered the employer by the employee is a question of fact. In determining which is the case, consideration shall be given not only to all the facts and circumstances of the employment relationship but also to whether the amount of such payments depends upon the production, sale, or use by, or the value to, the employer of the patent rights transferred by the employee. If it is determined that payments are attributable to the transfer of patent rights, and all other requirements under section 1235 are met, such payments shall be treated as proceeds derived from the sale of a patent.

(3) *Successive transfers.* The applicability of section 1235 to transfers of undivided interest in patents, or to successive transfers of such rights, shall be determined separately with respect to each transfer. For example, X, who is a holder, and Y, who is not a holder, transfer their respective two-thirds and one-third undivided interests in a patent to Z. Assume the transfer by X qualifies under section 1235 and that X in a later transfer acquires all the rights with respect to Y's interest, including the rights to payments from Z. One-third of all the payments thereafter received by X from Z are not attributable to a transfer to which section 1235 applies.

(d) *Payor's treatment of payments in a transfer under section 1235.* Payments made by the transferee of patent rights pursuant to a transfer satisfying the requirements of section 1235 are payments of the purchase price for the patent rights and are not the payment of royalties.

(e) *Effective date.* Amounts received or accrued, and payments made or accrued, during any taxable year beginning after December 31, 1953 and ending after August 16, 1954, pursuant to a transfer satisfying the requirements of section 1235, whether such transfer occurred in a taxable year to which the 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