ARTICLES

THE IMPACT OF THE UNITED STATES TAX LAWS ON INTERNATIONAL TECHNOLOGY TRANSFER: AN OVERVIEW AND SOME SUGGESTIONS FOR MINIMIZING THE BITE*

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Concomitant with the remarkable shrinkage of the world in the past fifty years through the astounding growth in speed and efficiency of transportation and communication systems has been the ever-increasing importance and volume of international technology transfer—much of it through international licensing of industrial property rights. Every license agreement or technology transfer necessarily involves at least two parties—the supplier or transferor of the technology and the receiver or transferee. But hidden in the wings are at least two additional parties—the governments of the two (or more) countries involved in the transaction. Although the governments may participate in the transaction sub silentio the impact of their presence may nevertheless be very strongly felt through the operation of their respective taxation laws on the overall economic effect of the transaction. In other words, taxation is a factor that none of the parties can afford to overlook in any international technology transfer, and its end effect can make or break the entire deal.

With the foregoing facts in mind, the authors of this article have sought to present a broad overview of the major provisions of the United States income tax laws that affect the international transfer of industrial property rights—which are the tools of the trade in carrying out international technology transfers. Admittedly, in an international technology transfer it will be essential to examine thoroughly the tax laws of all the various jurisdictions involved, but if one of the parties to the transaction is a United States entity, it is absolutely essential that the United States tax laws be closely studied.

The United States Internal Revenue Code is probably the most complex, intricate, and baffling legal document ever forged by man. In sheer bulk alone its volume exceeds the combined volume of the tax laws of the entire nine countries that make up the Common
Market (EEC). The United States possesses the largest economy in the world, is a great trading nation, and since World War II, through the activities of its multinational corporations, both large and small, has penetrated virtually every market in the world. Accordingly, in the majority of international technology transfers the United States tax laws constitute a factor that cannot be ignored.

Most of the discussion which follows concerns the tax treatment of United States taxpayers, i.e., resident corporations, trusts, estates, partnerships, and individuals, as there are understandably very few provisions of United States income tax laws which apply to foreign taxpayers who are unrelated to a domestic taxpayer. Although the discussion is primarily an overview of the more important United States tax provisions affecting industrial property rights, since space does not permit a full and detailed analysis, it is hoped that the scope of the discussion is broad enough to alert taxpayers to the various provisions that may cause problems. It is also hoped that implicit in the discussion will be hints on effective ways to minimize the bite.

II. THE STRUCTURE OF THE UNITED STATES TAX LAWS

The basic law governing United States income taxation is the Internal Revenue Code of 1954 (Code) and the regulations promulgated under the Code by the Internal Revenue Service (IRS). While there are many court decisions which provide significant aid in understanding and interpreting the language of the Code and the regulations, the primary source of the law in the area of international transfer of industrial property rights is the statutory framework. Although many states have their own income tax laws, this discussion will focus entirely on the tax laws of the federal government. Also, unless otherwise indicated, the principles discussed apply to individual and corporate taxpayers alike.

The most central concept in the Code is gross income. It is defined in very sweeping terms and includes "all income from whatever source derived . . . ."3 Gross income specifically includes, inter alia, compensation for services, gains from dealings in property, rents, and royalties.4 Taxable income is generally determined by taking

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1 See I.R.C. § 7701.
2 26 U.S.C. § 1 et seq. All textual references to sections refer to the Internal Revenue Code of 1954.
3 I.R.C. § 61(a).
4 Id.
one's gross income and subtracting from that amount deductions which the Code specifically permits.5

The Code establishes separate rates of taxation for individual and corporate taxpayers. For the individual taxpayer, the rates are structured progressively with the highest marginal rate in the highest income brackets set at 70%.6 There is, however, a maximum rate of 50% on personal service income which provides relief from the higher marginal rates of section 1 for individuals whose income consists primarily of salary and commissions.7

For the corporate taxpayer, the basic rate of taxation is 20% on the first $25,000 of taxable income, 22% on the next $25,000, and 48% on income above $50,000.8

III. TAX TREATMENT (CHARACTERIZATION) OF INDUSTRIAL PROPERTY RIGHTS UNDER THE UNITED STATES TAX LAWS

As a general proposition the owner of industrial property engaged in a sale or transfer of rights in that property will receive the most favorable tax treatment if the gain from the transaction is characterized as long-term capital gain. Generally, for corporate taxpayers the net capital gain is taxed at a rate of 30%, as opposed to the normal 48%, and for noncorporate taxpayers, 50% of the net capital gain is deductible from gross income9 with the remaining 50% of the gain taxed at the normal rates.10

Three basic requirements must be satisfied to qualify for the favorable treatment extended to capital gains:

1. There must be a capital asset as defined in section 1221 or property which is treated like a capital asset under section 1231 (quasi-capital asset);
2. There must be a sale or exchange of such property;11 and
3. The property must be held for a sufficient amount of time to

5 I.R.C. § 63. See I.R.C. § 161 et seq. for permissible deductions.
6 I.R.C. § 1.
7 I.R.C. § 1348.
8 I.R.C. § 11.
9 I.R.C. § 1201(a).
10 I.R.C. § 1202.
11 I.R.C. § 1201(b) and (c). The text simplifies the capital gains provisions of the Code by specifying the maximum rates on net capital gains for the corporate and noncorporate taxpayer. Actually, these rates vary from 7 to 35% for noncorporate taxpayers, and 22 to 30% for corporate taxpayers. For examples of computations and the operation of the alternative tax on capital gains, see I.R.S., TAX GUIDE FOR SMALL BUSINESS 104-14 (1977 ed.).
12 I.R.C. § 1222.
qualify as a long-term capital gain (more than nine months in 1977, more than one year after December 31, 1977).\textsuperscript{13}

Any transaction involving industrial property rights which does not meet the above requirements gives rise to ordinary income taxable at the normal rates.\textsuperscript{14}

Many special considerations exist with regard to the qualification of patents, trademarks, copyrights, and know-how for capital gains treatment. The most important of these considerations are treated below.

A. \textit{Transfers of Patent Rights}

A patent will ordinarily qualify as property for capital gains purposes. Depending upon the facts of a particular situation, there are three different avenues of obtaining capital gains treatment for a patent.

First, under the general capital gains provisions,\textsuperscript{15} a patent will qualify as a capital asset, and therefore be eligible for favorable capital gains treatment, if it does not fall within any of the following exclusions of section 1221: (1) stock in trade; (2) property includable in inventory at the end of the taxable year; (3) property held primarily for sale to customers; and (4) depreciable property used in a trade or business. Of course, the holding period and sale or exchange requirements discussed previously must also be met.

As a practical matter, qualification for capital gains treatment under sections 1221-23 will usually be limited to amateur inventors—and corporate and professional inventors will have to look to one of the other two avenues of obtaining capital gains treatment.

For corporations, the usual means of obtaining capital gains treatment on patents is via section 1231. Under section 1231 special treatment is given to property "used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167 . . . ."\textsuperscript{16} If the gains from the sale or exchange of section 1231 property exceeds losses, and the applicable holding period is met, all such gains are entitled to receive the favorable capital gains treatment.\textsuperscript{17}

A further advantage of section 1231 is that where losses from such

\textsuperscript{13} \textit{Id.} § 1222(3).
\textsuperscript{14} I.R.C. § 64.
\textsuperscript{15} I.R.C. §§ 1221-23.
\textsuperscript{16} I.R.C. § 1231(b)(1).
\textsuperscript{17} I.R.C. § 1231(a).
sales or exchanges exceed gains, the losses are treated as ordinary losses,18 and therefore are fully deductible against gross income.19 This favorable treatment is to be contrasted with the very limited deductibility of capital losses which are, as a rule, permitted only to offset capital gains.20 The professional inventor’s patents will ordinarily not qualify for section 1231 treatment, because inventory and property held primarily for sale to customers is specifically excluded from such treatment.21

The third and final avenue by which a patent can qualify for capital gains treatment is through section 1235. Under section 1235 the transfer of all substantial rights to a patent, or an undivided interest in the patent, will qualify for capital gains treatment (without regard to the actual holding period, and despite the fact that payments are periodic or contingent upon use, productivity, and the like) if:

1. The transferor is the individual whose efforts created the transferred property or an individual (other than an employer or related person) who acquired his interest in exchange for consideration paid to the creator prior to the invention’s reduction to practice,22 and
2. The transfer is not made directly or indirectly to a related person.23

Either a professional or an amateur inventor may qualify for section 1235 treatment, but not a corporation. Furthermore, although a controversial decision of the United States Tax Court held that section 1235 was the exclusive route to capital gains treatment for an individual inventor where payments were contingent upon productivity, use, or disposition, or payable periodically,24 the better view is that failure to qualify under section 1235 does not prevent qualification under the general provisions governing capital gains discussed above.25

It should be remembered that the professional inventor will or-

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18 Id.
19 I.R.C. § 165.
21 I.R.C. § 1231(b)(1)(A) and (B).
22 I.R.C. § 1235(b).
23 I.R.C. § 1235(d).
narily not qualify under the general capital gains provisions because section 1221(1) excludes "stock in trade or property held . . . primarily for sale to customers" from qualifying as a capital asset.

The greatest source of difficulty and a stumbling block in qualifying the transfer of a patent (and other forms of industrial property) for capital gains treatment is the threshold issue of what constitutes a "sale or exchange" under sections 1221-23, and similarly, what constitutes a "transfer of all substantial rights" under section 1235. The issue has been litigated time and again, and its proper resolution can be of critical importance in deciding how to structure an international technology transfer. The published decisions permit a few general observations.

Nonexclusive licensing will always fail to qualify for capital gains treatment, and thus the proceeds will be treated as ordinary income. An assignment by sale or exchange (provided it is of a capital asset) will always result in capital gains treatment. Between these two extremes, an exclusive license may or may not qualify as a "sale or exchange" under sections 1221-23, or as a "transfer of all substantial rights" under section 1235, depending on the nature and number of restrictions the licensor imposes on the licensee. The court decisions are numerous and often conflicting; nevertheless, an analysis of the pertinent precedents permits the following characterization of certain important restrictions as being good, bad, or gray:

1. Good:
   (a) Exclusive license to make, use, and sell for entire unexpired term of patent in one country;
   (b) the same, within a limited geographical area of one country.

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27 See, e.g., Transducer Patents Co. v. Renegotiation Bd., 492 F.2d 247 (9th Cir. 1974); MacDonald v. Comm'r, 55 T.C. 840 (1971); Myers v. Comm'r, 6 T.C. 258 (1946).
28 E.g., Waterman v. Mackenzie, 138 U.S. 252 (1891) (patent infringement case, but also the leading case holding that the grant of an exclusive right to make, sell, and use is a sale).
29 See, e.g., Rodgers v. Comm'r, 51 T.C. 927 (1969) (capital gains treatment for grants of exclusive right to grow, propagate, use, and sell patented almonds restricted to California [only area of commercial production in the United States] for two patents, and only certain parts of California for another. I.R.S. contention that Treas. Reg. § 1.1235-2 overrules Marco v. Comm'r, infra, insofar as § 1235 is concerned rejected and regulation declared invalid); Graham v. Comm'r, 26 T.C. 730 (1956); Marco v. Comm'r, 25 T.C. 544 (1955) (capital gains treatment under 1939 predecessor of §§ 1211-23 upheld for separate, exclusive licenses grant-
(c) the same, with a right to reacquire on a condition subsequent which protects licensor’s right to royalties;\(^{30}\)
(d) the same, with right to sue infringers.\(^ {31}\)

2. **Bad:**
(a) Exclusive license for less than the full term of the patent;\(^ {32}\)
(b) right to terminate the license at will.\(^ {33}\)

3. **Gray:**
(a) Exclusive license limited to a particular industry;\(^ {34}\)
(b) to make and sell (not use);\(^ {35}\)
(c) to make and use (not sell);\(^ {36}\)
(d) covering less than all claims in the patent;\(^ {37}\)
(e) with a prohibition against sublicensing and subassignment.\(^ {38}\)

The above listing is by no means exhaustive, and in any given situation where certain rights are to be reserved by a transferee of an exclusive license, close scrutiny of the case law is necessary to determine whether the proposed transaction will qualify as a “sale or exchange” under sections 1221-23, or as the “transfer of all substantial rights” under section 1235. Furthermore, the nature and scope of permissible restrictions differ depending upon whether

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\(^{30}\) *E.g.*, Treas. Reg. § 1235-2(b) (1965); Allen v. Werner, 190 F.2d 840 (5th Cir. 1951); Meyers v. Comm’r, 6 T.C. 258 (1946).

\(^{31}\) Bell Intercontinental Corp. v. United States, 381 F.2d 1004 (Ct. Cl. 1967); Watson v. United States, 222 F.2d 689 (10th Cir. 1955).

\(^{32}\) *E.g.*, Treas. Reg. § 1.1235-2(c) (1960); Willkerson v. United States, 435 F.2d 845 (3d Cir. 1970).


\(^{37}\) *Compare* Treas. Reg. § 1.1235-2(b) (1965) *with* Bannister v. United States, 262 F.2d 175 (5th Cir. 1958) and Merck & Co. v. Smith, 261 F.2d 162 (3d Cir. 1958).

qualifications for capital gains treatment is attempted under section 1235, or under sections 1221-23.

B. Transfers of Trademark Rights

In general a sale or exclusive, perpetual license of a trademark will yield capital gains treatment under the general capital gains provisions discussed above. However, under section 1253 stringent standards limit the rights which a transferor may safely retain if capital gains treatment is to be obtained. Section 1253(b)(2) lists six rights which constitute a “significant power, right, or continuing interest” in a transferred franchise, trademark, or trade name, and thus disqualify the proceeds of the transfer from being given capital gains treatment. Furthermore, section 1253(c) treats contingent payments in such transfers as ordinary income. Finally, since trademarks are not depreciable under section 167, they cannot qualify for section 1231 treatment.

C. Transfers of Copyrights

Copyrights and “similar property” in the hands of the creator or his donee are specifically excluded from the definition of a capital asset by section 1221(3). However, this exclusion does not apply to a purchaser or legatee. Therefore, a copyright may qualify for capital gains treatment under sections 1221-23 or section 1231 in the hands of a purchaser or legatee if the requirements discussed earlier with regard to patents are met. In general, the tax analysis of transfers of copyrights held by a purchaser or legatee proceeds along the same lines as indicated in the discussion of patents.

D. Transfers of Know-How

The term “know-how” admits of no easy definition and great difficulty exists in defining proprietary know-how for the purposes of characterization under the Code. “Know-how” has been broadly defined as everything that is needed to operate a going business except capital and labor. It includes such things as diverse as: trade secrets, formulas, raw material specifications, manufacturing tolerances, blueprints, engineering drawings, plant outlays, flowcharts,
operating manuals, catalysts, process steps, times, temperatures, pressures, detailed instruction manuals, in-plant assistance, technical assistance, training of personnel, and the like. Tangible property constituting know-how incident to the transfer of a patent clearly can be characterized as a capital asset, but the IRS currently maintains that only a trade secret can be recognized as a capital asset in an independent sale of know-how.

Furthermore, for an exclusive license to qualify as a sale or exchange, or a transfer of all substantial rights, the right to prevent all others from using or disclosing the trade secret must also be transferred. And where the proceeds from a transfer of know-how involve or approximate recompense for the rendering of personal services, it is likely to be treated as ordinary income. Finally, like trademarks, know-how has no determinable useful life and cannot be depreciated under section 167; therefore, it cannot qualify for section 1231 treatment.

E. Provisions Restricting Capital Gains Treatment on Transfers of Industrial Property Rights

Even if a transfer of industrial property rights meets all the technical requisites for capital gains treatment, part or all of such gain may be treated as ordinary income because of the overriding effect of various provisions of the Code.

Section 1245 provides for the recapture of depreciation allowed or allowable upon the disposition of tangible and intangible personal property. The effect of section 1245 is to treat any gain arising from the disposition of depreciable personal property as ordinary income to the extent of previously allowed or allowable deductions for depreciation or amortization. Patents and copyrights clearly fall within its scope, although trade secrets, trademarks, and other intangibles, such as patent and copyright applications, which are not depreciable, do not.

Section 1239 treats the gain from a sale or exchange of depreciable property (again, for our purposes, patents and copyrights) between related parties as ordinary income. Section 1239(b) defines "related persons" as: (1) a husband and wife, (2) an individual and a corpo-
ration of which 80% or more of the outstanding stock is owned directly or indirectly by or for such individual, and (3) two or more corporations in which 80% or more of the outstanding stock is owned directly or indirectly by or for the same individual.\(^5\)

Section 483 is another potential limitation on capital gains treatment in the sale or exchange of industrial property rights. Under this provision a portion of the sale price may be imputed as interest (and therefore, ordinary income) where the contract calls for payments due more than a year after the date of sale and makes no provision for interest payments. Although patent transfers under section 1235(a)\(^5\) are specifically exempted by section 483(f), other transfers of industrial property rights fall within the scope of section 483.

Two further limitations on capital gains treatment which relate to transactions with Controlled Foreign Corporations (CFC's) are discussed below.\(^5\)

IV. TREATMENT OF DEVELOPMENT AND ACQUISITION EXPENSES RELATING TO INDUSTRIAL PROPERTY RIGHTS

A. Currently Deductible Expenses under Section 162

The two basic questions to ask about expenditures in connection with industrial property rights are: (1) "Are they currently deductible or must they be capitalized?"; and (2) "If they must be capitalized, are they eligible for depreciation?" Most business expenses are generally deductible from gross income under section 162 (ordinary and necessary expenses incurred in a trade or business) or section 212 (ordinary and necessary expenses incurred for the production or collection of income). Under section 162, the following kinds of expenditures are currently deductible in the taxable year in which they are incurred, provided they are trade or business expenses:

1. Royalty payments by a nonexclusive licensee under a patent, copyright, or trademark;\(^5\)

\(^5\) Section 267 complements § 1239 by disallowing loss deductions arising out of transactions between related taxpayers.

\(^5\) Presumably, other patent transfers entitled to capital gains treatment under provisions other than § 1235 are also exempt by virtue of § 483(f). See Curtis T. Busse v. Comm'r, 58 T.C. 389 (1972), aff'd, 479 F.2d 1147 (7th Cir. 1973).

2. Research and development (R&D) expenses of a professional inventor;\textsuperscript{54}
3. Contingent payments with regard to the sale or transfer of a trademark, franchise, or trade name;\textsuperscript{55}
4. Patent and copyright infringement litigation expenses;\textsuperscript{56}
5. Trademark litigation expenses applicable to lost profits;\textsuperscript{57} but not expenses incurred by a successful litigant in a trademark infringement suit, although the losing party may deduct his expenses under section 162;\textsuperscript{58}
6. Litigation expenses for the collecting of patent, copyright, or trademark royalties (under section 212 for individual investors);\textsuperscript{59}
7. Expenses incurred by the creator of copyrighted or similar property, only if the property is the creator’s stock in trade or used in his business;\textsuperscript{60}
8. Expenses incurred by the purchaser of copyrighted or similar property, including the purchase price, but only if the property is stock in trade or used in the purchaser’s trade or business;\textsuperscript{61}
9. Amounts paid in satisfaction of judgments arising out of patent, copyright, or trademark litigation, if the litigation does not relate to perfection of title;\textsuperscript{62}
10. Expenditures to create and develop the value of trademarks, e.g., advertising.\textsuperscript{63}

B. The Option To Currently Deduct or To Capitalize Certain Research and Development (R&D) Expenses under Section 174

Prior to the enactment of section 174 in 1954, expenditures on R&D in connection with patents and know-how were deductible, if at all, as business expenses under section 162. In the great majority of cases, the courts required the taxpayer to capitalize these R&D expenditures under what is now section 263 of the Code. Section 174 was enacted to resolve the difficulties which had been created by the

\textsuperscript{54} E.g., Mathey v. Comm’r, 10 T.C. 1099 (1948), aff’d, 177 F.2d 259 (1st Cir. 1949), cert. denied, 339 U.S. 943 (1950); Claude Neon Lights v. Comm’r, 35 B.T.A. 424 (1937).
\textsuperscript{55} I.R.C. § 1253(d) (authorizing deduction under § 162(a)).
\textsuperscript{57} See generally Safety Tube Corp. v. Comm’r, 168 F.2d 787 (6th Cir. 1948) (patent case); Falls v. Comm’r, 7 T.C. 66 (1946) (patent case).
\textsuperscript{58} See Medco Prod. Co. v. Comm’r, 523 F.2d 137 (10th Cir. 1975).
\textsuperscript{59} See generally I.R.S., YOUR FEDERAL INCOME TAX at 94 (1977 ed.); CHICAGO TAX GUIDE, note 26 supra, at 28, 42, and 56.
\textsuperscript{60} See generally CHICAGO TAX GUIDE, note 26 supra, at 47-48.
\textsuperscript{61} Id.
\textsuperscript{62} See generally Helvering v. Hampton, 79 F.2d 358 (9th Cir. 1935).
judicially-imposed requirement that R&D expenses be capitalized.  

Section 174 gives the taxpayer the option of treating R&D expenses incurred in a trade or business as a current deduction or as a deferred expense, amortizable over a period of not less than 60 months. The regulations under section 174 define the "research and experimental expenditures" to which the provision applies as those "[w]hich represent research and development costs in the experimental sense."  

The following types of expenditures are within the purview of section 174:

1. All expenditures incident to the development or improvement of an experimental model, a plant process, a formula, an invention or similar property;
2. Costs of obtaining a patent, including attorneys' fees and fees incurred in obtaining foreign patents on inventions which the taxpayer owns.

It should be noted that section 174 covers expenditures made either directly by the taxpayer or indirectly on his behalf by a person or organization.

The following expenses are not included within the scope of section 174:

1. Expenditures for testing or inspecting materials or products for quality control, efficiency surveys, management studies, consumer surveys, and advertising or promotion (although most of these expenditures are deductible under section 162);
2. Professional fees incurred by a corporation in securing a tax or rate ruling;
3. Costs of acquiring another's patent model, production, or process, including the costs of obtaining foreign patents on inventions covered by United States patents owned by someone other than the taxpayer.
4. Research costs of a literary, historical, or similar project;\(^7\)
5. Expenditures for the acquisition or improvement of land which constitutes depreciable (under section 167) or depletable (under section 611) property (although depreciation and depletion allowances are covered by section 174).\(^7\)

C. Treatment of Certain Costs Related to Trademarks Rights As Amortizable Deferred Expenses under Section 177

As a general rule, expenses incurred in acquiring a trademark, such as legal fees for the acquisition, protection, or expansion of a trademark, or costs for its design, its registration, and similar costs, are nondeductible capital expenditures.\(^7\) Moreover, because trademarks have no determinable useful life, no allowance for depreciation or amortization is permitted.\(^7\)

Section 177 ameliorates the impact of some of these undesirable, or harsh, tax consequences by permitting the taxpayer to treat certain trademark expenditures as deferred expenses, amortizable over a period of not less than 60 months commencing with the first month of the taxable year in which they were incurred.\(^7\) In contrast with section 174, section 177 provides no option for currently expensing these items.

As defined by section 177(b), the trademark expenditures which may be amortized are those capital expenses "directly connected with the acquisition, protection, expansion, registration (federal, state, or foreign), or defense of a trademark or trade name . . . [which are] not part of the consideration paid for a trademark, trade name, or business." Accordingly, artist, legal, registration, and infringement litigation expenses are amortizable under section 177.\(^9\) The costs of purchasing an exclusive franchise or an existing trademark (even if incurred to protect or expand a previously owned trademark), as well as payments for an agreement to discontinue the use of a trademark (if the effect amounts to purchase of the trademark), are not within the scope of section 177, and therefore are nonamortizable capital expenditures.\(^8\) Similarly, any expenses

\(^7\) See, e.g., Duesenberg, Inc. v. Comm'r, 31 B.T.A. 922 (1934), aff'd, 84 F.2d 921 (7th Cir. 1936).
which can be currently expensed under sections 162 or 212, such as advertising, are outside the scope of section 177.81

D. Capitalization and Depreciation of Other Expenses Related to Industrial Property Rights under Sections 263, 165, and 167

Any expense which is not deductible under the provisions discussed above will usually be treated as a capital expenditure under section 263. However, capital expenditures incurred with regard to industrial property rights may be depreciated or amortized under section 167, if the property has an ascertainable useful life and is used in a trade or business. As a practical matter, only patents and copyrights have an ascertainable useful life for the purposes of section 167;82 although in a rare case, it might be possible to show that a trade secret has a finite life and is therefore depreciable.83 Additionally, straightline depreciation is the only permissible method for intangible property.84 Of special interest is the rule of Associated Patentees, Inc. v. Comm'r,85 which permits the purchaser of a patent to deduct as depreciation annual payments which are based on productivity, sales, or use during the year in which the payment is made.

Under sections 165 and 167, a loss deduction may be taken when an industrial property right becomes obsolete or is abandoned. With patents and copyrights which are depreciable, complete obsolescence through expiration of the property right is sufficient,86 but with trademarks and trade secrets, creatures of indeterminate life, full abandonment is required.87

E. Deduction of R&D Expenses Available to Nonresident Alien and Foreign Corporate Licensors

Generally no deductions are available to foreign licensors who are subject to United States taxation, if they are not engaged in a trade or business in the United States.88 On the other hand, where the

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81 By definition an amortizable trademark expenditure must be "chargeable to capital account," thereby excluding § 162 and § 212 expenses. I.R.C. § 177(b)(2).
82 Treas. Reg. § 1.167(a)-6 (1956).
83 Compare Treas. Reg. § 1.167(a)-3 (1960) with M. E. Cunningham Co. v. Comm'r, 10 TAx CT. MEM. DEC. (CCH) 276 (1951).
84 I.R.C. §§ 167(c); Treas. Reg. § 1.167(c)-1 (1972).
86 Treas. Reg. § 1.167(a)-6 (1956).
88 I.R.C. §§ 873(a) (foreign individuals) and 882(c) (foreign corporations). Sections 871(a) and 881 impose a flat 30% tax on the United States source income of foreign individuals and
foreign taxpayer is engaged in a trade or business within the United States, all allowable deductions are available to the extent that they are allocable to income which is "effectively connected to" the United States trade or business.89

The IRS has issued regulations regarding the allocation of R&D expenses which will permit foreign taxpayers to allocate a portion of these expenditures incurred in the taxpayer's home country (or elsewhere) as a deduction against income "effectively connected" with a United States trade or business.90 The concept of "effectively connected income" will be explored in more detail in the next section.

V. THE TREATMENT OF LICENSING INCOME DERIVED FROM TRANSFER OF TECHNOLOGY

A. United States Taxpayers

1. The Domestic and Foreign Source Rules

A "United States person," for purposes of the Code, is defined as "a citizen or resident of the United States, a domestic partnership, a domestic corporation, and any estate or trust (other than a foreign estate or foreign trust, within the meaning of section 7701(a)(31))."91 These "United States persons" (including resident aliens) are domestic taxpayers who are subject to United States taxation on all income, regardless of source.92

Sections 861-63 of the Code set up elaborate rules which distinguish between the foreign and domestic source income of a domestic taxpayer. Of particular interest in the international licensing field is the treatment of income derived from personal services, royalties, and the sale of personal property. With a few minor exceptions, the country in which personal services are performed is treated as the source of such income.93 Rental and royalty income is prescribed as having its source in the country in which the property giving rise to the rent or royalty is located.94 And lastly, the place of sale, i.e., the country in which passage of title occurs, is treated as the source of income from sales or exchanges of personal property.95 A place of

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88 I.R.C. §§ 871(b) and 874 (for foreign individuals) and § 882(c) (for foreign corporations).
90 I.R.C. § 7701(a)(31).
91 I.R.C. § 861(a)(30).
92 I.R.C. § 61.
contract, or *lex loci contractus*, standard is, however, often substituted for the title passage standard when transfers of intangible property rights are involved.⁹⁶

If the source of income for a United States taxpayer is a domestic source under these rules, normal domestic taxation rules apply and no special tax considerations are necessary. However, when the source is determined to be a foreign source under sections 861-63, several special considerations come into play. The first of these considerations involves the allocation of expenses, losses, and deductions.

Sections 861(b) and 862(b) provide for the deduction from foreign and domestic source income of those expenses "properly apportioned or allocated thereto, and a ratable part of any expenses, losses, or other deductions which cannot definitely be allocated to some item or class of gross income." Any items of income, expenses, and the like which are not specified in sections 861 or 862 are to be allocated or apportioned under the regulations prescribed by the IRS under section 863(a). This latter provision will rarely be applicable to international licensing transactions, as, in the main, they will fall within sections 861 and 862.

The allocation of deductions is important to a domestic taxpayer, particularly with respect to limitations on the available foreign tax credit. The new regulations under section 861⁹⁷ take the approach that most deductions will be "definitely related" to a particular item of gross income, and therefore will not require ratable apportionment under section 863(a). The determination of which item of gross income a particular expense is "definitely related" to is a factual one, and the essential consideration is whether the expense was incurred as a result of, or incident to, a specific activity or property which gave rise to the income.⁹⁸

2. *The Use of the Foreign Tax Credit*

Section 901 provides that, subject to the limitations of section 904, United States taxpayers (and under section 906, nonresident aliens and foreign corporations with regard to income "effectively connected" with a trade or business in the United States) may credit (dollar for dollar) against their United States tax liability: foreign income, war profits, and excess profits taxes paid on foreign

⁹⁶ See, e.g., Sabatini v. Comm'r, 32 B.T.A. 705 (1935), modified, 98 F.2d 753 (2d Cir. 1938).
⁹⁸ Id. § 1.861-8(b).
source income. If the taxpayer chooses to take the available tax credit, no deduction from gross income is permitted under section 164 of the Code. It is with regard to the determination of the foreign tax credit that the geographic source of income rules discussed above play two very significant roles: (1) they determine which country exercises taxing jurisdiction with respect to various items of income for the purpose of allowing a foreign tax credit; and (2) they determine the allocation of various deductions between foreign and domestic source income, and, in so doing, have a significant impact on the overall limitation on the foreign tax credit imposed by section 904.

Section 902 provides an additional, indirect foreign tax credit to a domestic corporation on dividends received from a foreign corporation in which the domestic corporate shareholder "owns at least 10 percent of the voting stock . . . ." Operationally, section 902 permits the domestic corporate shareholder to credit the same proportion of any foreign income taxes paid, or deemed to be paid, by the foreign distributing corporation on its accumulated profits (from which the dividends were paid) as the amount of the dividends received "bears to the amount of such accumulated profits in excess of such income, war profits, and excess profits taxes (other than those deemed paid)." The same proportionate credit applies to income taxes paid by second and third-tier foreign corporations if the foreign corporation from which the dividends are received "owns 10 percent or more of the voting stock of a second foreign corporation from which it receives dividends . . . ." and in turn, the second foreign corporation "owns 10 percent or more of the voting stock of a third corporation from which the second foreign corporation receives dividends . . . ." The net result, if it is assumed that the stock ownership requirements are met, is that a portion of foreign taxes paid by up to three foreign corporations is deemed to have been paid by the domestic corporate shareholder and is creditable against its United States tax liability. Additionally, when a section 902 credit is taken, section 78 of the Code requires that a constructive dividend equal to the amount of the foreign tax credit (taxes deemed paid under section 902(a)) be included in the domestic shareholder's gross income.

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9 I.R.C. § 275(a)(4). Section 164 allows deductions for certain enumerated taxes paid or accrued within the taxable year.

10 I.R.C. § 902(a).

11 I.R.C. § 902(b).
Both the direct foreign tax credit of section 901 and the indirect foreign tax credit of section 902 are subject to the limitation imposed by section 904. Prior to December 31, 1975, the taxpayer could choose between the so-called "country by country" and "overall" limitations. As amended by the Tax Reform Act of 1976, however, only the overall limitation applies, and therefore this discussion will be limited to the overall limitation.

The overall limitation on the amount of the foreign tax credit is determined by multiplying the taxpayer's total United States tax liability by a fraction composed of the taxpayer's total foreign source income over his total taxable income. Any foreign tax credit not used (either because the credit exceeds United States tax liability or the overall limitation) may be carried back two years and forward five years. It should be noted, however, that section 904(c) requires that the excess tax paid be carried back first to the second preceding taxable year, then to the first preceding taxable year and then in sequence to each of the five succeeding taxable years.

In addition to repealing the country-by-country limitation of section 904, the Tax Reform Act of 1976 added a recapture provision for foreign losses. Section 904(f) provides that a portion of a domestic taxpayer's foreign source income in taxable years subsequent to any taxable year in which such taxpayer sustains an overall foreign loss (generally defined as the excess of deductions properly allocable to foreign source income over gross foreign source income excluding net operating losses and noncompensable foreign expropriation and casualty losses) shall be treated as domestic source income. The portion so treated is the lesser of "the amount of such loss . . . or 50 percent (or such larger percentage as the taxpayer may choose) of the taxpayer's taxable income from sources without the United States for such succeeding taxable year."

Two final points need to be made concerning the foreign tax credit. First, the credit is limited to foreign income taxes, foreign

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102 Pub. L. No. 94-455, 90 Stat. 1520 (codified in scattered sections of the I.R.C.). The principal effect of the repeal of the per-country limitation is to permit losses from any foreign country to reduce income from any other foreign country, thereby reducing the amount of foreign taxes available to be used as a credit against United States taxes. See House Comm. on Ways and Means, Summary of the Conference Agreement on the Tax Reform Act of 1976 (H.R. 10612), 94th Cong., 2d Sess. 33 (1976), reprinted in [1976 U.S. Code Cong. & Ad. News 2897.]

103 I.R.C. § 904(a).

104 I.R.C. § 904(c).

105 I.R.C. § 904(f)(1).
profits taxes, or taxes paid in lieu of an income tax. As a consequence, turnover sales', gross receipts', value-added, or other similar kinds of taxes are not eligible for the credit, although they may be deducted from gross income under section 164. Second, section 905 and the regulations under it provide rules governing the year in which the credit may be taken, as well as the requisite kinds of information and proof which the taxpayer must supply to the IRS with regard to the determination and allowance of the foreign tax credit.

3. The Importance of Income Taxation Treaties in Reducing Total Tax Liability in International Licensing Transactions

At present, the United States has tax conventions with more than 40 countries, including most of the industrial countries of Western Europe. The terms of these treaties vary considerably, since they are individually negotiated. Accordingly, the applicable treaty must be examined in detail to determine its specific effect on a given transfer of industrial property rights. With this caveat in mind, a few general observations can be made.

The basic aim of all of these tax treaties is to avoid double taxation, i.e., to insure that foreign source income received by a domestic United States taxpayer (and alternatively, United States source income received by a foreign taxpayer) is not taxed first by the foreign country and then again by the United States. These double taxation treaties either eliminate or greatly reduce foreign taxation, i.e., withholding on royalties and other types of income received by a domestic taxpayer from the treaty country. Not surprisingly, to the extent that a taxation treaty reduces foreign taxes on foreign source income, the foreign tax credit must be similarly reduced.

Typically, the most significant limitation on the exemption or reduction allowed by these tax conventions is their nonapplicability to foreign taxpayers (licensors) who maintain a permanent business establishment in the country which is the source of the income. Under the influence of the OECD's Draft Double Taxation Convention on Income and Capital, the concept of the permanent business establishment exclusion has been modified by recent treaties to cover only royalty income which is "effectively connected" with a permanent establishment of the licensor in the foreign source country. Therefore, a taxpayer who maintains a permanent establish-

106 I.R.C. §§ 901(a) and 903.
107 These tax treaties are most conveniently found in Tax Treaties (CCH).
ment in the foreign source country will not be excluded from the benefits of a treaty exemption or reduction, unless the facts and circumstances indicate the royalty income is "effectively connected" with that permanent establishment.

4. The Forced Recognition of Income from Foreign Personal Holding Companies and Controlled Foreign Corporations

As a general proposition, foreign source income of foreign taxpayers is not taxed by the United States. In earlier times, United States companies were able to take advantage of this fact by establishing foreign subsidiaries in low tax jurisdictions (foreign tax havens) to carry on the bulk of their foreign licensing transactions, and, as a consequence, incur little or no tax on their foreign licensing income. In due course, two sets of related provisions were enacted by Congress to eliminate or drastically reduce the sheltering of foreign licensing income by United States corporations through the use of tax havens.

Before 1937, it was possible for a United States corporation to set up a wholly-owned, or partially-owned, subsidiary in a foreign country to act as its licensing agent and as a repository for its foreign licensing income. Switzerland was at one time a favored venue for such a foreign licensing subsidiary, because it imposed a relatively low tax rate (at least in some of its Cantons) on income derived from royalties. Switzerland was also a favored location because it had an excellent network of double taxation treaties with the other industrialized nations of Western Europe and the United States. By transferring its foreign industrial property rights to its Swiss licensing subsidiary the United States parent could use its Swiss company as a foreign licensing agent and collector of royalty income derived from foreign licensing.

The appeal of this arrangement from the viewpoint of the United States parent was that it could deputize its Swiss company to collect all foreign royalty income, using the very well-developed Swiss network of double taxation treaties to minimize withholding taxes by the licensee's country, accumulate the foreign royalty income in the Swiss company, and then only repatriate this royalty income to the United States at times that were convenient to the overall interests of the United States parent. For example, royalty income could be repatriated only in those years when the United States parent needed the additional foreign income to bolster a weak year of domestic income. Thus, selective repatriation of foreign income
could be used to smooth out the ripples or ups and downs in domestic income.

In 1937, Congress passed legislation to force annual recognition of passive income, such as, royalties. A loophole still remained, however. United States corporations shifted the consideration being paid by foreign licensees for use of their industrial property rights from royalties to charges for managerial and engineering services and technical assistance which were paid to their foreign licensing agents, such as, the Swiss subsidiary in the earlier example. Congress then moved again in 1962 to close this additional loophole by passing legislation to force annual recognition of foreign income derived from compensation for such managerial and engineering services and technical assistance in connection with the licensing of industrial property rights.

The first of these provisions, now sections 551-58 and known as the foreign personal holding company (FPHC) provisions, were enacted in 1937 to deal with foreign corporations established by United States taxpayers which were used solely or primarily for the licensing of intangible property rights. Section 552(a) defines an FPHC as any foreign corporation:

1. which derives at least 60% of its gross income from foreign personal holding company income (FPHCI); and
2. which, at any time during the taxable year, has at least 50% of the value of its outstanding stock owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States.

In turn, FPHCI is defined by section 553(a) to include dividends, interest, royalties, annuities, gains from the sale of stock or securities, rents, and other, mostly passive, types of income. Section 554 sets up attribution rules for stock ownership under which stock owned by family members or a related corporation, partnership, estate, or trust is attributed proportionately to the individual shareholders, beneficiaries, or partners; and options and convertible securities are deemed to be outstanding stock in the FPHC.

If it is determined that a corporation is an FPHC (as defined in sections 552 and 553), then section 551(b) requires each United States shareholder to include in gross income his pro rata share of the undistributed FPHC income. Undistributed FPHC income is defined by section 556(a) as "the taxable income of a foreign personal holding company adjusted in the manner provided in subsection (b) [permitting deductions for taxes, charitable contributions,
and other expenses], minus the dividends paid deduction (as defined in section 561).” Section 551(e) permits the shareholder to increase the basis of his stock by the amount of undistributed FPHCI included in his gross income under section 551(a).

Although the FPHC provisions provided a sufficient deterrent against creating foreign corporations for the receipt of passive income, e.g., royalties and dividends, tax avoidance problems persisted in connection with foreign corporations set up in tax haven jurisdictions by United States taxpayers to conduct ordinary business operations. Before 1962, the IRS relied primarily on section 482 (which gave it the authority to allocate income, deductions, and the like among related organizations so as to clearly reflect income) to police transactions between a foreign corporation and its domestic parent.

Then, in 1962, Congress enacted the second set of provisions addressed to the tax haven problem. These are sections 951-64, known as the Controlled Foreign Corporations (CFC) or Subpart F provisions, and they were designed to close the still existing loopholes that could be exploited by the use of foreign subsidiaries.

The CFC provisions are among the most complex of any provisions in the Code, but they operate in a manner similar to the FPHC provisions already discussed. The heart of Subpart F is the CFC, defined by section 957(a) to mean “any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned . . . by United States shareholders on any day during the taxable year of such foreign corporation.” For the purpose of Subpart F, a United States shareholder is defined as one who owns 10% or more of the total combined voting power of all classes of stock entitled to vote in the foreign corporation.\(^1\) Therefore, to qualify as a CFC, control of the corporation must be lodged in five or fewer United States shareholders. As with the FPHC, attribution rules are set out in section 958 for the purpose of establishing constructive ownership of stock held by persons and entities related to the United States shareholder.

If a foreign corporation qualifies as a CFC, then each “United States shareholder,” i.e., one owning 10% or more of all classes of voting stock, is required to report as gross income his pro rata share of four specific kinds of undistributed CFC income.\(^2\) The foreign corporation must be a CFC for at least 30 consecutive days, and the

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\(^1\) I.R.C. § 951(b).

\(^2\) I.R.C. § 951(a).
attribution applies only to United States shareholders owning stock on the last day of the corporation's taxable year.\textsuperscript{110}

The first of the four specific kinds of undistributed CFC income attributable to a United States shareholder is Subpart F income, defined by section 952 as the sum of income derived from insurance of United States notes, foreign base company income (FBCI), and two morality items added by the Tax Reform Act of 1976: namely, illegal bribes, kickbacks, and the like (defined in section 162(c)) paid by or on behalf of the corporation and an amount of the corporation's income which is derived from participation in an international boycott as defined in section 999. In international licensing, however, the most important item is FBCI.

FBCI is defined in section 954, and involves a peculiarly complex scheme of inclusions and exclusions. The most important items included in FBCI may be summarized as follows:

1. Passive income, such as, dividends, rents, interest, and royalty payments, except rents and royalties derived from the active conduct of a business and not received from a related person;
2. Income derived by the CFC from selling personal property it purchased from a related person, or from buying personal property for sale to a related person, if the property is both produced and sold for use outside the country in which the CFC is incorporated;
3. Income of a branch office operated outside the CFC's country of incorporation, when the office's activities are substantially the same as a wholly-owned subsidiary of the CFC;
4. Income from compensation, commissions, and the like for the performance of technical, managerial, engineering, architectural, and like services, when performed outside the CFC's country of incorporation; and
5. Income from the use of any aircraft or vessel in foreign commerce or from the sale thereof, except to the extent it is reinvested in qualified investments in foreign base shipping operations (as defined in section 955(b)).

Under section 954(b)(3) if FBCI is less than 10% of the CFC's gross income, then no FBCI is deemed to exist; conversely, if FBCI is greater than 70% of the CFC's gross income, all gross income is treated as FBCI.

The second kind of undistributed CFC income attributable to a United States shareholder is his pro rata share of the CFC's previously excluded Subpart F income withdrawn from investment in

\textsuperscript{110} Id.
less developed countries (LDC's).\textsuperscript{111} Prior to 1975, income from qualified investments in LDC's was excluded from FBCI by section 954(b), but the Tax Reduction Act of 1975\textsuperscript{112} eliminated this exception. Under new sections 954 and 955, if qualified investments in LDC's are reduced during the taxable year, the United States shareholder reports his pro rata share of such reduction to the extent that the income from such investments was previously excluded from FBCI.

The third category of attributable income is the amount of previously excluded Subpart F income withdrawn from foreign base shipping operations.\textsuperscript{113} And the final category of CFC undistributed income attributable to a United States shareholder is his pro rata share of the increase in earnings invested in United States property as defined in section 956(b).\textsuperscript{114}

When a CFC has any of these four items of attributable income in a given tax year, each United States shareholder is required to report as gross income his pro rata share of these items.\textsuperscript{115} Amounts actually distributed are not attributable, and are taxed under the normal rules for corporate distributions.\textsuperscript{116} Undistributed income previously attributed to a United States shareholder will not be taxed upon actual distribution.\textsuperscript{117} Finally, the United States shareholder is entitled to increase the basis of his stock by the amount of attributed income, and must reduce the basis when previously taxed income is distributed.\textsuperscript{118}

As noted earlier, two provisions of the Code operate in conjunction with the CFC provisions to disallow capital gains treatment on income arising out of certain transactions involving a CFC. First, section 1248 of the Code requires United States shareholders to treat gain from the sale, redemption, or liquidation of their stock in a CFC as a dividend (therefore, ordinary income), but only to the extent there are earnings and profits accumulated after 1962. Amounts previously included in the shareholder's gross income under section 951 are excluded from the definition of earnings and profits by section 1248(d); thus, section 1248 is properly considered

\textsuperscript{111} Id.
\textsuperscript{112} Pub. L. No. 94-12, 89 Stat. 26 (codified in scattered sections of the I.R.C.).
\textsuperscript{113} See I.R.C. §§ 951(a), 954(b)(7), 954(f) and 955(b).
\textsuperscript{114} I.R.C. § 956(b).
\textsuperscript{115} Id.
\textsuperscript{116} I.R.C. § 959(a).
\textsuperscript{117} Id.
\textsuperscript{118} I.R.C. § 961(a).
a mechanism which shores up the CFC provisions by taxing as ordinary income any previous earnings which escaped the net of the Subpart F income attribution provisions.

Second, section 1249 provides that any gain arising from the sale or exchange (after 1962) of a patent, invention, model, design (whether or not patented), copyright, secret formula, or process or any "other similar property" to a CFC shall be treated as ordinary income. However, it is to be noted that control for the purpose of section 1249 means that the seller (transferor) controls more than 50% of the total combined voting stock of the foreign corporation—a much higher standard than that required for attribution of a CFC's undistributed income. The regulations state that sales of trademarks are not within the scope of section 1249.119

Section 1249 exposure can be avoided by using section 351 which provides tax-free treatment of transfers to a corporation which is controlled (at least 80% of all voting power) by the transferor immediately after the transfer. Where a section 351 transfer is made to a foreign corporation, the transferor is required to obtain a so-called section 367 ruling from the IRS. The section 367 ruling will ensure that the transfer receives tax-free treatment under section 351, provided the transferor proves to the satisfaction of the IRS that the transaction has not been undertaken to avoid taxes. Absent a section 367 ruling, such an exchange will usually produce current taxation. Other provisions of the Code which provide for the nonrecognition of any gain resulting from corporate mergers, liquidations,20 and reorganizations,21 similarly require a section 367 ruling if a United States person transfers property to a foreign corporation in the course of the transaction.

B. United States Taxation of Foreign Licensors

The discussion up to this point has been directed mainly toward the tax treatment of domestic taxpayers by the United States. What follows is a brief summary of the taxation of the United States source income of foreign taxpayers.

Sections 871-96 of the Code establish the basic structure for the taxation of the United States source income of foreign licensors. Sections 871 and 881 impose a flat 30% tax on the gross United States source income of nonresident aliens and foreign corporations,
without any allowance for deductions.

Sections 1441 and 1442 provide for the withholding of this tax by the United States source. This 30% tax on gross income is, however, applied only "to the extent the amount so received is not effectively connected with the conduct of a trade or business within the United States."¹²²

Foreign licensors who are engaged in a trade or business in the United States and whose income is "effectively connected" with such a trade or business are, with few exceptions, taxed as if they were domestic taxpayers.¹²³ An important distinction between the 30% tax imposed on investment-type income ("not effectively connected") and normal tax on business income ("effectively connected") is that the business-type income includes all effectively connected income regardless of source, while the investment-type income includes only United States source income.

Section 864 defines various terms such as "trade or business within the United States" and "effectively connected." With regard to royalty-type income, section 864(c) sets up two tests to determine whether United States source income is effectively connected:

1. whether the income, gain, or loss arises out of assets used in or held for use in the conduct of a trade or business within the United States; or
2. whether the activities of such a trade or business were a material factor in the realization of the income, gain, or loss.

All other United States source income is treated as "effectively connected" to the United States trade or business of the foreign individual or corporation. Certain foreign source income is also deemed to be "effectively connected" with the trade or business within the United States.¹²⁴

Foreign taxpayers who have "effectively connected" income under sections 871 and 882 are entitled to various deductions which include all expenses incurred in connection with such income.¹²⁵ They are also permitted to take advantage of the more limited foreign tax credit of section 906 with respect to effectively connected income.

Where a tax treaty or convention is in force between the United States and the country of a foreign taxpayer, United States taxes

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¹²² I.R.C. §§ 871(a) and 881(a).
¹²³ I.R.C. §§ 871(b) and 882.
¹²⁴ I.R.C. § 864(c)(4).
¹²⁵ I.R.C. §§ 873 and 882(c).
and their withholding will be reduced or eliminated, depending upon the terms of the particular treaty. Section 7852(d) of the Code provides that "no provision of [the Code] shall apply in any case where its application would be contrary to any treaty obligation of the United States . . . ."[136]

Most tax treaties are not applicable to income effectively connected with a permanent establishment that the foreign taxpayer maintains in the United States. Some older treaties require only a permanent establishment for exclusion from treaty benefits; however, section 894(b) extends the "effective connection" requirement to all United States tax treaties, thereby granting treaty benefits to all United States source income not effectively connected with the permanent establishment maintained by the foreign taxpayer in the United States.

VI. CONCLUSION

As stated at the outset, the analysis of the impact of the United States tax laws on international technology transfers is an intricate, complex, tedious, and often baffling matter. In this discussion, which is necessarily of limited scope, it has been possible only to comment briefly on the more important Code provisions that affect international licensing. It is hoped, however, that this overview has at least succeeded in erecting some signposts and warning signals that may act as a rough guide for licensors and licensees through the thicket of United States tax laws and regulations and that will prove valuable in flagging those areas in a given licensing situation which need more careful study and perhaps the seeking of expert tax advice. It is also hoped that some hints have been given on approaches that can help minimize the overall bite. Tremendous sums of money are often at stake in international technology transfers and inadequate, improper, or nonexistent tax planning can result in dramatic and unnecessary losses. On the other hand, intelligent and imaginative, yet realistic, structuring of the tax consequences in an international license agreement can result in enormous savings to either or both of the parties.

[136] See also I.R.C. § 894(a) (exempting income of any kind to the extent required by United States treaty obligations).