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Extraordinary Ideas Now Ordinary Income: Incentives Created by the Tax Cut and Jobs Act's New Treatment of Self-Created Intellectual Property

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EXTRAORDINARY IDEAS NOW ORDINARY INCOME: INCENTIVES CREATED BY THE TAX CUT AND JOBS ACT'S NEW TREATMENT OF SELF-CREATED INTELLECTUAL PROPERTY

*Savannah Story**

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I. INTRODUCTION

A premise of protecting intellectual property rights is to encourage innovation by granting the creator of an idea a monopoly in a market so the creator may reap enough benefits to recoup the costs of innovation.[1] This protection encourages innovation because "[p]rivate producers have an incentive to invest in innovation only if they receive an appropriate return."[2] This system was conceived by the founding fathers and is codified in the Constitution.[3] Intellectual property rights permit holders to go after others who try to utilize the underlying intellectual property; this protection creates a financial incentive to create because it allows for protection in the market.[4]

Similar to incentivizing innovation via intellectual property rights, governments use taxes to incentivize certain behaviors.[5] Intellectual property has historically been a revenue-generating taxable asset.[6] Prior to the passage of the Tax Cuts and Jobs Act of 2017 (TCJA), patents and unpatented inventions created by individual taxpayers were categorized as capital assets and were therefore generally subject to significantly lower tax rates than ordinary income.[7] The revision of the code occurs in the Tax Cut and Jobs Act, section 26 U.S.C. § 1221:

> (a) . . . '[C]apital asset' means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> [. . .]

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[1] Stanley M. Besen & Leo J. Raskind, *An Introduction to the Law and Economics of Intellectual Property*, 5.1 J. ECON. PERSP., 1, 5 (1991).

[2] *Id.*

[3] *Id.* at 8; U.S. CONST. art. I, § 8, cl. 8.

[4] Besen & Raskind, *supra*note 1, at 3–4 ("[M]ainstream of the economics profession has generally argued that economic efficiency requires government support for innovative and creative activity, but a dissenting tradition has argued that government action of any kind, including the awarding of copyrights and patents, is unnecessary to stimulate such activity." (citations omitted)). There is legitimate debate whether the protection of intellectual property rights is necessary to encourage innovation, this note proceeds under the analysis of the current system—protecting recognized rights to intellectual property.

[5] J.D. Foster, *Incentives Influence Behavior, and Tax Rates Certainly Influence Incentives*, U.S. Chamber of Commerce (Sep. 23, 2016), https://www.uschamber.com/series/above-the-fold/incentives-influence-behavior-and-tax-rates-certainly-influence-incentives

[6] Michael Rosen, *Tax reform's impact on intellectual property*, AEIDEAS (Jan. 31, 2018, 6:00 AM), http://www.aei.org/publication/tax-reforms-impact-on-intellectual-property/.

[7] *Id.*

> (3) a patent, invention, model or design (whether or not patented), a secret formula or process, a copyright, a literary, musical, artistic competition, a letter or memorandum, or similar property, held by—
>
> > (A) a taxpayer whose *personal efforts* created such property,
> >
> > (B) in the case of a letter, memorandum, or similar property, a taxpayer for whom such property was prepared or produced, or
> >
> > (C) a taxpayer in whose hands the basis of such property is determined, for purposes of determining gain from a sale or exchange, in whole or part by reference to the basis such property in the hands of a taxpayer . . . [8]

A Joint Explanatory Statement of the TCJA explained this change was intended for any "gains or losses from the sale or exchange of a patent, invention, model or design (whether or not patented) ... [to] not receive capital gain treatment," meaning this type of income will be categorized as ordinary income.[9] This change "applies to dispositions after December 31, 2017."[10] Additionally, this note focuses on the effects this policy change will have on the sale of patents, although the current U.S. Code changes the status of all intellectual property rights. Patents were chosen as the primary focus because they present the most straight forward and new policy change.

Going forward, this means that income generated from the sale of intellectual property assets are subject to the corporate income tax rate when the rights are held by a corporation, and income generated when an intellectual property asset is sold by an individual is subject to the individual income tax rate. "Overall, it appears that the new law poorly treats owners of and investors in self-created [intellectual property]."[11]

Many companies currently based their intellectual property rights in countries such as Ireland.[12] The United States policy change comes at a time when countries like Ireland "may be phasing out popular aspects of its favorable tax

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[8] 26 U.S.C. §1221(2017) (emphasis added).

[9] *Joint Explanatory Statement of the Committee of Conference*, H.R. 1 (2017), at 259.

[10] *Id.* at 260.

[11] James M. McCarten, *Patent Turmoil: Self-created IP after Tax Reform*, BURR ALERT (Jan. 2018) (alteration in original) http://www.burr.com/wp-content/uploads/2018/01/ALERT_Patent-Turmoil_Self-Created-IP-After-Tax-Reform_McCarten.pdf.

[12] Rosen, *supra* note 6.

treatment."[13] Understanding how the U.S. tax code treats intellectual property rights as compared to other nations can be helpful in explaining the possible incentives created by the current change in U.S. policy.

There are portions of the tax code which contradict the assertion that intellectual property assets are no longer capital assets. However, this note proceeds on the assumption that the code is interpreted consistently with the Joint Explanatory Statement's stated purpose. Scholarly statutory interpretation that suggests this is the appropriate reading of the language.[14] Prior to the passage of the TCJA, 26 U.S.C. § 1221 excluded copyrights and "literary, musical or artistic composition" from capital asset treatment.[15] The recent revision added patents and other inventions to the list of items excluded from capital asset treatment.[16] The Conference Committee Report reflected the intention of the amendment to exclude the "gains or losses from the sale or exchange of a patent" from capital gain treatment.[17]

The sale of an intellectual property asset could be categorized as a capital asset under 26 U.S.C. § 1235, despite the revision of § 1221, since Congress left in place contradicting language in § 1235:[18]

> 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.[19]

This direct contradiction was addressed by Professor Polito, one of the few scholars that have analyzed this contradiction. After analyzing the congressional intent and various methods of statutory interpretation, Professor Polito determined that the statutes' provided intent will either stand in court or the relevant statutes will be revised to no longer categorize intellectual property assets as capital assets.[20]

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[13] *Id.*

[14] *See* Anthony Polito, *Did Congress Goof? TCJA and the Taxation of Self-Created Patents and Inventions*, TAX NOTES 51, 5 (forthcoming) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3223822. When Congress revised 26 U.S.C. § 1221(a)(3), they failed to repeal to special carve out for self-created intellectual property rights in § 1235 that specifically granted capital gain treatment of self-created patents and inventions.

[15] *Id.* at 51 (citing U.S.C. § 1221 (a)(3)).

[16] *Id.* at 52.

[17] *Id.* at 52–53. (Citing H.R. REP. NO. 115-466, at 413-14 (2017) (Conf. Rep.), *available on Westlaw* at 2017 WL 6406640 (Leg. Hist.).)

[18] WILLIAM BYRNES, TAXATION OF INTELLECTUAL PROPERTY § 6.06 (Matthew Bender 2018).

[19] 26 U.S.C. 5§1235 (2018).

[20] Polito, *supra* note 15

II. BACKGROUND

A. TCJA'S TREATMENT OF INTELLECTUAL PROPERTY IS IN LINE WITH UNDERLYING TAX POLICIES

On its face, no longer categorizing self-created intellectual property as a capital asset brings federal tax policy more in line with principles of income tax—"the creator of [intellectual property] is actually being compensated for labor" which should be taxed at typical income rates.[21] But along with bringing this tax provision in line with the income tax policy also comes the risk of the tax distorting the purpose of protecting intellectual property rights—to provide inventors the ability to economically recover the costs of innovation.[22] This change could hinder small inventors' financial motivation for inventing[23] because "creators of intellectual property can often maximize monetary return from its exploitation through sale... to others."[24] The purpose of protecting intellectual property rights is stimulating innovation; while some people will undoubtedly innovate regardless, the promise of some sort of monetary reward helps to spur innovation among those who might not otherwise do so.[25]

Additionally, the revision of 26 U.S.C. § 1221 raises the question of whether the new tax regime strikes the appropriate balance required for the protection to encourage innovation—financial incentive. The new provision is unlikely to affect the secondary patent market because this provision only applies to the sale of a patent from the original holder.[26]

B. INTELLECTUAL PROPERTY ASSETS ARE EASILY MANIPULATABLE FOR TAX PURPOSES

Intangible assets such as intellectual property constitute a major asset for multinational firms.[27] The unique aspect of intangible assets is that they do "not have a clear geographical location."[28] The intangible nature of intellectual

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[21] *Id.* at 53. *Be sure to change this based on what you put in for FN 22*

[22] Besen & Raskind, *supra* note 1, at 5.

[23] Malathi Nayak, *Tax Bill Would Eliminate Capital Gains Treatment for IP Sales*, BNA (Nov. 3, 2017), https://www.bna.com/tax-bill-eliminate-n73014471731/. *See also,* Schechner, *supra*, note 12 ("it appears that the new law poorly treats owners of and investors in self-created [intellectual property].").

[24] BYRNES, *supra* note 18 § 6.01.

[25] Christopher M. Kalanje, *Role of Intellectual Property in Innovation and New Product Development,* WIPO (last visited April 4, 2019) https://www.wipo.int/export/sites/www/sme/en/documents/pdf/ip_innovation_development.pdf.

[26] Kalanje, *supra* note 27.

[27] Lisa Evers, Helen Miller, and Christoph Spengel, *Intellectual property box regimes: effective tax rates and tax policy considerations*, 22 INT. TAX PUB. FIN. 502, 503 (2014).

[28] *Id.*

property creates flexibility that can be manipulated by firms to reduce their tax obligations.[29] "[A]bout half of the income shifted from high-tax to low-tax countries by US manufacturing firms can be accounted for by income from intangibles linked to research & development."[30] This profit shifting manipulation "leads to significant revenue losses for high-tax countries."[31] These mechanisms, which businesses use to shift profits in a way that erodes a country's tax base, are referred to as "base erosion and profit shifting" (BEPS) actions.[32] Profit shifting mechanisms such as this cost the United States billions of dollars of tax revenue annually.[33]

Firms generally do locate their intellectual property in the lowest tax rate countries.[34] "A firm can register legal ownership of a patent in a subsidiary that is located in a country different to the firm's headquarters, different to the location where the underlying technology was created and different to the location where the intellectual property will be applied."[35] But, tax rates are not the only consideration firms look at when determining where to base their intellectual property. Firms also consider the strength of the protections in a given country in addition to the country's market size.[36] Firms also may simply choose to locate their intellectual property in the same country as their research and development because of the convenience of co-location.[37]

C. INTELLECTUAL PROPERTY TAX BOX REGIMES

In response to the tax incentives that were shifting revenue, some countries developed "Intellectual Property Box" tax regimes which reduced the corporate "tax levied on the income derived from patents and in some cases from other

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[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] JANE G. GRAVELLE, CONG. RESEARCH SERV., R44900, BASE EROSION AND PROFIT SHIFTING (BEPS): OECD TAX PROPOSALS (2017) (quoting *Base erosion and profit shifting*, OECD (last visited April 4, 2019), http://www.oecd.org/tax/beps/) (BEPS are "tax-avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations."). .

[33] *Id.*

[34] Rachel Griffith, Helen Miller, and Martin O'Connell, *Ownership of Intellectual Property and Corporate Taxation*, 112 J. OF P. ECON. 12 (2014).

[35] *Id.* at 12; *see* Schechner, *supra*, note 12 ("The Double Irish is a structure that allows companies to reduce taxable income by setting up two entities—an Irish-registered parent based in a tax haven such as Bermuda that houses a company's foreign [intellectual property] rights, and an Irish subsidiary, which licenses the [intellectual property] and pays royalties in turn. Since Ireland doesn't tax the royalties paid, the company's tax bill is effectively reduced.").

[36] Rachel Griffith, Helen Miller, and Martin O'Connell, *Ownership of Intellectual Property and Corporate Taxation*, 112 J. OF P. ECON. 12 (2014).

[37] *Id.*

forms of intellectual property."[38] As of 2014, "[t]welve European countries [...] offer[ed] a reduced rate of corporate tax on the income derived from parents and, in many cases, income from other forms of intellectual property."[39] These rates range from 0% to 15.5%.[40] Most recently, the United Kingdom has been luring "U.S. companies with its 10 percent patent box rate."[41] These "boxes" were introduced to incentivize investment, attract high-skilled jobs, and to increase tax revenue.[42] "The importance of intangible assets for multinational companies cannot be overestimated."[43] Because of this importance, and the impact the location on a community that the presence of a multinational company can have, it is unsurprising that the majority of developed states have used intellectual property box tax incentives to lure multinational corporations.[44]

D. CRITICS OF IP BOX REGIMES

Critics have referred to intellectual property boxes as "'a race to the bottom' in capital taxation."[45] Largely because they lead to "harmful tax competition between countries."[46] Also, critics point out that these systems put significant emphasis on a relatively small subset of businesses that hold intellectual property, when these tax reductions could be more beneficial if dispersed throughout the economy.[47] Intellectual property boxes were first introduced in Ireland and France in the 1970s.[48] But since their introduction to the national stage, few

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[38] Evers, Miller & Spengel, *supra* note 27, at 503.

[39] *Id.* at 505.

[40] *Id.*

[41] REPUBLICAN STAFF OF JOINT ECON. COMM., 114TH CONG., PATENT BOXES: A BRIEF HISTORY, RECENT DEVELOPMENT, AND NECESSARY CONSIDERATIONS (Mar. 10, 2016), https://www.jec.senate.gov/public/_cache/files/02a2a18a-1e08-42ce-8c14-72b6138b54dd/031016-patent-boxes.pdf (hereinafter *Patent Box Report*)

[42] Evers, Miller & Spengel , *supra* note 27, at 504; GRAVELLE, *supra* note 32 ("[T]he term 'box' refers to checking a box on the tax return.").

[43] BYRNES, *supra* note 18 § 17.01 ("[I]ntangible assets such as patents... can have a substantial bearing on a company's value and, subsequently, they can affect the entire economy of the relevant community where the company is located.").

[44] *Id.* Many countries have additionally used tax incentives such as tax credits for research and development costs. The influence of this incentive is excluded from this Note's analysis of 26 U.S.C. § 1221.

[45] *Id.* (citing ORG. FOR ECON. CO-OPERATION AND DEV., OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT, COUNTERING HARMFUL TAX PRACTICES MORE EFFECTIVELY, TAKING INTO ACCOUNT TRANSPARENCY AND SUBSTANCE, ACTION 5 – 2014 FINAL REPORT 1, 9 (2014).

[46] *Id.* (citing Rafael Sanz-Gómez, *The OECD's Nexus Approach to IP Boxes: A European Union Law Perspective*, WU INT' TAX'N RES. PAPER SERIES 1, 3 (2015))

[47] *Patent Box Report, supra* note 41. f

[48] *See* BYRNES, *supra* note 18 § 17.03 (citing A. Alstadsæter, et. al., *Patent Boxes Design, Patents Location and Local R&D* 22 (IPTS Working Papers on Corp. R&D and Innovation No. 6/2015, 2015).

scholars have researched the effectiveness in boosting the country that adopted them.[49] One study found that companies operating in a country that had an intellectual property box issued more patents than countries without, but the resulting tax erosion in tax revenue did not appear to offset the increased income from patent applications, "at least in the short term."[50] This trade-off further demonstrates the inherent tension with the TCJA's revisions to 26 U.S.C. §1221, decrease tax revenue or encourage innovation (or at least "geographical location" of a creator's intellectual property).

E. CONGRESS'S INTENT TO REVISE 26 U.S.C. § 1221 IS SIMILAR TO THE MOTIVATIONS OF TAX BOXES

Congress' revision of §1221(a)(3) was intended to have similar effects as intellectual property boxes created by other countries—to incentivize firms to hold intellectual property in their country."[51] It is unclear whether the TCJA's approach will have similar effects in the United States. Given the overlapping incentives and reduced tax liabilities of intellectual property tax boxes and the revised § 1221(a)(3), the consequences of these boxes on patent holdings can be a case study and comparison for the potential effects of the new intellectual property categorization.

F. TAX BOX POPULARITY IN UNITED STATES?

There are three primary reasons jurisdictions adopt intellectual property boxes: to incentivize innovation, attract mobile Intellectual Property assets, and efficiently raise tax revenue.[52] These incentives have enticed United States Legislators to incorporate an intellectual property box into our tax code.[53] In 2013, a member of Congress proposed an intellectual property box regime to be adopted in the Internal Revenue Code.[54] Generally, this type of regime provides tax relief for income related to any form of revenue generated from intellectual property.[55] The introduction of a U.S. intellectual property box gained bipartisan support in 2015 to combat the poaching of United States companies' intellectual property into other nations.[56]

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[49] *Id.*

[50] *Id.*

[51] Sam Schechner, Tax Change Aims to Lure Intellectual Property Back to the U.S. (Jan. 24, 2018), https://www.wsj.com/articles/companies-explore-whether-u-s-can-replace-double- irish-1516789801

[52] BYRNES, *supra* note 18 § 17.04 .

[53] *Id.*

[54] Manufacturing Innovation in America Act of 2013, H.R. 2605, 113th Cong. (2013).

[55] *Id.*

[56] Peter Merrill, *Innovation Boxes: Beps and Beyond, National Tax Journal*, December 2016, 69 (4) 1.

An intellectual property box could provide for greater tax relief than the recent revision of 26 U.S.C. § 1221 because the language of the proposed intellectual property box would have generally applied to any "taxpayer" of intellectual property, meaning individuals and corporations.[57] But proposals in 2015 would have only would have Tax Boxes be applicable to corporations. Therefore the benefits would not be available to individuals. However, this proposal was not adopted. In fact, the current U.S. Tax Code "make[s] is unprofitable for U.S. companies to use IP Boxes of foreign jurisdiction" by imposing a significant tax when a U.S. company attempts to transfer its intellectual property assets to its parent company from a foreign subsidiary."[58]

With the discussion of corporate tax reform movement of 2017, the idea of a U.S. intellectual property box regime resurfaced.[59] Historically, the United States has offered significant tax incentives for innovation, with full deduction of research and development costs to corporations and individuals.[60] The Joint Economic Committee noted that innovation is inherently linked to the economy, which makes "the economic pie bigger for everyone."[61]

G. STABILITY OF THE TCJA REVISIONS

The long-term effects of this policy change are uncertain for many reasons. There is a possibility that a political shift will result in reversal.[62] It is unlikely "'any firm would be well served by betting the ranch on the stability of the new tax law,' said Edward Kleinbard, a former U.S. tax official who is now a tax professor at the University of Southern California law school."[63] Because of the uncertainty in whether this tax policy will last, the true effects and incentives created by the new characterization of intellectual property assets may be unknown for years to come.

Excluding the proceeds from the sale of patents and inventions will have significant impacts on individual creators. The capital asset categorization prior to the passage of TJCA ranged from 15-20%, depending on the individual's income.[64] Under the TCJA, the proceeds of an individual's sale of intellectual property will be subject to respective individual income tax rates, ranging from

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57 *Id.*

58 BYRNES, *supra* note 19 § 17.04.

59 *Id.* (citing *Patent Box Report*, *supra* note 41).

60 *Patent Box Report*, *supra* note 44.

61 *Id.*

62 *Rosen*, *supra*, note 6.

63 Schechner, *supra* note 12.

64 Maurie Backman, *The Capital Gains Tax Rate: What you Need to Know for 2017*, THE MOTLEY FOOL (Dec. 16, 2016, 8:41 AM), https://www.fool.com/retirement/2016/12/16/capital-gains-tax-rate-for-2017.aspx (Individual single tax filer making $37,500-$112,500 paid 15% on capitals gains profits. Individual single tax filers making $112,500 and above paid 20% on capital gains profits).

22%-38.5%.[65] The tax impact for individuals will likely vary dramatically depending on the specific individual's income. Whether this reduction in profit is significant enough to decrease incentives to innovate is uncertain.

III. ANALYSIS

The revision of the tax code creates two primary issues. First, the revisions penalize non-corporate holders of patents and inventions. Second, the revision is unlikely to achieve its intended goal of keeping intellectual property assets in the United States.

A. THE TCJA'S REVISIONS TO § 1221 PENALIZE NON-CORPORATE PATENT HOLDERS

The TCJA hurts non-corporate patent holders because these are the only taxpayers whose tax rates are affected by the new revisions. Though the change may not necessarily disincentivize individual inventors, it provides less financial reward than to corporate patent holders. Whether or not the change decreases research and development of patentable ideas and inventions, it still will serve as financial penalty that individuals will face and the corporations will not. The influence this revision will have on behavior is uncertain, and may be minimal and insignificant. However, the financial consequence will occur regardless of whether it changes inventive behavior. This result is not "right or wrong," but it is a policy choice that the United States must realize it is choosing. This consequence is not inevitable.

This revision is in line with the general trend of tax law and intellectual property law favoring corporations over individuals. But to protect corporate interests and remain competitive in the market to be the geographical home for corporations and their intellectual property, U.S. policies do not have to penalize non-corporate patent holders and inventors.

B. THE REVISIONS ARE UNLIKELY TO MOTIVATE CORPORATIONS TO RETAIN INTELLECTUAL PROPERTY ASSET TAXABLE INCOME IN THE UNITED STATES

The effects of TCJA have limited real financial incentives for corporations to hold the intellectual property in the United States because the effects of the provisions combined with the new corporate tax rate will almost cancel each other out while only penalizing non-corporate tax payers. There are alternatives

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[65] *Joint Explanatory Statement of the Committee of Conference*, *supra* note 9 at 10.
For comparison, individuals making $38,700-$70,00 are in the 22% bracket; $70,000-$160,00 are in the 24% bracket; $160,000-$200,000 are in the 32% bracket; $200,000-$500,000 are in the 35% bracket; over $500,000 are in the 38.5% bracket.

to the current characterization of intellectual property under the TCJA that could accomplish more of Congress' intended goals.

The United States could implement an intellectual property tax box that was comparable to other countries. The box should be available to any profit resulting from intellectual property, regardless of the entity that holds or created the property. Although at first glance this type of policy seems to create a huge tax cut to intellectual property income, the tax box rate could be set in the range comparable to capital gains rates. To make the United States tax policy more competitive, rates would not need to be as low as other countries for multiple reasons.

The United States can entice companies to hold intellectual property in the United States with only a slight reduction in taxes because the United States patents have stronger and broader intellectual property protections than many countries. Stronger protections can level the playing field if the tax rate is at least low enough that the costs saved offset the costs of the tax.

The tax rates would also not need to be as low as other countries because there are financial and practical benefits of a company holding its intellectual property rights in its country of primary business. So long as the tax rate is set below the transaction costs for holding intellectual property rights in a foreign country, corporations will have incentive to keep and maintain their intellectual property in the United States. The ease of location combined with a competitive tax rate will be sufficient to entice firms to maintain their intellectual property in the United States.

Implementing an intellectual property box may also demonstrate more stability in the tax treatment of intellectual property than the current version of § 1221. The TCJA is full of contradictory treatment of intellectual property rights, which create haste for individuals to plan their tax behavior around the current code. Also, the legitimate concerns with stability and polarization of the current political climate in the United States causes some firms to hesitate when considering whether to subject their finances to that instability. Creating an intellectual property tax box may demonstrate a clear and unequivocal commitment to tax treatment of intellectual property tax assets. A demonstration of stability will not only entice intellectual property to be held in the United States, but also will create incentives for firms to keep it the United States.

Creating a intellectual property box will also help the United States tax policy achieve another goal—to raise revenue. The point of tax is not only to incentivize invention, but also to increase the size of the tax base. Although intellectual property box reduces the magnitude of taxes paid per patent, it will also entice more companies to maintain their intellectual property in the United States, increasing the size of the tax base. This is a policy change that can encourage innovation, encourage intellectual property to be held in the United States, while not reducing the net tax revenue.

An intellectual property box also provides a simplification 6 U.S.C. § 1221 of the tax code. Simply applying the same lower rate to all income related to intellectual property is efficient.

An intellectual property box would bring the goals of income tax in line with the goals of protecting intellectual property. The current system entices corporations to hold their intellectual property in foreign countries, and therefore encourages and creates financial incentive to redirect intellectual property to foreign countries. By getting rid of this incentive to flee and encouraging the holding of intellectual property in the United States, an intellectual property box would make it more likely that more firms are being taxed on their true income from intellectual property. This is potentially what the revision to § 1221 was aimed at doing since it will treat the fruits of labor in developing patents as income, rather than some sort of asset acquisition. However, the competition created by other countries that provide lower tax rates to lure intellectual property prevents the current code from solving the issue of accurately reflecting the true income from patents because of the diversionary effect that keeps intellectual property assets from being located and taxed in the United States.

An intellectual property box would also be in line with the underlying principles of protecting intellectual property rights. An intellectual property box would incentivize innovation because the financial reward of developing a patentable invention would be significant. Additionally, it would allow a patent holder to have a monopoly in the market for a limited period of time. This monopoly provides an economic incentive to tip the scale of research and development investment toward innovation.

If an intellectual property box is politically not feasible, an alternative would be to amend the current statutes as soon as possible to allow firms and individuals to appropriately plan their tax behavior. Additionally, another option would be returning § 1221 to its previous form. Although a return to the old § 1221 would not solve the issue of the current "international tax competition," it would at least remove the tax penalty now imposed on non-corporate patent creators.

V. CONCLUSION

The effects of TCJA's revision of 26 U.S.C. § 1221 are uncertain. The legal effect of the multiple contradictions regarding intellectual property income in the code are uncertain. The stability of this policy for years to come is uncertain. With uncertainty around every corner, the true effect this policy has on tax planning is difficult to predict. The instability could result in no change in current behavior and innovation and patent location would remain at the status quo. Regardless, there are options that would lead to better results for all parties involved than the outcomes under the current code.

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