



Giving Intellectual Property

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The interdisciplinarity of intellectual property and taxation poses many challenges to the disparate existing norms in each respective field of law. This Article identifies and critiques the current tax regime governing the giving of intellectual property as a manifestation of the failure to understand the principles and policies underlying intellectual property and the firm. It proposes an economic, incentives-based system that would encourage firms to extricate part of their repository of residual rights by surrendering their monopolistic ownership of intellectual property for the benefit of charitable organizations and, in turn, the development and growth of society.

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INTRODUCTION

Scholars of modern theories of the firm regard the firm as the repository of residual property rights,¹ specifically, intangible intellectual property rights.² Under property-based theories of the firm, intellectual property rights allocate and maximize the firm's own resources in addition to serving interfirm functions in the market.³ Thus, as the economy becomes increasingly dependent on information and technology, the proprietary rights of intellectual property are important to the firm and its existence.⁴ For example, a firm's repository of intellectual property rights often functions as a signal of the firm's financial prospects, among other things.⁵ Consequently, the firm has a strong desire to control its repository for optimal return.⁶ With this in mind, under what regime would the firm relinquish part of its repository for the benefit of social good?

Imagine that you are the CEO of a firm that holds a very large patent portfolio. Like many of your competitors, your firm possesses more patents than it needs for its monopolistic present and future pipe drugs and has no desire to devote part of its budget to pay for the maintenance

¹ See David McGowan, *Legal Implications of Open-Source Software*, 2001 U. ILL. L. REV. 241, 263-65 (applying property-based theories of firm in evaluating open source software licensing, and arguing that decentralized open source community functions like firm); D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 VAND. L. REV. 1399, 1444-47 (2002) (analyzing property-based theories of firm and its fiduciary duties).

² See Dan Burk, *Intellectual Property and the Firm*, 71 U. CHI. L. REV. 3, 3-7 (2004) (examining relationship between intellectual property and firm).

³ *Id.* at 8 ("Property-based theories of firm suggest that the right to access and use dedicated resources must be allocated within the firm as well as beyond the firm. This means that, in addition to their recognized inter-firm functions, proprietary rights may also serve to coordinate resources within a firm."); see, e.g., Edmund W. Kitch, *The Law and Economics of Rights in Valuable Information*, 9 J. LEGAL STUD. 683, 709 (1980); see also Edmund W. Kitch, *The Nature and Function of the Patent System*, 20 J.L. & ECON. 265, 276 (1977) (suggesting that under property-based theories of firm, assignment of patents vests firm with control of intangible assets for optimal results because firm can best coordinate, allocate, and promote resources).

⁴ See Burk, *supra* note 2, at 8-20 (analyzing different intellectual property doctrines through lenses of property-based theories of firm for better understanding of intellectual property law).

⁵ See generally Clarisa Long, *Patent Signals*, 69 U. CHI. L. REV. 625 (2002) (analyzing patent rights as "signaling mechanism[s]" that convey information about firm, including its financial prospects).

⁶ See Oren Bar-Gill & Gideon Parchomovsky, *The Boundaries of the Firm 2* (N.Y. Univ., Law & Econ., Working Paper No. 18, 2005), available at <http://lsr.nellco.org/cgi/viewcontent.cgi?article=1020&context=nyu/lewp> (stating that intellectual property law is "important factor influencing the boundary between the firm and the market").

of unused patents. Given the negative spotlights on numerous corporate scandals in the media, your firm wants to donate a number of patents to educational and research institutions to enhance its corporate image and to further these institutions' basic fundamental and purely scientific investigation. However, the firm also wants to receive tax incentives for such giving. You have heard from one of your peers that your firm may not be able to enjoy a current tax deduction for its intellectual property donations, but may be entitled to future tax deductions if the charitable donee generates income from the intellectual property.

Why should a firm freely relinquish its monopoly on its patents, and forego the positive signals such patents send, if there are no immediate financial incentives to do so, but only speculative future tax benefits? Why does the law burden the intellectual property holder to identify commercially-driven institutions as potential donees if it has any hope of realizing some kind of financial tax benefit in the future? Why is the donation of intellectual property treated vastly differently from the donation of real estate to a local university or of old furniture to the Salvation Army? Even though the firm may now decide to not use certain patents, the research and development resources spent on those patents have been enormous. Hence, the common reaction from firms is understandable: absent immediate economic incentives, no donations will be made.

The interdisciplinarity of intellectual property and taxation poses many challenges to the disparate existing norms in each respective field of law. The hypothetical above demonstrates the failure to understand the principles and policies underlying intellectual property. Federal intellectual property laws and federal tax laws should work together to benefit society as a whole by facilitating the progress of science and the creation of useful arts. U.S. patent and copyright laws provide patent holders and authors of copyrights monopolistic rights vis-à-vis the significant legal protections for patents and copyrights for a limited time.⁷ Federal tax laws allow most taxpayers to immediately recover the costs of their inventions and creations, despite the fact that these properties have long protectible lives under patent and copyright law.⁸

⁷ The U.S. Constitution empowers Congress to "promote the progress of science and the useful arts, by securing for limited times to authors and inventors the exclusive right to their writings and discoveries." U.S. CONST. art. I, § 8, cl. 8. The United States has a legal system of strong intellectual property rights. For a discussion of U.S. patent protections, see *infra* notes 44-46 and accompanying text. For a discussion of U.S. copyright protections, see *infra* notes 47-53 and accompanying text.

⁸ For example, section 174 of the Internal Revenue Code ("Code") permits a taxpayer

While both intellectual property and tax laws promote socially desirable inventive and creative activities, additional tax incentives are needed to encourage the dissemination of technologies and useful arts to the public for the maximum social good. To achieve the policy goals of ultimate innovation and creation, the government should provide incentives to encourage patentees to donate, rather than abandon, their “orphan” patents to universities, hospitals, and other nonprofit organizations with research and development facilities that can properly exploit the patents. Similarly, incentives should be in place to encourage authors and artists to donate their copyrights and literary manuscripts and works of art to public libraries, museums, and other cultural institutions, rather than sell their works to private collections in the United States and overseas.

This Article advocates for the implementation of systematic incentives that would encourage donors to surrender their monopolistic ownership of intellectual property for the benefit of charitable organizations and, in turn, the development and growth of society. Part I of this Article explores the trend of charitable giving and the impact of technology on postmodern philanthropy. Part II discusses the importance of intellectual property in the global, knowledge-based economy and demonstrates the benefit of outright ownership of intellectual property by charitable donees. Although this Article recognizes that the present tax system requires intellectual property donors to make complete assignments to charities to obtain tax benefits, it demonstrates that the present system does not adequately encourage donors to make outright gifts to charity.

Part III critiques recently enacted legislation that targets intellectual property charitable donations. It argues that the current regime fails to incentivize socially desirable donations by eliminating any immediate financial incentives for intellectual property charitable donations. This Article identifies several problems with the regime’s focus on post-contribution economic incentives, which negatively favors income-generating intellectual property over other forms and favors commercially-driven donees over educational donees and other donees committed to basic science research. Part IV proposes a system based on

to immediately deduct research or experimental expenditures. I.R.C. § 174(a) (2006). Section 263A(h) paves the way for writers, artists, and painters to immediately deduct their “qualified creative expenses.” I.R.C. §§ 162, 263A(h). For a thorough discussion of the tax treatment of patent and copyright development costs, see JEFFREY A. MAINE & XUAN-THAO N. NGUYEN, *INTELLECTUAL PROPERTY TAXATION: TRANSACTION AND LITIGATION ISSUES* (2003).

immediate incentives to encourage social giving through the use of valuation premiums, rigorous enforcement mechanisms, and enhanced donee accountability. To achieve optimal social giving, this Article proposes an elective deduction regime whereby intellectual property donors may choose to realize immediate tax benefits upon contribution or to enjoy deductions in post-contribution years to the extent the charitable donee generates income from the intellectual property.

I. THE ART OF GIVING

Giving⁹ takes many forms. People give their time and talent to volunteer at community centers, hospitals, churches, and schools. Some devote years of their lives to missionary works; to volunteer in such organizations as the Peace Corps,¹⁰ AmeriCorp,¹¹ and Habitat for Humanity;¹² and to serve in the military on missions that vary from peacekeeping to humanitarian aid. Others decide to donate their prized collections of art and artifacts to their institutions of choice.¹³

⁹ For the jurisprudence of giving as opposed to taking by the government, see Abraham Bell & Gideon Parchomovsky, *Givings*, 111 YALE L.J. 547, 563 (2001). Professors Bell and Parchomovsky elegantly map the jurisprudence of giving that includes: (a) physical giving where “the government bestows a property interest upon a private actor”; (b) regulatory giving, “when a government enhancement of property value by means of regulation goes too far”; and (c) derivative giving, “when, as a result of a government giving or taking, surrounding property increases in value even though no direct giving has occurred.” *Id.* This Article uses the term “giving” in the context of charity.

¹⁰ Peace Corps, What Is the Peace Corps? Webpage, <http://www.peacecorps.gov/index.cfm?shell=learn.whatispc> (last visited Mar. 3, 2006) (stating that since Peace Corps’s inception, there have been more than 182,000 Peace Corps volunteers in 138 host countries).

¹¹ Corp. for Nat’l & Cmty Serv., What Is AmeriCorps? Webpage, <http://www.americorps.org/about/ac/index.asp> (last visited Mar. 3, 2006) (explaining that AmeriCorps volunteer programs ranging from building affordable housing to providing disaster relief).

¹² Habitat for Humanity, *Annual Report FY 2003: Message from Our Founder and President*, <http://www.habitat.org/giving/report/2003/letters.html> (last visited Mar. 3, 2006) (stating that Habitat for Humanity built 150,000th house on July 1, 2003); see also Habitat for Humanity Int’l, *Jimmy Carter Work Project 2005*, <http://www.habitat.org/jcwp/2005/> (last visited Mar. 3, 2006) (describing Jimmy Carter Work Project 2005 to build houses by volunteers).

¹³ The Dallas Museum of Art received three extensive art collections valued at \$400 million from the Hoffmans, Rachofskys, and Roses. *Dallas Museum of Art Receiving Collections*, BOSTON.COM, Feb. 16, 2005, http://www.boston.com/ae/theater_arts/articles/2005/02/16/dallas_museum_of_art_to_get_art_donations. The donations comprised the largest combined gift in the museum’s history. *Id.* The gifts “seed the future with new opportunities for exhibitions, research, programs and discoveries.” *Id.*; see also Ralph Blumenthal, *Major Gifts of Cash and Art for Texas Museums*, N.Y. TIMES, Feb. 16, 2005, at E1; Florence Griswold Museum, *American Naïve Paintings from the National Gallery of Art*, <http://www.tfaoi.com/newsmu/nmus78a.htm> (last visited Mar. 3, 2006) (indicating that

All charitable donations, ranging from the small daily acts of giving to organized philanthropic efforts, benefit society.¹⁴ Accordingly, charitable giving has been central to the United States and its national character for centuries.¹⁵ In the earliest days of European settlement, John Winthrop told the Puritans sailing to the Massachusetts Bay Colony that to succeed in the new land, they needed to be a model of Christian charity.¹⁶ In the early nineteenth and twentieth centuries, the philanthropy of notables such as Peabody, Rockefeller, Carnegie, and Ford left a strong imprint on society. George Peabody, regarded as the founder of modern philanthropy, was a remarkable New England international banker who became America's first great educational philanthropist.¹⁷ The Rockefeller Foundation's gifts affected medical research, education, and

collections of American folk paintings at National Galleries were generous gifts and bequests made by Garbisch); Museum of Fine Arts, Boston, *Arts of the Americas*, <http://www.mfa.org/collections/index.asp?key=17> (last visited Mar. 3, 2006) (introducing important gifts in Arts of Americas collections); George O'Bannon, *The Ballard Collection*, <http://www.rugreview.com/113ball.htm> (last visited Mar. 3, 2006) (describing collections of oriental rugs given to various museums); The Metropolitan Museum of Art, *American Folk Art in The Metropolitan Museum of Art*, www.tfaoi.com/newsm1/n1m135.htm (last visited Mar. 3, 2006) (reporting exhibit of American Folk Art where collections were mostly gifts and bequests); The Metro. Museum of Art, *Works of Art: European Paintings*, http://www.metmuseum.org/Works_of_Art/introduction.asp?dep=11 (last visited Mar. 3, 2006) (introducing and discussing various gifts and bequests to European Paintings Collection at Metropolitan Museum of Art); The Metro. Museum of Art, *Works of Art: The Robert Lehman Collection*, http://www.metmuseum.org/Works_of_Art/introduction.asp?dep=15 (last visited Mar. 3, 2006) (introducing Robert Lehman Collection to Metropolitan Museum of Art as part of permanent collection).

¹⁴ In 2004, overall private giving by individuals, foundations, and corporations totaled \$248.52 billion. The Found. Ctr., *The State of Foundation Giving, 2005*, http://fdncenter.org/research/trends_analysis/pdf/yearbook05_ch01.pdf (last visited Mar. 3, 2006); see also Mark Sidel, *Law, Philanthropy and Social Class: Variance Power and the Battle for American Giving*, 36 U.C. DAVIS L. REV. 1145, 1146 (2003) (noting important role of community foundations and trusts that provide philanthropic grants to combat poverty and support arts and cultural causes).

¹⁵ See Jack E. Karns, *Justifying the Nonprofit Hospital Tax Exemption in a Competitive Market*, 13 WIDENER L. REV. 388, 390-93 (2003) (tracing and analyzing history of public charity and philanthropy in United States). Charitable organizations contribute substantially to the arts, cultures, hospital cares, higher education, secondary education, day care, vocational training, and family counseling. See David C. Hammack & Dennis R. Young, *Perspectives on Nonprofits in the Marketplace*, in NONPROFIT ORGANIZATIONS IN A MARKET ECONOMY: UNDERSTANDING NEW ROLES, ISSUES AND TRENDS 1, 4-5 (David C. Hammack & Dennis R. Young eds., 1993).

¹⁶ Senator Chuck Grassley, Chairman, Senate Comm. on Fin., Opening Remarks at the Hearing on Charities and Charitable Giving: Proposals for Reform (Apr. 5, 2005) (on file with author).

¹⁷ The George Peabody Library provides information about George Peabody and his philanthropy. See The George Peabody Library, History Webpage, <http://www.peabodyevents.library.jhu.edu/history.html> (last visited Apr. 19, 2006).

public health in Europe, the Soviet Union, and China from World War I through the Cold War.¹⁸ The industrialist Andrew Carnegie established the Carnegie Corporation of New York in 1911 to promote “the advancement diffusion of knowledge and understanding,” funding projects in the areas of education, international peace and security, international development, and the strengthening of U.S. democracy.¹⁹ Henry and Edsel Ford created the Ford Foundation with gifts and bequests to be a resource for innovative people and institutions worldwide.²⁰

Furthermore, in the last twenty years, changes in technology have tremendously impacted virtually every aspect of the economy, society, and charitable giving.²¹ Technological changes have facilitated the growth of private wealth held by individuals and corporate entities.²² Indeed, in the late 1990s, the Internet boom and robust economy were the key factors for the accumulation of personal wealth.²³ Along with the new wealth came concerns about philanthropy.²⁴ Potential donors

¹⁸ See generally ROCKEFELLER PHILANTHROPY AND MODERN BIOMEDICINE: INTERNATIONAL INITIATIVES FROM WORLD WAR I TO THE COLD WAR (William H. Schneider ed., 2002) (detailing Rockefeller Foundation’s efforts to establish global biomedical programs in first half of 20th century).

¹⁹ Carnegie Corporation of New York Webpage, <http://www.carnegie.org> (last visited Mar. 3, 2006).

²⁰ Ford Foundation, *Who Are We*, <http://www.fordfound.org/about/mission.cfm> (last visited Mar. 3, 2006).

²¹ See PRESIDENT’S INFO. TECH. ADVISORY COMM., REPORT TO THE PRESIDENT: INFORMATION TECHNOLOGY RESEARCH: INVESTING IN OUR FUTURE 23 (1999), available at http://www.nitrd.gov/pitac/report/pitac_report.pdf (“As we approach the new millennium, it is clear that the ‘information infrastructure’ — the inter-connected networks of computers, devices, and software — may have a greater impact on worldwide social and economic structures than all networks that have preceded them.”); *id.* at 47 (“Within the next two decades, the Internet will have penetrated more deeply into our society than the telephone, radio, television, transportation, and electric power distribution networks have today. For many of us, the Internet has already become an integral part of our daily lives.”); see also Lyria Bennett Moses, *Understanding Legal Responses to Technological Changes: The Example of In Vitro Fertilization*, 6 MINN. J.L. SCI. & TECH. 505, 512 (2005) (“[A]n account of the historical development of technology might describe technological change as a process of knowledge change, increasing the ability or potential of a people or society to solve problems.”). See generally MCKENZIE WARK, *A HACKER MANIFESTO* (2004) (discussing impact of information technology on law, politics, and society).

²² See The Found. Ctr., *supra* note 14 (providing charts that illustrate increase in personal wealth accumulated as direct result of tremendous growth in technology).

²³ See *id.*

²⁴ See Susan R. Jones, *Lawyering for a New Democracy: Current Issues in the Changing Roles and Practices of Community Economic Development Lawyers*, 2002 WIS. L. REV. 437, 443 (“[M]ulti-millionaires of the booming technology industries are changing the way philanthropy is approached.”); see also Jed Emerson, *In Brief: Giving, Study Shows Gifts by Entrepreneurs*, CHRON. PHILANTHROPY, Nov. 30, 2000, ; David Whitford, *The New Shape of*

searched for optimum ways to give their accumulated wealth, and a new breed of donors was born. Multimillionaires and billionaires from the technology industry approached philanthropy with venture capitalist principles, seeking a maximum return of social impact from their giving.²⁵ The Melinda and Bill Gates Foundation,²⁶ for example, has surpassed the philanthropic notables of yesteryear, spearheading postmodern philanthropy by directing the Gates's newly accumulated wealth toward charitable giving.²⁷ In addition, technology-savvy individuals have turned to the Internet and developed e-philanthropy as a new approach to maximize social good.²⁸

The wealth accumulated during this recent technological revolution has spawned an increase in the number of charitable organizations.²⁹ In 2001, charitable foundations reached record asset holdings,³⁰ and today, countless websites offer advice to prospective donors, matching them with potential donees, projects, and causes.³¹ A recent study showed that

Philanthropy: The Internet Generation Is Bringing the Principles of Venture Capital to Philanthropy. It's Innovative — But Is It Effective?, FORTUNE, June 12, 2000, at 315.

²⁵ Karl Taro Greenfeld, *A New Way of Giving*, TIME, July 24, 2000, at 48, 51 (“This new breed of philanthropist scrutinizes each charitable cause like a potential business investment, seeking maximum return in terms of social impact — for example, by counting the number of children taught to read or the number inoculated against malaria.”). Similarly, a new challenge faced by both donors and grantees is the trend toward chipping away the “variance power.” Sidel, *supra* note 14, at 1150. The variance power, which allows community foundations and trusts to alter the dispositions of their donors, is the “legal pillar that has freed American community philanthropy to search for innovation and support pioneering yet unpopular ideas and policies.” *Id.* at 1147, 1150. This is important because tension often lies where the grantees would like unrestricted forms of giving while the philanthropists would like to maintain some control over the gifts. *Id.* at 1149 (stating that unrestricted form of giving “is warmly welcomed by community foundations because it allows maximum flexibility in the dispersal of funds,” while “many philanthropists are somewhat wary of such open-ended gifts, because they would like to retain some role in the selection of charitable recipients”).

²⁶ See Jon Cronin, *Bill Gates: Billionaire Philanthropist*, BBC NEWS, Jan. 25, 2005, <http://news.bbc.co.uk/2/hi/business/3913581.stm> (reporting that, since its inception in 2000, Melinda and Bill Gates Foundation has given more than \$7 billion to global health and learning).

²⁷ Richard Williamson, *Gates Surpasses the Late Greats of Philanthropy*, NONPROFIT TIMES, Jan. 1, 2000, <http://www.nptimes.com/Jan00/janfro1.html> (reporting information about Bill and Melinda Gates Foundation's programs worldwide).

²⁸ See, e.g., Greenstar Foundation, *E-Philanthropy: Changing Our Way of Giving* (Aug. 1999), <http://www.greenstar.org/e-philanthropy/>.

²⁹ The Found. Ctr., *supra* note 14 (reporting that rapid rise in personal wealth led individuals to create many charitable foundations).

³⁰ *Id.*

³¹ See Michael Coren, *Charities Find Dollars on the Internet*, CNN.COM, Dec. 20, 2004, <http://www.cnn.com/2004/TECH/internet/12/15/giving.internet/> (reporting that websites assist “a new generation of philanthropists [in] find[ing] causes close to their

49% of Americans volunteer their time for civic activities, and nearly 75% of Americans make financial contributions to charities.³² These donations to foundations, institutions, and organizations promote social welfare in various areas of philanthropy.³³

Dependent on charitable generosity, potential charitable donees search for and court potential donors. As the role of government in public funding continues to diminish,³⁴ nonprofit organizations compete for private support to fulfill and expand their charitable missions.³⁵ Private donations are pivotal to offset the shrinking public funding of arts, science, social science, communications, education, health, research, religion, and democracy.³⁶ Thus, an incentives-based system that facilitates giving is essential, not only to the donors and donees, but also to the development and growth of society.

hearts and homes by allowing potential donors to search charities by zip code, state and cause"); see, e.g., Charity Navigator Homepage, <http://www.charitynavigator.org/> (last visited Mar. 3, 2006).

³² See Susan Raymond, *Venture Philanthropy: An Idea Whose Time Has Come*, ONPHILANTHROPY, Aug. 15, 2000, http://www.onphilanthropy.com/tren_comm/tc2001-09-06j.html (reporting that according to recent study conducted by John Hopkins University, "49 percent of Americans volunteer their time for civic activities, compared to 13 percent of Germans and 19 percent of the French" and that "[s]imilarly, nearly three quarters of Americans make financial contributions to charity, compared to 44 percent of Germans and 43 percent of the French").

³³ Coren, *supra* note 31 (reporting increase in online donations to various charities and causes).

³⁴ Government funding increased only 2.9% for the period between 1992 and 1996, compared to 8.4% between 1987 and 1992. Jed Emerson, *The U.S. Nonprofit Capital Market: An Introductory Overview of Developmental Stages, Investors and Funding Instruments* 6 (1998), <http://www.insp.efc.be/download.php?d=21&f=1>.

³⁵ Charitable entities provide social value and are a vital element to the building of the modern economy. See BRUCE R. HOPKINS, *THE LAW OF FUNDRAISING* § 1.1, at 2-3 (2d ed. 1996) (stating that charities perform functions that relieve government from its obligation); Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 835 (1980). With respect to corporate charitable giving, corporate management is often constrained "to choose recipients of the kind that government is under popular pressure to provide [for]." Victor Brudney & Allen Ferrell, *Corporate Charitable Giving*, 69 U. CHI. L. REV. 1191, 1214 (2002). Such charitable giving "lessens the pressure for government funding" and offers attendant regulatory and tax incentives. *Id.*

³⁶ See Susan R. Jones, *Representing the Poor and Homeless: Innovations in Advocacy Tackling Homelessness Through Economic Self-Sufficiency*, 19 ST. LOUIS U. PUB. L. REV. 385, 409 (2000) (illustrating, through various surveys, that private charity substantially complements government work).

II. INTELLECTUAL PROPERTY AND THE BENEFIT OF CHARITABLE OWNERSHIP

A. *Patents and Copyrights as Gifts*

Intellectual property, such as patents, copyrights, trade secrets, and trademarks, has become increasingly important in most sectors of the economy and society.³⁷ The rapid growth of technology and information has enhanced companies' intellectual property ownership portfolios, as companies seek to protect their rights in their inventions and creative works of authorship.³⁸ Moreover, as the economy has become increasingly global and knowledge-based, the role of intellectual property has become vitally important.³⁹ For example, the World Trade Organization, encompassing approximately 150 nations,⁴⁰ imposes upon

³⁷ Alan Greenspan, Fed. Reserve Chairman, Remarks Regarding Intellectual Property Rights at the Stanford Institute for Economic Policy Research Economic Summit (Feb. 27, 2004), available at <http://www.federalreserve.gov/boarddocs/speeches/2004/200402272/> (noting importance of information technology, and stating that "the emergence of an electronic platform for the transmission of ideas at negligible marginal cost may, therefore, be an important factor explaining the recent increased conceptualization of the GDP"); *id.* ("Ideas are at the center of productivity growth. Multifactor productivity by definition attempts to capture product innovations and insights in the way that capital and labor are organized to produce output. Ideas are also embodied directly in the capital that we employ."); see also Merrill Matthews, Jr. & Tom Giovanetti, *Why Intellectual Property Is Important*, IDEAS, (Inst. for Policy Innovation, Lewisville, Tex), July 8, 2002, available at <http://www.ipi.org> (follow "Publications" hyperlink, then follow "by Author" hyperlink) (stating that United States has become powerhouse of intellectual property as economy has shifted from industrial- to information-based economy and new creative class of workforce has replaced other groups of workers).

³⁸ Greenspan, *supra* note 37 ("[I]n recent decades, as the economic product of the United States has become so predominantly conceptual, [so] have issues related to the protection of intellectual property rights come to be seen as significant . . ."). Companies highly value their intellectual property assets. See, e.g., IBM, *Intellectual Property and Licensing*, <http://www.ibm.com/ibm/licensing/> (last visited Mar. 3, 2006) ("In 2005, IBM received 2,974 U.S. patents from the USPTO. This is the thirteenth consecutive year that IBM has received more US patents than any other company in the world. In addition to delivering these innovations through its products and services, IBM maintains an active patent and technology licensing program.").

³⁹ See Robin Cowan & Elad Harison, *Intellectual Property Rights in a Knowledge-Based Economy* (MERIT-INFONOMICS Research Memorandum 2001), <http://ideas.repec.org/p/dgr/umamer/2001026.html> (discussing various doctrinal protections for different types of intellectual property in emergence of knowledge-based industries); see also Fed. Trade Comm'n, *FTC and DOJ to Hold Roundtable Discussions to Conclude Hearings on Competition and Intellectual Property Law and Policy* (Oct. 18, 2002), <http://www.ftc.gov/opa/2002/10/intellect.htm>; The National Academies Homepage, <http://www.nationalacademies.org> (last visited Mar. 3, 2006) (stating scope of national project to study role of intellectual property in knowledge-based economy).

⁴⁰ World Trade Org., *Members and Observers*, <http://www.wto.org/english/>

all nation-members systematic protection and enforcement of intellectual property rights within the global free trade movements.⁴¹ Such a system indicates the role of patents and copyrights, among other intellectual property rights, in shaping the present and future direction of the global, knowledge-based economy.⁴²

To compete globally, the United States embraces a legal system of strong intellectual property rights.⁴³ Under U.S. intellectual property law, patents confer ownership for twenty years from the date of filing the patent application.⁴⁴ The patent ownership encompasses the right to exclude others from making, using, selling, offering for sale, or importing the patented invention.⁴⁵ The owner of a patent is free to transfer all or part of the patent to others, and a transfer of patent ownership is recorded with the U.S. Patent Office.⁴⁶ With respect to

thewto_e/whatis_e/tif_e/org6_e.htm (last visited Mar. 3, 2006) (stating that WTO has 149 members as of December 2005).

⁴¹ World Trade Org., *Intellectual Property: Protection and Enforcement*, http://www.wto.org/english/tehwto_e/tif_e/agrm7_e.htm (last visited Mar. 6, 2006) (discussing Uruguay Round, which established “minimum level of protection that each government has to give to the intellectual property of fellow WTO members”); World Trade Org., *Overview: A Navigational Guide*, http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm1_e.htm (last visited Mar. 3, 2006) (“WTO agreements cover goods, services and intellectual property. They spell out the principles of liberalization, and the permitted exceptions. They include individual countries’ commitments to lower customs tariffs and other trade barriers, and to open and keep open services markets. They set procedures for settling disputes. They prescribe special treatment for developing countries. They require governments to make their trade policies transparent by notifying the WTO about laws in force and measures adopted, and through regular reports by the secretariat on countries’ trade policies.”).

⁴² With the fast growth and importance of the Internet and e-commerce, the WTO continues to play a central role in shaping the direction of governance of the new medium of global commerce. See generally Sacha Wunsch-Vincent, *WTO, E-commerce, and Information Technologies*, U.N. INFO. & COMM. TECH. TASK FORCE, available at <http://www.iie.com/publications/papers/wunsch1004.pdf> (last visited Mar. 3, 2006) (discussing role of WTO in IT governance).

⁴³ In addition to having a legal protection system for intellectual property rights, the federal government implements a strong enforcement system at both the national and international levels. See generally E. Anthony Wayne, Assistant Sec’y for Econ. & Bus. Affairs, Testimony Before the House Appropriations Committee, Subcommittee on Commerce, Justice, State, the Judiciary, and Related Agencies (Apr. 23, 2002), <http://www.state.gov/e/eb/rls/rm/2002/9645.htm> (describing U.S. Department of State’s role in enforcement of U.S. intellectual property rights through foreign policy).

⁴⁴ There are three different patent categories: utility, plant, and design. Margo A. Bagley, *Patent First, Ask Questions Later: Morality and Biotechnology in Patent Law*, 45 WM. & MARY L. REV. 469, 484 n.54 (2003). A utility or plant patent is valid for 20 years from the date of filing. 35 U.S.C. § 154 (2004). A design patent is effective for 14 years from the date of grant. 35 U.S.C. § 173.

⁴⁵ 35 U.S.C. § 154(a)(1) (2000).

⁴⁶ Under patent law, the applicant, patentee, or his assignee may grant and convey “an

copyright law, the term of protection for a copyright is the life of the author plus seventy years.⁴⁷ If the author is an entity, the term of protection lasts for 120 years from the date of creation or ninety-five years from the date of publication.⁴⁸ A copyright is a form of protection provided to the authors of original works of authorship including literary, dramatic, musical, audiovisual, artistic, architectural, and pictorial works and sound recordings.⁴⁹ Software is also a work of authorship entitled to copyright protection.⁵⁰ The copyright grant

exclusive right under his application for patent, or patents, to the whole or any specified part of the United States.” 35 U.S.C. § 261 (2006). If the assignment, grant, or conveyance is not recorded with the U.S. Patent and Trademark Office within three months from its issuance, it will be void as against any subsequent purchaser for a valuable consideration. *Id.*

⁴⁷ See 17 U.S.C. §§ 302-305 (2000).

⁴⁸ *Id.*

⁴⁹ The Copyright Act sets forth that:

(a) Copyright protection subsists, in accordance with this title, in original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. Works of authorship include the following categories: (1) literary works; (2) musical works, including any accompanying words; (3) dramatic works, including any accompanying music; (4) pantomimes and choreographic works; (5) pictorial, graphic, and sculptural works; (6) motion pictures and other audiovisual works; (7) sound recordings; and (8) architectural works.

(b) In no case does copyright protection for an original work of authorship extend to any idea, procedure, process, system, method of operation, concept, principle, or discovery, regardless of the form in which it is described, explained, illustrated, or embodied in such work.

17 U.S.C. § 102(a)-(b) (2000).

⁵⁰ Software code may be source code or object code. Source code is “[h]uman-readable program statements written by a programmer or developer in a high-level or assembly language that are not directly readable by a computer” and “needs to be compiled into object code before it can be executed by a computer.” MICROSOFT CORP., MICROSOFT COMPUTER DICTIONARY 418 (1999). Object code is “[t]he code, generated by a compiler or an assembler, that was translated from the source code of a program.” *Id.* at 317. Software code is considered a “literary work” within the meaning of the Copyright Act because software code is expressed in “verbal or numerical symbols or indicia.” 17 U.S.C. § 101 (2006); see also *Atari Games Corp. v. Nintendo of Am., Inc.*, 975 F.2d 832, 838-39 (Fed. Cir. 1992) (finding that computer programs fall within terms of Copyright Act); Mathias Strasser, *A New Paradigm in Intellectual Property Law? The Case Against Open Source*, 2001 STAN. TECH. L. REV. 1, 24 (2001) (“Since Section 101(a) defines the concept of ‘literary work’ broadly, encompassing ‘words, numbers, or other verbal or numerical symbols or indicia,’ and since the legislative history makes it clear that Congress intended that concept to encompass software in all its manifestations, it soon became clear that the Copyright Act covers both the source code and the object code of software.”).

subsists in the reproduction, derivative, distribution, public display, and public performance rights of the work.⁵¹ The author of a copyright can, by executed contract, assign all or part of his or her exclusive rights to a third party.⁵² The assignment of ownership is recorded with the U.S. Copyright Office.⁵³

B. Benefits of Intellectual Property Ownership by Charitable Organizations

Modern theorists regard the firm as the repository of residual property rights, such as intangible intellectual property assets.⁵⁴ The firm may assign these residual rights, such as patents, if it decides, upon internal

⁵¹ The copyright statute provides that the components of a copyright include:

the exclusive rights to do and to authorize any of the following:

- (1) to reproduce the copyrighted work in copies or phonorecords;
- (2) to prepare derivative works based upon the copyrighted work;
- (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
- (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly;
- (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly; and
- (6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.

17 U.S.C. § 106(1)-(6).

⁵² See generally *I.A.E., Inc. v. Shaver*, 74 F.3d 768, 775 (7th Cir. 1996) (“The ‘transfer of copyright ownership’ is defined, in the Copyright Act, as an exclusive license or some other instrument of conveyance. The definition expressly excludes a nonexclusive license.”); *In re Patient Educ. Media, Inc.*, 210 B.R. 237, 240 (Bankr. S.D.N.Y. 1997) (“Ownership is the *sine qua non* of the right to transfer, and the copyright law distinguishes between exclusive and nonexclusive licenses. A ‘transfer of copyright ownership’ includes the grant of an exclusive license, but not a nonexclusive license.”).

⁵³ See Christopher Sprigman, *Reform(aliz)ing Copyrights*, 57 STAN. L. REV. 485, 493 (2004) (discussing recording of ownership transfer requirement).

⁵⁴ Initial ownership of a patent is with the inventor, but the ownership can be transferred. See, e.g., Jerry C. Liu, *Overview of Patent Ownership Considerations in Joint Technology Development*, 2005 SYRACUSE SCI. & TECH. L. REP. 1; William Lynch Schaller, *Growing Pains: Intellectual Property Considerations for Illinois Small Businesses Seeking to Expand*, 35 LOYOLA U. CHI. L.J. 845, 912 (2004) (stating that only individuals can qualify as inventors for purposes of applying for patent, thus, in order for company to own and apply for patent; “ownership of the invention must be transferred to the company by written assignment from an individual”).

evaluation, that they are no longer needed for the firm's functions in the market. In such cases, the firm grants ownership in the intellectual property assets to an assignee-donee.⁵⁵ Donating residual patents to charitable organizations, such as educational and research institutions, enables the firm to control its competitors' access to those intellectual property rights.

Moreover, as the new owner of a patent, the assignee enjoys all the rights conferred under patent law.⁵⁶ For example, if the charity is a university, its researchers, graduate students, and undergraduate students enjoy the right to use the patent in their scientific investigation and study.⁵⁷ If the patent covers a particular method, the university can conduct experiments using the method without obtaining a license from the assignor.⁵⁸

Rather than assigning or donating the patent to a charitable organization altogether, the firm may alternatively execute a license to use the patent to a charitable organization. A license is generally nothing more than a promise by the licensor not to sue the licensee,⁵⁹ as long as

⁵⁵ 35 U.S.C. § 261 (2006) ("Applications for patent, patents, or any interest therein, shall be assignable in law by an instrument in writing.").

⁵⁶ The assignee enjoys the patent grant, which confers the right to exclude others from making, using, selling, offering for sale, or importing the patented invention. Furthermore, as the assignee of inventions, a university is entitled to prosecute the applications and to make amendments during prosecution. *See* Regents of Univ. of N.M. v. Knight, 321 F.3d 1111, 1122 (Fed. Cir. 2003) (affirming district court's finding that university assignee may correctly prosecute and amend applications during prosecution of patent applications).

⁵⁷ Universities usually have their own patent policies. For example, a university may embrace a policy that it owns all patents and inventions created by its employees during their time of employment. *See, e.g.,* Univ. of W. Va. Bd. of Trs. v. Van Voorhies, 342 F.3d 1290, 1296 (Fed. Cir. 2003) (discussing whether university's patent policy reaches second-generation patents).

⁵⁸ If the patent covers a research tool or method, the desire to have ownership is even greater because universities cannot rely on the experimental exception in their use of the patented tool or method to further their own investigation. *See* Elizabeth Rowe, The Experimental Use Exception to Patent Infringement: Do Universities Deserve Special Treatment? 1 (unpublished Working Paper, 2005), available at <http://papers.ssrn.com> (arguing that universities should be liable for patent infringement if they use patented research tool or method in their investigation without permission in hopes that experimental exception works in their favor).

⁵⁹ *See generally* Jim Arnold Corp. v. Hydrotech Sys., Inc., 109 F.3d 1567, 1577 (Fed. Cir. 1997) ("[L]icenses are considered as nothing more than a promise by the licensor not to sue the licensee."); *id.* ("[Under a license agreement], title to the patent does not change hands However, assignments pass title to the patentee's rights, with all the accompanying rights of ownership, from the patentee to the assignee."). Unlike assignments, patent licenses are not recorded in the Patent Office Assignment branch. *See* Laurence H. Pretty, *Issues of Ownership of Intellectual Property Assets Arising in a Deal Context*, 751 PLI/PAT 9, 19

the licensee follows all the conditions set forth under the license agreement.⁶⁰ If the licensee, however, uses the patent beyond the scope of the license grant, the licensee is in breach of the license and infringes the patent.⁶¹ Thus, to a charitable organization, having a license, rather than owning a patent outright, means having a restricted right to use the patent with all the limitations described in the license agreement.⁶²

These limitations may include the ability to use the patent only for certain defined purposes,⁶³ within identified laboratories belonging to particular investigators or for certain periods of time.⁶⁴ Limits on the patent's purpose and temporal and geographical limitations,⁶⁵ among others,⁶⁶ may hinder investigation and studies based on the subject patent if certain uses constitute a breach of the license agreement and infringement on the patent.⁶⁷ Furthermore, costs associated with patent litigation are exorbitant and may serve to reinforce the licensee's fear of using the patent beyond the limitations.⁶⁸

(2003) (stating that Patent Office "assignment record does not record patent licenses").

⁶⁰ See generally *MedImmune, Inc. v. Centocor, Inc.*, 409 F.3d 1376, 1379 (Fed. Cir. 2005) ("[O]nce the license agreement was in place and [licensee] was in compliance with the terms of the agreement, [licensee] could not be under reasonable apprehension that it would face infringement suit by [licensor].").

⁶¹ See generally *Monsanto Co. v. McFarling*, 363 F.3d 1336, 1338 (Fed. Cir. 2004) (affirming patent infringement finding where licensee breached license agreement that included several restrictions, including prohibition of replanting second generation of seeds).

⁶² See, e.g., Mary J. Hildebrand, *Software Licensing*, 786 PLI/PAT 513, 516-37 (2004) (setting forth issues for consideration in software licensing); Mary M. Squyres, *Global Licensing: A License to Use*, 824 PLI/PAT 363, 367-400 (2005) (indicating various terms and restrictions included in license to use).

⁶³ See Ethan Horwitz, *Patent and High Technology Licensing*, 831 PLI/PAT 57, 67-68 (2005) (discussing "field of use" restriction).

⁶⁴ *Id.* at 68-69 (discussing license term).

⁶⁵ *Id.* at 67-68 (discussing territory restriction in patent and technology license agreements).

⁶⁶ *Id.* at 69 (providing reservation of rights by licensor).

⁶⁷ See, e.g., *Madey v. Duke Univ.*, 307 F.3d 1351, 1352-62 (Fed. Cir. 2002) (demonstrating license use problem). Madey was a prominent researcher in the Department of Physics at Duke University and held several patents relating to the performance of free electron laser ("FEL") technology. *Id.* at 1352. After Madey was relieved from his post at Duke, some members of the university and research collaborators used the FEL equipment that remained at the university after Madey's departure. *Id.* Subsequently, Madey sued Duke for patent infringement. *Id.* The Federal Circuit rejected Duke's argument that its nonprofit and educational status was adequate proof of the experimental exception to infringement. *Id.* The court held that the infringing use was to further the university's legitimate business objectives of: (1) educating and enlightening faculty, researchers, and students; (2) enhancing Duke's status; and (3) attracting additional research grants and talented faculty and students. *Id.* at 1362.

⁶⁸ Litigation costs include not only breach of license agreement claims, but also patent

A license may generate other uncertainties and administrative burdens as well. Who at the charity will negotiate the license agreement? Will that person possess an understanding of all the limitations indicated in the license agreement? Will that person be able to communicate the limitations to those who desire to use the patent license in their investigation and study? Who will monitor the use of the patent to insure compliance with the limitations? Most charitable organizations do not have technology transfer offices to handle patent incoming license concerns,⁶⁹ and even those organizations fortunate enough to have technology transfer offices generally understaff such offices.⁷⁰

Most charitable organizations are unwilling or ill-equipped to deal with the limitations and uncertainties associated with the unattractive process of obtaining a license to use a patent.⁷¹ Thus, many prefer to obtain the outright ownership of the patent.⁷² As an assignee, as opposed to a licensee, a charity has unrestricted use of a patent, eliminating any uncertainties. Consequently, the charity can limit costs incidental to obtaining a patent license or arising from the use of the patent under the license agreement.

infringement claims. See John Flock, *Patent Licensing: Outlines*, 825 PLI/PAT 227, 235 (2005) (stating that when licensee uses patent beyond scope of license grant, licensee faces both breach of contract and patent infringement claims). Likewise, in cases relating to a licensee's use of a copyright beyond the scope of the license grant, both claims of breach of contract and copyright infringement are present. In a recent case where the licensee breached the license agreement and infringed the copyrights, the jury awarded the plaintiff \$19 million in damages. See *Lowry's Reports, Inc. v. Legg Mason, Inc.*, 271 F. Supp. 2d 737, 741-44 (D. Md. 2003).

⁶⁹ Generally, universities with technology transfer offices focus on the outgoing technology licenses, where the universities license their innovations to the commercial sectors in exchange for royalty income. See, e.g., Univ. of Cal., University Technology Transfer — Questions and Answers Webpage, www.ucop.edu/ott/tech.html (explaining university technology transfers and licensing programs) (last visited Apr. 18, 2006); see also Gina C. Freschi, *Navigating the Research Exemption's Safe Harbor: Supreme Court to Clarify Scope — Implications for Stem Cell Research in California*, 21 SANTA CLARA COMPUTER & HIGH TECH. L.J. 855, 888 (2005) (“[Technology] transfer is the formal transferring of new discoveries and innovation resulting from scientific research conducted at universities to the commercial sector.”); Amy Kapczynski, *Addressing Global Health Inequities: An Open Licensing Approach for University Innovations*, 20 BERKELEY TECH. L.J. 1031, 1041 (2005) (“[Through] technology transfer licenses[,] universities negotiate with drug companies engaged in commercializing the universities’ academic discoveries.”).

⁷⁰ See Univ. of Cal., *supra* note 69.

⁷¹ Indeed, since university technology transfer offices mainly address issues relating to the outgoing of technology, such as disclosure, publication, and license agreements with the private sector, they do not have enough staff to focus solely on obtaining licenses on behalf of their researchers. See *supra* notes 69-70.

⁷² See generally *Ortho Pharm. Corp. v. Genetics Inst., Inc.*, 52 F.3d 1026, 1030-35 (Fed. Cir. 1995) (explaining and contrasting rights of patent owner and licensee).

The outright assignment of a patent means the charitable assignee possesses its own portfolio of patents. The charity can use the donated patents to further its own investigation and study that may lead to the creation of future inventions and thus ownership of new patents. Moreover, the charity can then rely on its own enhanced portfolio to attract new talents, funding, and investment.⁷³

With respect to copyrights, when a firm gifts a copyright to a charity, the charity receives the unfettered rights provided under U.S. copyright law. As the assignee of the copyright gift, the charity possesses the exclusive right to reproduce the copyrighted work, to prepare derivative works, to distribute copies or phonorecords of the copyrighted works, to perform the copyrighted work publicly, and to display the copyrighted work publicly.⁷⁴

Furthermore, with outright ownership of the copyright in a particular work, the charity, specifically its researchers and educators, do not have to obtain permission⁷⁵ or rely on the "fair use" doctrine to use the copyrighted work. This is especially advantageous because the fair use doctrine presents many uncertainties, and the distinction between fair use and infringement is difficult to define in some cases.⁷⁶ These

⁷³ Intellectual property portfolios have become valuable assets and important tools to attract investment and venture capital. See generally Ben Depoorter, *The Several Lives of Mickey Mouse: The Expanding Boundaries of Intellectual Property Law*, 9 VA. J.L. & TECH. 4, 28-29 (2004) (discussing origin of property rights in information goods in face of new digital markets for content).

⁷⁴ Among the statutory exclusive rights, the right to prepare derivative works has been expanded, in some cases too broadly, essentially providing "copyright owners the right to control interesting, creative, and culturally significant reuses of their works." Rebecca Tushnet, *Copy This Essay: How Fair Use Doctrine Harms Free Speech and How Copying Serves It*, 114 YALE L.J. 535, 545 (2004).

⁷⁵ *Gardner v. Nike, Inc.*, 279 F.3d 774, 780 (9th Cir. 2002) ("[W]e hold that the 1976 Act does not allow a copyright licensee to transfer its rights under an exclusive license, without the consent of the original licensor.").

⁷⁶ Determining fair use requires a case-by-case approach many have criticized as being unworkable. See, e.g., Michael J. Madison, *A Pattern-Oriented Approach to Fair Use*, 45 WM. & MARY L. REV. 1525, 1530-35 (advocating for pattern-oriented approach to fair use to achieve more consistent and predictable fair use jurisprudence). See generally Andrew Chin, *Antitrust Analysis in Software Product Markets: The First Principle Approach*, 18 HARV. J.L. & TECH. 1, 71 (2004) (noting that fair use doctrine application is fact-specific and uncertain); Tushnet, *supra* note 74, at 545 (noting that successful fair use defense is expensive and risk of litigation deters scholars and publishers from building on prior works and investing in potentially infringing works). Under the fair use doctrine, the use of a copyrighted work may be considered "fair" if the purpose is for criticism, comment, news reporting, teaching, scholarship, or research. See generally Jacqueline Lipton, *Information Property: Rights and Responsibilities*, 56 FLA. L. REV. 135, 153-54 (2004) (discussing fair use doctrine). There are four factors to consider in determining whether or not a particular use is fair: (1) the purpose and character of the use, including whether such use is of a commercial nature or

uncertainties, coupled with the cumbersome process of acquiring permission, make anything other than full ownership of the copyright somewhat onerous. Further, if the charity negotiates for a license to use certain copyrights, as a licensee of a nonexclusive copyright license, it will face limitations and constraints similar to those associated with a patent license as described above.⁷⁷

Charitable donees clearly prefer to become assignees rather than licensees of patents and copyrights through outright gifts from donors. The question arises, then, whether there is a system currently available to encourage the firm that would like to completely assign its intellectual property assets to a particular charity.⁷⁸ The current charitable tax deduction scheme requires a donor to give its entire interest (or undivided interest) in donated property to a qualified charity. More specifically, no income tax deduction is allowed for contributions of

is for nonprofit educational purposes; (2) the nature of the copyrighted work; (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and (4) the effect of the use upon the potential market for or value of the copyrighted work. *See id.* Decisional authority indicates that there is no definite number of words, lines, paragraphs, notes, or excerpts that may safely be reproduced to ensure that the use is a "fair use" and not an act of infringement. *See Tushnet, supra* note 74, at 545-46 (highlighting notorious decisions relating to fair use doctrine's application, and noting infringement of right to make derivative works). Acknowledging the source of the copyrighted material also does not necessarily insulate the user from an infringement suit. *See* Roger L. Zissu, *Copyright Luncheon Circle: The Interplay of Copyright and Trademark in the Protection of Character Rights with Observations on Dastar v. Twentieth Century Fox Film Corp.*, 51 J. COPYRIGHT SOC'Y U.S.A. 453, 456-62 (2004) (citing example of such infringement suit).

⁷⁷ If a licensee uses a copyright in violation of the terms and restrictions stated in the license agreement, the licensee risks an infringement action. *See generally* *United States v. King Features Entm't. Inc.*, 843 F.2d 394 (9th Cir. 1988) (holding that licensee of copyrighted work violated copyright licensing agreement which did not permit cartoon viewing on closed-circuit military television or on foreign military bases).

⁷⁸ Commentators have noted that in the world of charity giving, "donors prefer to avail themselves of the charitable contribution deduction." Nina J. Crimm, *Through a Post-September 11 Looking Glass: Assessing the Roles of Federal Tax Laws and Tax Policies Applicable to Global Philanthropy by Private Foundations and Their Donors*, 23 VA. TAX REV. 1, 17 (2003). Thus, the incentive system centers on the availability of tax deductions. *Id.* at 22 (noting that numerous studies suggest that federal tax laws impact philanthropy); *see also* CHARLES T. CLOTFELTER, *FEDERAL TAX POLICY AND CHARITABLE GIVING* 288 (1985); Gerald E. Auten et al., *The Effects of Tax Reform on Charitable Contributions*, 45 NAT'L TAX J. 267, 267 (1992); Charles A. Clotfelter, *Federal Tax Policy and Charitable Giving*, in *PHILANTHROPIC GIVING: STUDIES IN VARIETIES AND GOALS* 105, 124 (Richard Magat ed., 1989); Joseph Cordes, *The Cost of Giving: How Do Changes in Tax Deductions Affect Charitable Contributions?*, *EMERGING ISSUES IN PHILANTHROPY: SEMINAR SERIES* (The Urban Inst., D.C.), 2001, at 1-3, available at http://www.urban.org/UploadedPDF/philanthropy_2.pdf; William C. Randolph, *Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions*, 103 J. POL. ECON. 709, 735 (Aug. 1995).

partial interests in property, defined as an “interest in property which consists of less than the taxpayer’s entire interest in such property.”⁷⁹

With respect to donated patents, for example, a donor may not take a charitable deduction if he or she retains any substantial right in the donated patent. In order to qualify for an income tax charitable deduction under section 170 of the Internal Revenue Code (“Code”), the taxpayer must transfer “all substantial rights” in a patent, defined as “all rights which are of value at the time the rights to the patent are transferred.”⁸⁰ In addition, a patent subject to a conditional reversion is not deductible unless the likelihood of the triggering event occurring is so remote as to be negligible.⁸¹ Assume, for example, that a donor’s contribution of a patent to a university is contingent upon a certain professor remaining as a member of the university’s faculty for the rest of the patent’s life, which is fifteen years. Under these facts, the donor would not be entitled to a charitable deduction because on the date of the contribution the possibility that the professor will no longer be a member of the university’s faculty for fifteen years is considered “not so remote as to be negligible.”⁸²

With respect to copyright donations, a copyright creator must donate both the copyright and the tangible work embodying the copyright in

⁷⁹ I.R.C. § 170(f)(2)-(3) (2006). There are exceptions, however, if the partial interest is a charitable remainder interest in a trust. More specifically, a deduction is allowed for a contribution of a remainder interest in trust if the trust is: (1) a charitable remainder annuity trust, (2) a charitable remainder unitrust, or (3) a pooled income fund. I.R.C. §§ 170(f)(2)(A), 664(d)(1)-(2). For nontrust transfers, a deduction is allowed for a remainder interest in personal residences or farms. *Id.*

It should be noted that in Notice 2004-7, the IRS stated that it “intends to disallow improper charitable deductions claimed by taxpayers in connection with the transfer of patents or other intellectual property to charitable organizations.” I.R.S. Notice 2004-7, 2004-3 I.R.B. 310. Notice 2004-7 set forth four situations arising out of intellectual property transfers to charitable organizations that will be closely scrutinized, including the transfer of a nondeductible partial interest in intellectual property. *Id.*

Although donations of partial interests do not qualify for the income tax charitable deduction, donations of “undivided interests” do qualify. I.R.C. § 170(f)(3)(B)(ii).

⁸⁰ See Rev. Rul. 2003-28, 2003-1 C.B. 594 (citing Treas. Reg. § 1.1235-2(b)(1) (2006)). The “all substantial rights” test is primarily used to help determine whether a patent transfer constitutes a sale (capital gains treatment) or a license (ordinary income treatment). The test, however, is also useful in analyzing the tax treatment of a charitable donation.

⁸¹ *Id.* (citing Treas. Reg. § 1.170A-1(e)).

⁸² *Id.* The regulations provide an example of a condition that is considered negligible so as to qualify for a tax deduction. *Id.* (“A transfers land to a city government for as long as the land is used by the city for a public park. If, on the date of the gift, the city does plan to use the land for a park, and the possibility that the city will not use the land for a public park is so remote as to be negligible, A is entitled to a deduction under section 170 for his charitable contribution.”).

order to realize a tax deduction. For example, no income tax deduction is allowed at all if an artist donates his or her painting to a charity but not the copyright on the painting.⁸³ Likewise, no income tax charitable deduction is allowed if a taxpayer donates an original, historic motion picture film to a charity, but retains the exclusive right to make reproductions of such films and to exploit such reproductions.⁸⁴ In order for a donor to qualify for an income tax charitable deduction in these examples, both the copyright and the work embodying the copyright (the original painting or film) must be given to the charitable organization. Merely donating the film or painting without the copyright would be considered a donation of a nondeductible partial interest in the property.⁸⁵

Although the tax system *requires* intellectual property donors to make

⁸³ Treas. Reg. § 1.170A-7(b)(1).

⁸⁴ *Id.*

⁸⁵ In this regard, an interesting disconnect exists between federal copyright law and federal income tax law. Under federal copyright law, the ownership of a copyright or any exclusive rights under the copyright is distinct from ownership of any material object in which the work is embodied. *See Nika Corp. v. City of Kansas City*, 582 F. Supp. 343, 367 (D.C. Mo. 1983) (holding ownership of copyright distinct from ownership of physical object in which copywritten work is embodied); *Michael Todd Co., Inc. v. L.A. County*, 57 Cal. 2d 684, 691 (1962) (holding copyright ownership is intangible property distinct from any property interest in material object copyrighted). Transfer of ownership of any material object, including the copy or recording in which the work is first fixed, does not itself convey any rights in the copyrighted work embodied in the object. *See Nika*, 582 F. Supp. at 367; *Michael Todd*, 57 Cal. 2d at 691. With respect to federal income tax law, however, the two pieces of property — the intangible copyright and the tangible painting — are treated as one. In other words, for tax purposes, a copyright is not distinct from any material object in which the copyright is embodied.

While federal income tax law is inconsistent with copyright law, it is also inconsistent with federal estate and gift tax law. In 1981, Congress aligned the gift and estate tax provisions with federal copyright law so that in the case of a “qualified contribution” of a “work of art,” the work of art and the copyright on it shall be treated as separate properties. I.R.C. § 2055(e)(4)(A) (2006). In contrast to the income tax charitable deduction provision, the estate and gift tax charitable deduction provisions expressly allow for the treatment of a tangible work of art and the copyright on the work as two distinct properties, allowing a gift or estate tax deduction for the transfer of either of these properties to a charitable organization. *See id.* § 2055(e)(4) (stating that copyright and tangible personal property will be treated as items of separate property for purposes of estate tax charitable deduction); *id.* § 2522(c)(3) (stating same treatment for gift tax charitable deduction). Accordingly, an estate tax charitable deduction would be allowed if a decedent willed a painting to a charity, but left the copyright on the painting to her heirs. There is no apparent explanation for the inconsistency between the federal income tax charitable deduction and the federal gift and estate tax charitable provisions. The effect, though, is that an artist would not be entitled to an income tax deduction if she made an inter vivos gift of a painting to a charity (keeping the copyright), but would be entitled to an estate tax deduction if she gave the painting to the charity at her death (and the copyright interest passed to an heir).

complete assignments to charities to obtain any deduction, the question arises whether the system adequately *encourages* donors to make outright gifts to charity. Since owning patents and copyrights is equal to having a monopoly in those patents and copyrights for a specific duration of time, what are the driving factors persuading the firm, as the repository of residual property rights, to surrender its monopoly?⁸⁶ Under the U.S. Constitution, the owner of the patent or copyright and society have a bargain: the owner enjoys the monopoly during a certain time period,⁸⁷ and society enjoys the patent or copyright once it becomes part of the public domain⁸⁸ at the conclusion of the time limit.⁸⁹ Why should the firm, as the repository of residual property rights, give up its bargain prematurely, unless there are incentives to facilitate and encourage the ending of the monopoly and the transferring of the ownership into the hands of charitable institutions?⁹⁰ The firm could very well enjoy the

⁸⁶ See *Sony Corp. of Am. v. Universal City Studios*, 464 U.S. 417, 429 (1983) (ruling that limited monopoly in copyright or patent “is intended to motivate the creative activity of authors and inventors by the provision of a special reward, and to allow the public access to the products of their genius after the limited period of exclusive control has expired”); *Mazer v. Stein*, 347 U.S. 201, 219 (1954) (“The economic philosophy behind the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors in ‘Science and Useful Arts.’”).

⁸⁷ See *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.*, 489 U.S. 141, 146 (1989) (“The Patent Clause itself reflects a balance between the need to encourage innovation and avoidance of monopolies which stifle competition without any concomitant advance in the ‘Progress of Science and useful Arts.’”); *Sears, Roebuck & Co. v. Stiffel Co.*, 376 U.S. 225, 229 (1964) (“Patents are not given as favors . . . but are meant to encourage invention by rewarding the inventor with the right, limited to a term of years fixed by the patent, to exclude others from the use of his invention.”); see also Peter A. Jaszi, *Goodbye to All That — A Reluctant (and Perhaps Premature) Adieu to a Constitutionally-Grounded Discourse of Public Interest in Copyright Law*, 29 VAND. J. TRANSNAT’L L. 595, 599-600 (1996) (emphasizing “economic and cultural bargain between authors and users [are] . . . at the heart of U.S. [copyright] law, as reflected in the Patent and Copyright Clause [of the Constitution], and a parade of Supreme Court precedents”). See generally J.H. Reichman & Jonathan A. Franklin, *Privately Legislated Intellectual Property Rights: Reconciling Freedom of Contract with Public Good Uses of Information*, 147 U. PA. L. REV. 875, 897 (1999) (discussing bargain between authors and legislators).

⁸⁸ The concept of “public domain” upon the expiration of the patent monopoly was first addressed in the *Singer* case. *Singer Mfg. Co. v. June Mfg. Co.*, 163 U.S. 169, 196-97 (1896).

⁸⁹ Indeed, the patentee has no right to collect royalties after the patent enters the public domain upon the expiration date. See generally *Brulotte v. Thys Co.*, 379 U.S. 29, 33 (1964) (“[T]he exaction of royalties for use of a machine after the patent has expired is an assertion of monopoly power in the post-expiration period when . . . the patent has entered the public domain.”).

⁹⁰ Under property-based theories of the firm, the proprietary rights in the intellectual property assets serve to coordinate and allocate intrafirm activities as well as interfirm

fruit of its ownership by selling the intellectual property monopoly for its current fair market value. By donating the intellectual property assets, the firm forfeits the potential income generated by and from the asset.⁹¹ Unless financial incentives exist that reflect the value of the intellectual property in the knowledge-based economy and thus serve as a significant motivating force for donating, the firm will continue to keep the monopoly until the time limit expires.⁹² Charitable organizations will only be able to obtain the benefits of the intellectual property through the onerous process of seeking licenses. As a consequence, the charity and its charitable missions will be hindered, since a license must be negotiated, permissions must be obtained, and limitations dictated by the licensor must be obeyed.

III. DISINCENTIVIZING INTELLECTUAL PROPERTY CHARITABLE GIVING

Since 1917, the government has provided a financial incentive for taxpayers to transfer money and property to charities by giving taxpayers an immediate tax deduction for their donations.⁹³ Although this economic incentive has been costly from a federal revenue standpoint,⁹⁴ promoting socially efficient donations represents sound policy. By encouraging private philanthropy, the charitable deduction

functions in the market. *See supra* notes 1-6 and accompanying text. That means the role of intellectual property is crucial to firms and they would not easily sever the ownership of the intellectual property. *See supra* notes 1-6 and accompanying text. Hence, regulations enacted to motivate and encourage firms to sever such ownership must contemplate the value intellectual property assets provide to the firm's functions. *See infra* Part IV.

⁹¹ Assignment of intellectual property rights by the firm means that it will have no title, interest, or right in the intangible intellectual property, unless the firm reserves some of its rights by having an assignment and license-back arrangement. *See* Sheila J. McCartney, *Licensing Alternatives to Limit Antitrust and Misuse Exposure*, 7 J. PROPRIETARY RTS. 10, 16 (1995) (discussing grant back practice).

⁹² *See infra* notes 139-60.

⁹³ I.R.C. § 170 (2006); *see* Revenue Act of 1935, Pub. L. No. 74-407, § 102(o), 49 Stat. 1014, 1016 (1935) (allowing charitable tax deduction for contributions by corporations); Revenue Act of 1917, Pub. L. No. 65-50, § 1201(2), 40 Stat. 300, 330 (1917) (allowing charitable tax deduction for contributions by individuals).

⁹⁴ The government lost an estimated \$145 billion in federal revenues from 2001 to 2005 as a result of the general charitable tax deduction provision. John D. Colombo, *The Marketing of Philanthropy and the Charitable Contribution Deduction: Integrating Theories for the Deduction and Tax Exemption*, 36 WAKE FOREST L. REV. 657, 658 (2001). The Joint Committee on Taxation estimates that total forgone tax revenues from the charitable deduction will be \$228.5 billion between 2005 and 2009. *See* Andrew Chamberlain & Mark Sussman, *Charities and Public Goods: The Case for Reforming the Federal Income Tax Deduction for Charitable Gifts*, SPECIAL REPORT (Tax Found., D.C.), Nov. 2005, at 2, available at <http://www.taxfoundation.org/publications/show/1191.html> (follow "Special Report No. 137" hyperlink).

minimizes the need for direct government subsidies to those organizations and prevents the government from allocating subsidies as it sees fit.⁹⁵ The charitable deduction creates a more diverse, interesting society by allowing taxpayers, many of whom are politically powerless, to choose and support particular organizations they deem important, thereby advancing their own interests.⁹⁶ By encouraging private donations, the charitable deduction provision helps foster a more ethical, moral society.⁹⁷

As originally enacted in 1954, the charitable deduction provision contained few limitations. To qualify for a charitable deduction, one had to make a money or property contribution to a qualified charity.⁹⁸ A "contribution" was interpreted as a "voluntary transfer of money or property made with no expectation of procuring a financial benefit commensurate with the amount of the transfer."⁹⁹ Services rendered to a charity were not considered property and thus did not qualify.¹⁰⁰ The Code provided several categories of qualified organizations, including "certain religious, charitable, scientific, literary, education"

⁹⁵ See Colombo, *supra* note 94, at 682 (explaining that timing of amendments to section 170 charitable deduction provision suggests that government was seeking "voluntary transfers from private sector . . . to fund needed social programs"); Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1397 (1988) (explaining subsidy theory); Peter J. Wiedenbeck, *Charitable Contributions: A Policy Perspective*, 50 MO. L. REV. 85, 115-16 (1985).

⁹⁶ See Joannie Chang et al., *Cross-Border Charitable Giving*, 31 U.S.F. L. REV. 563, 566 (1997) (theorizing that charitable contributions should not be taxed, as they "relieve governmental burdens"); Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L. REV. 1, 7 (2002) (explaining that one advantage of charitable deduction is that it gives donor-taxpayer direct control over donation, rather than forcing him to rely on Congress's choice of donee). *But see* Chamberlain & Sussman, *supra* note 94, at 1 (questioning which groups should qualify as "charitable organizations" for purposes of charitable tax deduction).

⁹⁷ See Chang et al., *supra* note 96, at 567 (citing James J. McGovern, *The Exemption Provisions of Subchapter F*, 29 TAX LAW. 523, 526 (1976); Edward H. Rabin, *Charitable Trusts and Charitable Deductions*, 41 N.Y.U. L. REV. 912, 920-25 (1966)).

⁹⁸ I.R.C. § 170 (1954).

⁹⁹ Rev. Rul. 83-104, 1983-2 C.B. 46. Accordingly, if a donor receives a quid pro quo for a transfer to a charity, there is no "contribution" and, hence, no charitable deduction allowed.

¹⁰⁰ Treas. Reg. § 1.170A-1(g) (2005). The apparent rationale for disallowing a deduction for the rendition of services is the administrative difficulty attendant upon determining the fair market value of personal service donations. *See, e.g.,* Holmes v. Comm'r, 57 T.C. 430, 435 n.3 (1971). As another justification, the value of such services rendered have not been taken into account for tax purposes (e.g., included in income). Treas. Reg. § 1.61-2(c) (2003). It should be noted that unreimbursed expenses incurred incidental to the rendition of such services may, however, constitute a deductible charitable contribution. Treas. Reg. § 1.170A-1(g) (2005).

organizations.¹⁰¹ If a property contribution was made to a qualified charitable donee, the amount of the contribution had to be determined. The charitable deduction provision, as originally enacted, provided that the amount of a taxpayer's charitable contribution was generally the fair market value of the property contributed.¹⁰²

By granting an immediate deduction equal to the fair market value of donated property, the charitable deduction provided an important economic incentive for patentees, authors, and artists to donate their patents and creative works to further charitable organizations' activities. As originally enacted, the charitable deduction regime served as a vital tool for the transfer of technology. Large corporations with research and development facilities often develop patents that later become inconsistent with their missions or core technologies, that are inappropriate for licensing to third parties, or that have no value (for defensive purposes) in competitive markets.¹⁰³ Thus, the charitable deduction provision in its original form encouraged research corporations to donate these "orphan patents" to universities with major scientific research programs in which the technologies could be properly exploited.¹⁰⁴ Research universities and other nonprofit donees were given the opportunity to develop potential new technologies, while businesses avoided high patent maintenance costs and received a charitable tax deduction equal to the fair market value of the donated patents. Dow Chemical, in a prime example of such a technology

¹⁰¹ I.R.C. § 170(c)(2). Other classifications include: federal, state, or local governmental entities; certain war veterans' organizations; domestic fraternal societies, orders, or associations operating under the lodge system; and nonprofit cemetery companies and corporations. I.R.C. § 170(c)(1), (c)(3)-(5).

¹⁰² See Rev. Rul. 58-260, 1958-1 C.B. 126 ("The fair market value of an undivided interest in a patent, which is contributed by the owner of the patent to an organization described in Section 170(c) . . . constitutes an allowable deduction as a charitable contribution, to the extent provided in Section 170, in the taxable year in which the property was contributed."); see also H.R. REP. NO. 91-413, at 53 (1969), as reprinted in 1969 U.S.C.C.A.N. 1645, 1699 (providing that taxpayer who contributed appreciated property to charity was allowed deduction for fair market value of property); Treas. Reg. § 1.170A-1(c) ("If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170(e)(1) . . .").

¹⁰³ See RON LAYTON & PETER BLOCK, INT'L INTELLECTUAL PROP. INST., IP DONATIONS: A POLICY REVIEW 5 (2004), available at http://www.iipi.org/reports/IP_Donations_Policy_Review.pdf.

¹⁰⁴ The primary patent donors are large corporations with major research and development departments, including Dow Chemical, Proctor and Gamble, Boeing, Caterpillar, and Eastman Chemical. *Id.* at 6. The primary patent donees are universities that have the remaining capacity to exploit patents. *Id.*

transfer, reportedly donated 10,000 patents to qualified charitable organizations over a five-year period.¹⁰⁵ As intellectual property has become increasingly valuable and important to the knowledge-based economy, the practice of donating intellectual property has flourished. Rather than continuing to encourage such donations, however, the government has scrutinized intellectual property donations and imposed statutory requirements limiting intellectual property donation deductions.

Most recently, Congress enacted tax legislation in 2004 that substantially altered the charitable deduction scheme for intellectual property.¹⁰⁶ In particular, the American Jobs Creation Act of 2004 (“2004 Act”) eliminates the fair market value standard and reduces the amount a donor can deduct. The new legislation applies to most forms of intellectual property, including patents, certain copyrights, trademarks, trade names, trade secrets and know-how, certain software, and similar intellectual property or applications or registrations of such property.¹⁰⁷

For intellectual property contributions made on or after June 3, 2004, the 2004 Act limits the charitable deduction amount to the lesser of the taxpayer’s tax basis in the donated intellectual property or the fair market value of the intellectual property at the time of the

¹⁰⁵ *Id.*

¹⁰⁶ On October 22, 2004, President Bush signed into law the American Jobs Creation Act of 2004 (“2004 Act”). American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418. The provision is effective for contributions made after June 3, 2004. H.R. REP. NO. 108-548 (2004). The 2004 Act is a hybrid of various versions that had been introduced earlier. For earlier versions, see S. 1637, 108th Cong. § 495(b) (2004) (limiting initial charitable tax deduction to donor’s tax basis in donated intellectual property, but allowing donor to receive from charity up to 50% of any royalties received by charity with respect to donated intellectual property); S. 2103, 108th Cong. § 1(b) (2004) (limiting initial charitable tax deduction to donor’s tax basis in donated intellectual property, but allowing fair market value deduction for “qualified contributions” to “qualified research organization” (e.g., technology gifts to charities that apply their expertise to scientific and commercial development)).

¹⁰⁷ H.R. REP. NO. 108-548 (2004). The new legislation does not apply to self-created copyrights, described in I.R.C. §§ 1221(a)(3), 1231(b)(1)(C) (2002). Section 1221(a)(3) excludes from the definition of “capital asset” any copyright held by the creator (taxpayer whose personal efforts created the property) or a taxpayer with a basis carried over from the creator. *Id.* § 1221(a)(3). The 2004 Act does not apply to self-created copyrights because the 1969 legislation previously eliminated the fair market value standard for self-created copyrights. *See infra* notes 125-27. Furthermore, the new legislation also does not apply to off-the-shelf computer software described in I.R.C. § 197(e)(3)(A)(i). Namely, the 2004 Act does not apply to computer software that: (1) is (or has been) readily available to the general public on similar terms, (2) is subject to a nonexclusive license, and (3) has not been substantially modified. *Id.*

contribution.¹⁰⁸ In most cases, wherein intellectual property appreciates in value, the lesser amount is the donor's tax basis. Often, the donor's tax basis in intellectual property is very small; in many cases, the donor's basis is zero because intellectual property development costs are often deducted when incurred.¹⁰⁹ As a result, the 2004 Act reduced or, in many cases, eliminated an immediate tax deduction for gifts of intellectual property.

Although the 2004 Act reduces or eliminates the initial charitable deduction, it permits a donor to take additional charitable deductions in later years based on a certain percentage of the donee's income attributable to the intellectual property.¹¹⁰ More specifically, a donor is allowed additional deductions for a limited number of years based on a specified percentage of the qualified donee income received or accrued by the charity from the donated property itself, rather than income stemming from the activity in which the donated property is used.¹¹¹ "Qualified donee income" is defined specifically as "any net income received by or accrued to the donee which is *properly allocable to the qualified intellectual property*."¹¹² For purposes of these future deductions, "qualified intellectual property" does not include intellectual property

¹⁰⁸ I.R.C. § 170(e)(1)(B) (2006) (as amended by 2004 Act). The new provision applies to charitable contributions of intellectual property made after June 3, 2004. H.R. REP. 108-548.

¹⁰⁹ For example, section 174 of the Internal Revenue Code ("Code") permits a taxpayer to immediately deduct research or experimental expenditures. I.R.C. § 174(a). Research or experimental expenditures are broadly defined as "expenditures incurred in connection with the taxpayer's trade or business which represent research and development costs in the *experimental or laboratory sense*" and generally include "all costs incident to the development or improvement of a product." Treas. Reg. § 1.174-2(a)(1) (1994) (emphasis added). Expenditures are incurred in the "experimental or laboratory" sense if they are incurred in "activities intended to discover information that would eliminate *uncertainty* concerning the development or improvement of a product." *Id.* The regulations under section 174 specifically provide that the costs of obtaining a patent are research and experimental expenditures. *Id.* Such costs include not only expenses incurred in creating patentable technology, but also attorneys' fees in the prosecution of patent applications. *Id.* (emphasis added).

¹¹⁰ I.R.C. § 170(m)(3).

¹¹¹ *Id.*

¹¹² *Id.* (emphasis added). Temporary regulations issued under section 170 do not elaborate on this definition of "qualified donee income." Section 170(m)(10)(D)(ii) suggests, however, that income arising from the charity's use of the donated property in its exempt activities (as opposed to royalties from licensing the property) does not give rise to qualified donee income. *Id.* § 170(m)(10)(D)(ii). As noted by one commentator: "[A]pplying the definition of qualified donee income is likely to prove difficult in many circumstances." Kevin Shortill, *New Rules for Charities Receiving Certain Contributions of Intellectual Property*, 2005 EOT 30-14, July 27, 2005, at 4.

donated to a private foundation.¹¹³

The amount of the additional deduction a taxpayer may take each year is determined using a sliding-scale percentage of qualified donee income received or accrued by the charity that is allocable to the property.¹¹⁴ The percentage decreases each year, for a period of twelve years.¹¹⁵ In the first and second years after the contribution, a taxpayer can deduct 100% of the qualified donee income.¹¹⁶ In year three, a taxpayer can deduct 90% of the qualified donee income.¹¹⁷ Moreover, in year ten, the taxpayer can deduct only 20% of the qualified donee income.¹¹⁸

In order to qualify for an additional deduction in a future year, the aggregate of the amounts calculated using the sliding-scale must exceed the amount of the initial deduction claimed in the year of the contribution.¹¹⁹ Additional charitable deductions are not allowed with respect to any revenues or income received or accrued by the donee after the expiration of the legal life of the intellectual property.¹²⁰ Additional

¹¹³ I.R.C. § 170(m)(9) (stating that additional deductions are not allowed for donations to private foundations, other than private operating foundations or certain other foundations described in I.R.C. § 170(b)(1)(E)).

¹¹⁴ *Id.* § 170(m)(1), (7).

¹¹⁵ The amended statute provides that the additional deductions are limited to 12 years after the contribution. *Id.* § 170(m)(10)(C)-(D). This 12-year limitation seems to be in conflict with another rule providing that additional deductions are limited to the legal life of the intellectual property, or ten years after the date of the contribution, whichever occurs first. *Id.* § 170(m) (5)-(6).

¹¹⁶ *Id.* § 170(m)(7).

¹¹⁷ *Id.*

¹¹⁸ *Id.* The following chart shows the actual sliding scale:

Taxable Year of Donor Ending on or After Applicable Date of Contribution	Percentage
1st.....	100
2nd.....	100
3rd.....	90
4th.....	80
5th.....	70
6th.....	60
7th.....	50
8th.....	40
9th.....	30
10th.....	20
11th.....	10
12th.....	10

Id.

¹¹⁹ *Id.* § 170(m)(2).

¹²⁰ *Id.* § 170(m)(6).

charitable deductions are not available when intellectual property is contributed to a private foundation (other than a private operating foundation or certain other Code section 170(b)(1)(E) private foundations).¹²¹

The 2004 Act was intended to curb improper charitable tax deductions resulting from overvaluations of donated patents and other forms of intellectual property.¹²² Before enactment of the 2004 Act, the amount of a charitable deduction in connection with the donation of many forms of intellectual property, such as patents, was equal to the fair market value of the intellectual property at the time of the contribution, subject to certain exceptions.¹²³ The government defined “fair market value” as “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.”¹²⁴ The government, however, never fully articulated or formalized a standard or approach for determining the fair market value of donated intellectual property. As a consequence, valuation conflicts between donors and the government increasingly occurred as intellectual property grew in value and the practice of intellectual property donations also grew.

As valuation abuses became more common, the government began to scrutinize intellectual property donations and impose statutory requirements limiting intellectual property donation deductions. In its first major attack on intellectual property donations, Congress took significant measures to curtail the availability of immediate tax benefits for contributions of copyrights by creators. Internal Revenue Code section 170(e), added by the Tax Reform Act of 1969, reduced the amount of the charitable deduction from fair market value to the creator’s basis in the copyright (out-of-pocket expenses that had not previously been

¹²¹ *Id.* §§ 170(e)(1)(B)(iii), 170(m).

¹²² See Jobs and Growth Tax Relief Reconciliation Act of 2003, S. 6457, 108th Cong. (2003) (noting “widespread abuse involving donations of patents and similar property”); S. REP. NO. 108-192, at 218 (2003) (noting concern that intellectual property donors “are taking advantage of the inherent difficulties in valuing such property and are preparing or obtaining erroneous valuations”); see also *I.R.S. Commissioner Testimony: Charitable Giving Problems and Best Practices*, IRS NEWS RELEASE, June 22, 2004, at 14-15, available at <http://www.irs.gov/pub/irs-news/ir-04-081.pdf> (“A key issue in intellectual property donations, as in all other property donations, is whether the property has been appropriately valued. In the case of patent and other intellectual property donations in particular, we have concerns about over valuations, whether consideration has been received in return, and whether only a partial interest of property is being transferred.”).

¹²³ See *infra* note 125 and accompanying text.

¹²⁴ Treas. Reg. § 1.170A-1(c)(2) (2005).

deducted).¹²⁵ In many cases, copyright creators have a zero basis in their copyrights, as “qualified creative expenses” are immediately deductible and do not have to be capitalized.¹²⁶ As a result, the 1969 amendment

¹²⁵ Tax Reform Act of 1969, Pub. L. No. 91-172, § 201(a), 83 Stat. 487, 555. The statutory mechanics of the 1969 amendment are worth exploring. Section 170(e) applies to contributions of certain appreciated property. *Id.* Whether a reduction in the amount of the contribution of appreciated property (from fair market value to cost basis) occurs depends on the character of gain that would be recognized on a hypothetical sale of the property by the donor. *Id.* If the gain on a hypothetical sale by the donor would be characterized as *long-term capital gain*, the amount of the deduction is not reduced (e.g., the amount of the donor’s contribution is equal to the property’s fair market value). *Id.* If, however, the gain on a hypothetical sale would be *ordinary income* or *short-term capital gain*, the amount of the deduction is reduced by the amount of that lurking ordinary income or short-term capital gain. I.R.C. § 170(e)(1)(A).

The 1969 amendment affected the deduction of copyright donations by copyright creators, because artistic and other copyrighted works produced by donors are excluded from the definition of “capital asset” and, if sold, produce ordinary income. *Id.* § 1231(a)(3), (b)(1)(C). The definitions of “capital asset” and “section 1231 property” both exclude a “copyright, a literary, musical or artistic composition, a letter or memorandum, or similar property” in the hands of the person who created them (or in the possession of a person who received the property as a gift from the person who created it). *Id.* Accordingly, capital gains treatment is not available to the creator of a copyright, literary, musical, or artistic composition or similar property, nor is it available to any person who acquires such property by gift. *Id.* The regulations provide:

[P]roperty is created in whole or in part by the personal efforts of a taxpayer if such taxpayer performs literary, theatrical, musical, artistic, or other creative or productive work which affirmatively contributes to the creation of the property, or if such taxpayer directs and guides others in the performance of such work.

Treas. Reg. § 1.1221-1(c)(3).

Under this system, the amount of the charitable deduction for such copyright creators is the copyright’s fair market value *minus* the amount of such ordinary income that would be reported by the donor on the sale of the copyright. *See* Tax Reform Act of 1969, Pub. L. No. 91-172, §201(a)(1)(B), 83 Stat. 487, 549 (codified as amended at I.R.C. §170(e)(1)(A)). The amount of ordinary income from a hypothetical sale is equal to the property’s fair market value *minus* the cost basis in the work (e.g., out-of-pocket expenses in creating the work to the extent they were not deducted when incurred). *See id.* at 555. Most copyright creators have a zero basis in their creations, as qualified creative expenses are immediately deductible and do not have to be capitalized. *See infra* note 126. Hence, the amount of the charitable deduction for a copyright creator is often reduced by the full fair market value, producing no deduction for the creator.

¹²⁶ For example, the creation costs incurred by certain authors and artists in producing manuscripts and works of art are deductible. Code section 263A(h) provides an important, but narrow, exemption from the capitalization requirements of section 263A in the case of certain writers, photographers, and artists. I.R.C. § 263A(h). Added to the Code in 1988, section 263A(h) provides that “qualified creative expenses” are not required to be capitalized. *Id.*; *see* H.R. REP. NO. 100-795, at 531 (1988); H.R. REP. NO. 100-1104, at 145 (1988), *as reprinted in* 1988 U.S.C.C.A.N. 5048, 5205 (noting purpose of exemption was to relieve writers, photographers, and artists from burden of uniform capitalization rules, especially when activities may not generate income for years). A “qualified creative expense” is any expense paid or incurred by an individual in the trade or business of being

precluded copyright donors from enjoying any immediate financial benefit from their charitable donations.¹²⁷

The 1969 amendment, in contrast, had little impact on patent donations.¹²⁸ A patent donor who transferred all substantial rights in the patent would generally get a deduction equal to the full fair market value of the patent.¹²⁹ By retaining a fair market value deduction for

a “writer,” “photographer,” or “artist,” which, except for the uniform capitalization rules of section 263A, would be otherwise deductible for the taxable year. I.R.C. § 263A(h)(2). If the exemption provision of section 263A(h) applies, qualified creative expenses of producing copyrightable works are not subject to the uniform capitalization rules of section 263A and may be deductible if the elements of section 162 are satisfied. If deducted in full, then the basis in the work of art would be zero.

¹²⁷ The 1969 Act also limited the amount of a taxpayer’s deduction to his or her tax basis if the property is tangible, personal property and the charity’s use of the property is unrelated to its charitable purpose or function or if the property is contributed to or for the use of a private foundation. I.R.C. § 170(e)(B)(i)-(ii). There are exceptions, however. *See, e.g., id.* § 170(e)(3)-(4), (6).

¹²⁸ As explained below, whether a taxpayer donating a patent to a charity was eligible for a charitable deduction equal to the patent’s fair market value (or whether the contribution had to be reduced by the amount of built-in-gain in the patent) depended on a number of factors, including whether the donor was an individual and whether the donor had transferred “all substantial rights” in the patent. *See infra* note 129.

¹²⁹ This is because if the individual donor had sold the patent, the gain would be treated as long-term capital gain under the special characterization provision applicable to patents. I.R.C. § 1235(a). Section 1235 provides long-term capital gain treatment for transfers of all substantial rights to patents by individuals and applies only if the transferor is a statutorily defined “holder” of the patent. *Id.* The “holder” of a patent is defined as: (1) any individual whose personal efforts created the patent property; or (2) any other individual — other than the employer or relative of the inventor — who acquired his interest in the patent property from the original inventor in exchange for money, or money’s worth, prior to the actual reduction to practice of the invention covered by the patent (“financial backer”). *Id.* § 1235(b).

Section 1235 only applies to a transfer “of all the substantial rights” to a patent or an “undivided interest” therein. *Id.* § 1235(a). The term “all substantial rights” refers to all rights (whether or not then held by the grantor) which are of value at the time the rights to the patent (or an undivided interest in it) are transferred. Treas. Reg. § 1.1235-2(b)(1). Therefore, to qualify for the benefits under section 1235, a transferor must typically transfer the entire bundle of rights under a patent (e.g., convey the exclusive right to make, use, and sell the patent in all geographical regions and in all fields of use). Whether or not all substantial rights to a patent are considered to have been transferred in a transaction depends upon the circumstances surrounding the entire transaction and not the particular terminology used in the transfer instrument. *Id.*

Section 1235 applies only to patents and not to other forms of intellectual property such as copyrights, trademarks, or know-how. I.R.C. § 1235(a). Although the Code does not define a “patent” for purposes of section 1235, the regulations provide that the term “patent” means a patent granted under the provisions of Title 35 of the U.S. Code, as well as any foreign patent granting rights generally similar to those under a U.S. patent. Treas. Reg. § 1.1235-2(a). The regulations under section 1235 also provide that it is not necessary that the patent or patent application for the invention be in existence if the requirements of

patent donations, but not for copyright donations, patent donations continued to flourish in the aftermath of the 1969 amendment.¹³⁰ In the late 1990s, patents became increasingly valuable assets and important to the knowledge-based economy.¹³¹ The fair market value standard appealed to the new breed of donors who approached philanthropy with venture capitalist principles, seeking maximum financial return from their giving.¹³²

The fair market value standard, however, also spawned valuation abuses by patent donors.¹³³ In 2003, the Internal Revenue Service (“IRS”) announced its intent to scrutinize questionable deductions of intellectual property contributions and to enforce requirements and limitations on

section 1235 are otherwise met. *Id.* Thus, section 1235 can apply to patentable technology for which a formal patent application has not yet been made. *See id.*

Because section 1235 would provide long-term capital gain treatment on the sale of a donated patent, the individual donor is entitled to a full fair market value charitable deduction. *See id.* This is so regardless of whether the donor is a professional inventor or dealer, no matter how long the donor held the patent, and whether or not a patent or patent application exists at the time of gift. *See id.* However, if a patent donor is not an individual (e.g., is a corporation, partnership, or trust), the amount of the charitable contribution deduction depends on the character of gain that would result on a hypothetical sale of the donated patent because section 1235 does not apply to corporations, partnerships, and trusts. *Id.* The Code provides general characterization provisions to determine whether the built-in gain is ordinary income, short-term capital gain, or long-term capital gain. I.R.C. §§ 1221-1222, 1231. For the hypothetical sale of a patent outside the scope of section 1235 to qualify for capital gains treatment, the patent must qualify as a capital asset under section 1221 or as a quasi-capital asset under section 1231 and must have been held for more than one year. *See id.*

¹³⁰ For patent donation activity prior to the 2004 Act, see *supra* notes 103-05 and accompanying text. Whether a donor is the creator or a collector should be irrelevant in determining the charitable deduction amount. There is no good reason why an art collector/investor is entitled to a full fair market value deduction, while an artist is entitled to deduct only his basis in the property (the cost of the brushes, canvases, pencils, or paper to the extent not previously deducted). As one notable artist stated: “If anyone else buys my painting for \$2, he can then give it to a museum and deduct \$10,000 from his taxes, if that is the market value of the piece. If I myself donate it, I get \$2 tax credit, because that is what the paint and canvas cost.” Burgess J.W. Raby & William L. Raby, *Artists, Collectors, and Private Foundation Status*, 103 TAX NOTES 195, 195 n.1 (2004) (quoting artist Ettore De Grazia, who gained notoriety after he burned over 100 of his oil paintings at Angel Spring in Superstition Mountains east of Phoenix over frustration with tax treatment of successful artists).

¹³¹ *See supra* notes 21-24, 37-42 and accompanying text (discussing increasing importance and value of patents).

¹³² *See supra* notes 25-28 and accompanying text.

¹³³ *See, e.g.,* Smith v. Comm’r, 41 T.C.M. (CCH) 1427 (1981) (concluding that value of donated patent was \$3500, although patent donor claimed charitable deduction in excess of \$200,000). For government concerns about overvaluations, see *supra* note 125 and accompanying text.

patent donation deductions.¹³⁴ The plan, released in Notice 2004-7, included a multipronged attack on donors, promoters, and appraisers. Notice 2004-7 stated that “some taxpayers that transfer patents or other intellectual property to charitable organizations are claiming charitable deductions in excess of the amounts to which they are entitled” and warned that “the Service intends to disallow improper charitable deductions claimed by taxpayers in connection with the transfer of patents or other intellectual property to charitable organizations.”¹³⁵ Although the Notice announced the government’s enforcement campaign against and planned attack on donors, promoters, and appraisers, it provided little guidance on the proper method of computing a patent’s fair market value. According to the Notice, “the fair market value of a patent must be determined after taking into account” factors including: “(1) whether the patented technology has been made obsolete by other technology; (2) any restrictions on the donee’s use of, or ability to transfer, the patented technology; and (3) the length of time remaining before the patent’s expiration.”¹³⁶

Unfortunately, the IRS’s enforcement campaign regarding intellectual property donations, announced in 2003, never got off the ground. It was rendered moot when, less than a year later in the 2004 Act, Congress hastily eliminated the fair market value standard for contributions of

¹³⁴ The Commissioner of the IRS stated in a news release:

[I]t is important for taxpayers considering donations of patents or other intellectual property to focus on the limitations of the deductions We’re seeing an increasing number of deductions that don’t pass the smell test. Donations that are overly inflated or made with strings attached are going to receive increased scrutiny.

Treasury Issue Notice Regarding Improper Deductions for Charitable Contributions of Patents and other Intellectual Property, IRS NEWS RELEASE, Dec. 22, 2003, at 1, available at <http://www.irs.gov/newsroom/article/0,,id=118864,00.html>.

¹³⁵ I.R.S. Notice 2004-7, 2004-3 I.R.B. 310. Notice 2004-7 sets forth the following four situations arising out of intellectual property transfers to charitable organizations that will be closely scrutinized: (1) the transfer of a nondeductible partial interest in intellectual property, (2) the donor’s expectation or receipt of a benefit in exchange for the contribution, (3) inadequate substantiation of the contribution, and (4) overvaluation of the intellectual property being transferred. *Id.* In addition to its warning to taxpayers, the Notice also sends a warning to promoters and appraisers that certain behavior will no longer be tolerated. *Id.* It states that the IRS will review promotions and appraisals of intellectual property when it scrutinizes suspect donations. *Id.* If the IRS identifies a situation in which a taxpayer abused his right to a charitable deduction, the taxpayer, promoter, and appraiser may all be subject to penalties. *Id.*; see I.R.C. § 6662 (2006) (penalty provision applicable to taxpayers); *id.* §§ 6694, 6700, 6701 (penalty provisions applicable to appraisers and promoters).

¹³⁶ I.R.S. Notice 2004-7, 2004-3 I.R.B. 310.

most forms of intellectual property.¹³⁷ By eliminating the fair market value standard, the 2004 Act reduces the number of negligent and intentional overvaluations of intellectual property donations and, correspondingly, reduces the administrative costs and burdens associated with overvaluations of donated intellectual property. In addition, the 2004 Act is expected to generate hundreds of millions of dollars in additional federal revenue each year.¹³⁸ However, the greater policy issue, one that has been overlooked by Congress, is whether it adequately incentivizes socially desirable intellectual property donations to further charitable goals.

A. *Advantages of System Based on Immediate Economic Incentives*

A fair market value measuring rod for charitable deductions allows donors to enjoy an immediate tax benefit equal to the fair market value of donated intellectual property, even though such donors are not required to report in their income the difference between the fair market value of the donated intellectual property and the original out-of-pocket costs or unrecovered basis in them.¹³⁹ By eliminating any immediate financial benefits for intellectual property contributions, the 2004 Act will have a dramatic impact on in-kind donations of intellectual property not targeted by the 1969 Act (e.g., donations of self-created copyrights).¹⁴⁰

¹³⁷ See *supra* notes 106-21 and accompanying text for a summary of the 2004 Act.

¹³⁸ An earlier version of the 2004 Act, which limited the initial deduction to the donor's tax basis, was expected to raise \$385 million per year. See Brenda Sandburg, *IRS Tweaks Rules for Patent Donations* (Jan. 1, 2004), available at http://www.ljnonline.com/pub/ljn_patent/4_9/news/141878-1.html (describing impact of S. 1637). The government savings are a bit misleading, however. If private charitable giving declines as a result of the 2004 Act, the government will need to provide increased direct subsidies to charities in response.

¹³⁹ Under the prior law, it seems that owners could donate their intellectual property "inventories" and enjoy incredible tax advantages by attempting to wipe out a substantial amount of income by donating a sufficiently large portion of their intellectual property holdings. Currently, however, the Code imposes various ceilings on the total amount that a donor may deduct in any given year. I.R.C. § 170(b). For example, donations made by individuals directly to public charities are deductible to the extent that such contributions do not exceed 50% of the taxpayer's adjusted gross income. *Id.* § 170(b)(1)(A), (b)(1)(F). Donations made in trust for public charities or for the use of private charities are generally subject to a general limitation of 30% of the taxpayer's adjusted gross income for the year. *Id.* § 170(b)(1)(B)(i). For ceilings on gifts of appreciated capital gain property, see *id.* § 170(b)(1)(C)(i), (b)(1)(D)(i). Contributions in excess of any of these ceilings are permitted to be carried over to the five succeeding years. *Id.* § 170(b)(1)(B), (b)(1)(C), (b)(1)(D)(ii), (d)(1).

¹⁴⁰ The 2004 Act does not affect donations of copyrights by their creators, as those donations were targeting by the 1969 legislation. See *supra* note 125. As noted above, the 1969 Act reduced the amount of a charitable deduction for copyright donors from fair market value to tax basis in the donated copyright. See *supra* notes 125-27 and

Indeed, it has been predicted that the charitable deduction system will no longer serve as a vital technology transfer tool. Potential patent donors, for instance, will undoubtedly opt to abandon their inventions under the new law rather than contribute them to charities, as was common under the old law. As one commentator predicted: "80-90% of the brainpower of the U.S. will be left on corporate shelves."¹⁴¹ According to the Intellectual Property Owners Association, eliminating a fair market value deduction will "effectively end the opportunity for academic and scientific professionals at nonprofit research institutions and universities to develop valuable technologies acquired through patent donations from U.S. companies for which the technology is no longer a part of their strategic business plans."¹⁴²

The predicted decline in in-kind charitable giving of intellectual property, particularly patents, will most likely prove accurate when one considers the dramatic impact that the Tax Reform Act of 1969 had on copyright donations by copyright creators. As discussed above, the 1969 Act eliminated the fair market value approach for donations of copyrights by copyright creators.¹⁴³ After the amendment, far fewer gifts were made by writers, artists, and photographers to museums, libraries, universities, and other charitable organizations.¹⁴⁴ Libraries and museums, in particular, reported significant reductions in and, in some cases, complete losses of gifts from noted authors, composers, and artists. The Museum of Modern Art in New York, for example, reportedly received 321 gifts from artists in the three years prior to the 1969 amendment, but only twenty-eight gifts from artists in the three years following the amendment — a 90% decrease.¹⁴⁵ Another account

accompanying text. The 2004 Act achieves horizontal equity by treating copyright donors and patent donors the same. This Article argues, however, that the 2004 Act went in the wrong direction in achieving horizontal equity.

¹⁴¹ See LAYTON & BLOCH, *supra* note 103, at 6.

¹⁴² CCH, AMERICAN JOBS CREATION ACT OF 2004: LAW, EXPLANATION AND ANALYSIS 432 (2004) (quoting association's comments regarding earlier, similar version of bill).

¹⁴³ See *supra* notes 125-27 and accompanying text.

¹⁴⁴ For the effect of the 1969 Act, see Douglas J. Bell, *Changing I.R.C. § 170(E)(1)(A): For Art's Sake*, 37 CASE W. RES. L. REV. 536, 547 (1987); William A. Drennan, *Charitable Donations of Intellectual Property: The Case for Retaining the Fair Market Value Deduction*, 2004 UTAH L. REV. 1045, 1127 (2004) (providing chart showing decline in copyright donations by copyright creators); Pamela J. Lajeunesse, *Tax Incentives for Support of the Arts: In Defense of the Charitable Deduction*, 85 DICK. L. REV. 663, 668 n.27 (1981); Larry D. McBennett et al., *Art Update: Tax Deductions for Self-Created Works of Art*, 30 FED. B. NEWS & J. 342, 342-43 (1983).

¹⁴⁵ S. 1889, 108th Cong. (2003) (imparting Senator Patrick Leahy's statements introducing Artist-Museum Partnership Act of 2003); see also ACF Newsource, *Artists' Gift*, www.acfnewsource.org/art/artists_gift.html (last visited Apr. 10, 2006).

shows that the Museum of Modern Art received forty-seven gifts from artists in the year 1969, but only one gift in the two years following the 1969 amendment.¹⁴⁶ The Library of Congress, which annually received fifteen to twenty large gifts of manuscripts from authors prior to 1969, received only one gift in the four years after the 1969 amendment.¹⁴⁷ More strikingly, whereas the Library of Congress annually received a total of 230 self-created musical manuscripts and 179,000 self-created literary manuscripts before 1969, it received none in the two years following the 1969 amendment.¹⁴⁸ Many of the musicians and artists who planned to date their papers and artworks to the Library of Congress instead sold them after the 1969 amendment.¹⁴⁹

Under the 2004 Act, for a charity to obtain ownership of intellectual property and for a donor to receive any immediate tax benefit, the intellectual property owner would have to sell the intellectual property to a third party, pay a tax on resulting gains, and then contribute the after-tax cash to the charitable organization. The charity, in turn, would have to use the donated cash to attempt to purchase the intellectual property from the third party purchaser. Most intellectual property owners and charities would not engage in such maneuvering; the related transactional costs and the risk that the charity may not be able to obtain the intellectual property upon acceptable terms and conditions would be too high in most cases. Moreover, as noted by one commentator, corporate inventors would not have an incentive to sell their patents and contribute after-tax cash because corporations pay federal income tax at the same rate on long-term capital gains and ordinary income.¹⁵⁰ Companies only have an incentive to make an in-kind donation of a patent rather than sell the patent and donate the after-tax proceeds.¹⁵¹

Although the new legislation has eliminated an immediate deduction for charitable intellectual property contributions, it does permit donors to take future deductions if the donated intellectual property generates

¹⁴⁶ See Lajeunesse, *supra* note 144, at 668 n.27.

¹⁴⁷ See S. 1889; see also *The "Community Solutions Act of 2001": Joint Hearing Before the Subcomm. on Human Res. & Subcomm. on Select Revenue Measures, 107th Cong. 190-91 (2001)* (statement for the record of Assoc. of Art Museum Dirs.) [hereinafter Assoc. of Art Museum Dirs. Statement]; ACF Newsource, *supra* note 145.

¹⁴⁸ See Lajeunesse, *supra* note 144, at 668 n.27.

¹⁴⁹ See McBennett et al., *supra* note 144, at 342-43 (discussing music composer Igor Stravinsky who sold papers to private foundation in Switzerland instead of donating them to Music Division of Library of Congress); see also S. 1889; ACF Newsource, *supra* note 145; Assoc. of Art Museum Dirs. Statement, *supra* note 147.

¹⁵⁰ See Drennan, *supra* note 144, at 1082-83.

¹⁵¹ *Id.*

income to the charitable donee.¹⁵² The government presumably believes that a charitable contribution system solely providing donors with uncertain, declining, future economic incentives will adequately encourage intellectual property donations. But this premise is flawed. Even if a charitable donee licenses donated intellectual property, the potential future deduction will not be substantial. First, it may take a charity several years before it receives any financial return on donated intellectual property. As the intellectual property begins to generate increasing royalty revenues, however, the amount of the charitable deduction under the 2004 Act declines by use of a sliding-scale percentage (the percentage decreases each year for a limited time period). Indeed, in the tenth post-contribution year, the donor may deduct only 20% of the income generated by the intellectual property. As noted by one commentator: "That's really not any great incentive for a corporation to spend its time digging through its patents."¹⁵³

The 2004 Act is inconsistent with the government's historical approach of encouraging economic and socially desirable behavior through immediate tax benefits. As the government is well aware, what incentivizes behavior is a system of immediate economic benefits rather than a system of speculative future benefits under an accrual approach. Indeed, tax law is replete with instances in which taxpayers are given immediate tax breaks to encourage desirable behavior.¹⁵⁴ For example, to encourage innovation, Code section 174 permits a taxpayer to immediately deduct research or experimental expenditures when they are incurred, rather than deduct such costs over the useful life or legally protected life of the resulting patent.¹⁵⁵ Providing an immediate tax deduction for desirable research and development is clearly inconsistent with the government's goal of matching income and the expenses that produced the income.¹⁵⁶ Nevertheless, immediate economic incentives

¹⁵² See *supra* notes 110-21 and accompanying text.

¹⁵³ See Fred Stokeld, *EO Provisions in Bush Budget Aimed at Stopping Abuses*, 102 TAX NOTES 699, 700 (2004).

¹⁵⁴ See, e.g., I.R.C. § 198 (2005) (providing special expenditure of environmental remediation costs); I.R.C. § 174 (2004) (providing immediate deduction for research and experimental expenditures); *id.* § 179 (providing election to expense certain depreciable business assets); *id.* § 179A (providing deduction for clean-fuel vehicles and certain refueling property); *id.* § 179B (providing deduction for capital costs incurred in complying with Environmental Protection Agency sulfur regulations); *id.* § 181 (providing special treatment for certain qualified film and television production expenses); *id.* § 190 (providing special treatment for expenditures to remove architectural and transportation barriers to handicapped and elderly).

¹⁵⁵ See *supra* note 8.

¹⁵⁶ The government has enacted various capitalization and cost recovery rules to

are seen as necessary means to achieve a competing, higher policy end: to encourage the development of new technologies to drive economic growth.

To further illustrate, many costs incurred in the development of computer software do not satisfy the definition of research and experimental expenditures under section 174 and would seemingly be nondeductible.¹⁵⁷ Nevertheless, to encourage computer software development, the government permits software developers to immediately deduct the costs of developing computer software, whether the software is patented or copyrighted.¹⁵⁸ Interestingly, the government has chosen to adopt a broad definition of “computer software” to

achieve a fair allocation of the costs of creating or acquiring an asset to the period in which the taxpayer realizes income from the asset. *See, e.g.*, I.R.C. §§ 263, 263A (2006) (requiring capitalization of certain creation and acquisition costs); *id.* §§ 167, 168, 197 (permitting depreciation or amortization deductions for capitalized costs); *see also* *Comm’r v. Idaho Power Co.*, 418 U.S. 1, 11-12 (1974) (explaining purpose of cost recovery system). In addition, the government has provided several exceptions for certain creation and acquisition expenditures. *See, e.g.*, I.R.C. § 174.

¹⁵⁷ Many costs incurred in computer software development are not experimental or investigative in a laboratory sense and fail to satisfy the uncertainty test under section 174. For example, the costs of developing routine accounting, management information, billing, or payroll systems involve no uncertainty with respect to the software design or capability. Hence, these costs would not qualify as section 174 research and experimental expenditures. *See* I.R.C. § 174. Likewise, costs to produce documentation for maintaining and describing computer software would not qualify.

¹⁵⁸ Rev. Proc. 2000-50, 2000-52 I.R.B. 601. This revenue procedure updated the IRS’s prior pronouncement on the deductibility of computer software costs, Rev. Proc. 69-21, 1969-2 C.B. 303, by integrating changes resulting from the 1993 enactment of sections 167(f) and 197 of the Internal Revenue Code. *Id.* For example, the definition of “computer software” under Revenue Procedure 2000-50 follows the definition given in section 197. I.R.C. § 197. Before the IRS superseded Revenue Procedure 69-21 with Revenue Procedure 2000-50, it twice issued Proposed Regulations governing computer software development costs. In 1983, the IRS issued Proposed Regulations that would have permitted computer software development costs to be deductible under section 174 only if they were paid or incurred in developing “new or significantly improved computer software.” Prop. Treas. Reg. § 1.174-2(a)(xi)(3), 48 Fed. Reg. 2799 (Jan. 21, 1983). This determination would be made with respect to the computer program itself rather than the end use of the program. *Id.* These Proposed Regulations were withdrawn the same year. IRS Gen. Couns. Mem. 38,996 (June 8, 1983); I.R.S. News Release IR-83-71 (Apr. 19, 1983). Furthermore, in 1989, the IRS issued revised Proposed Regulations under section 174, which softened the 1983 Proposed Regulations’s harsh “new or significantly improved” standard, focusing instead on whether the product met its basic design specifications related to function and performance level. Prop. Treas. Reg. § 1.174-2(a)(6), 54 Fed. Reg. 45154, 45165 (Oct. 30, 1989). In 1993, these regulations were withdrawn, and the IRS announced that it would continue to apply its position in Revenue Procedure 69-21. Prop. Treas. Reg. § 174(e), 58 Fed. Reg. 15819-15820 (Mar. 24, 1993). Revenue Procedure 69-21 was thus the governing standard until the IRS pronounced Revenue Procedure 2000-50.

encourage software development activities.¹⁵⁹

With respect to these examples (patent and software development), the government recognizes that financial incentives, provided to taxpayers with certainty and immediacy, are more effective than financial incentives provided on an uncertain, delayed basis. Therefore, to achieve optimal inventive and development activities, the government has adopted a system of immediate economic incentives. Ironically, with the 2004 Act, the government has taken an inconsistent approach in achieving the dissemination of innovation for social good.

Although the 2004 Act eliminated any immediate economic incentive for inventors to donate their patents by providing donors with only uncertain future benefits in return for their donations, it has kept in place an immediate economic incentive for outright cash gifts and most real estate gifts. Such retention is perhaps a result of the failure to acknowledge the significant shift in the level of importance from tangible, physical property to intangible property. It is a general reflection of the “legal and business uncertainty” associated with intangibles, as noted by Alan Greenspan, former Chairman of the Federal Reserve Board. According to Greenspan:

¹⁵⁹ This definition provides:

For the purpose of this revenue procedure, ‘computer software’ is any program or routine (that is, any sequence of machine-readable code) that is designed to cause a computer to perform a desired function or set of functions, and the documentation required to describe and maintain that program or routine. It includes all forms and media in which the software is contained, whether written, magnetic, or otherwise. Computer programs of all classes, for example, operating systems, executive systems, monitors, compilers and translators, assembly routines, and utility programs as well as application programs, are included. Computer software also includes any incidental and ancillary rights that are necessary to effect the acquisition of the title to, the ownership of, or the right to use the computer software, and that are used only in connection with that specific computer software. Computer software does not include any data or information base described in § 1.197-2(b)(4) of the Income Tax Regulations (for example, data files, customer lists, or client files) unless the data base or item is in the public domain, and is incidental to a computer program. Nor does it include any cost of procedures that are external to the computer’s operation.

Rev. Proc. 2000-50, 2000-52 I.R.B. 601.

Because the government defined “computer software” so broadly, Revenue Procedure 2000-50 applies not only to software development costs that would otherwise constitute “research and experimental expenditures” under section 174, but, more importantly, also to software development costs that do *not* satisfy the definition of “research and experimental expenditures” under section 174. *See id.* Thus, Revenue Procedure 2000-50 may permit the immediate deduction of computer software development costs, even where section 174 does not apply.

[T]his uncertainty derives from the fact that intellectual property is importantly different from physical property. Because they have a material existence, physical assets are more capable of being defended by police, the militia, or private mercenaries. By contrast, intellectual property can be stolen by an act as simple as broadcasting an idea without the permission of the originator. Moreover, one individual's use of an idea does not make that idea unavailable to others for their own simultaneous use.¹⁶⁰

As intangible property has gained importance in the modern economy and society, new legislation must respond accordingly.

B. Disadvantages of a System Based Solely on Future Economic Incentives

The current charitable deduction regime for intellectual property, based solely on speculative, future economic incentives, raises several policy concerns. Although the new law has attempted to achieve horizontal equity by treating patent and copyright donors alike,¹⁶¹ it also favors income-generating intellectual property over property that does not produce income. The new law essentially separates intellectual property donations into two groups: money-making and non-money-making.¹⁶² The inherent implication from such a dichotomy is that the intellectual property that is used for fundamental or purely scientific research is not as valuable as the intellectual property that is used in

¹⁶⁰ Greenspan, *supra* note 37.

¹⁶¹ Horizontal equity is the principle that persons in like circumstances should be taxed equally. See, e.g., JOSEPH M. DODGE, THE LOGIC OF TAX: FEDERAL INCOME TAX THEORY AND POLICY 55, 88 (1989) (“[W]e can postulate a kind of bedrock notion of tax fairness, called horizontal equity, which yields the following maxim: like-situated taxpayers should be taxed the same. It’s hard to disagree with that.”); LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP: TAXES AND JUSTICE 13 (2002) (“[H]orizontal equity is what fairness demands in the treatment of people at same levels.”).

¹⁶² For an example of this dualism in the copyright context, consider the copyright in J.K. Rowling’s *Harry Potter & the Half-Blood Prince* and the copyrights in Alan Dershowitz’s papers. The new law values the copyright in the former over the latter due to the former’s direct income-generating capability. The new law ignores the nonmonetary value in Alan Dershowitz’s papers, which were recently donated to Brooklyn College. See Brooklyn College, *Alan Dershowitz Donates His Papers to Brooklyn College*, <http://www.brooklyn.cuny.edu/bc/spotlite/news/090503.htm> (last visited Apr. 5, 2006) (reporting Alan Dershowitz’s donation to Brooklyn College). Researchers and students can use and rely on such papers for their investigation, research, and studies. Such activities resulting from the papers donated to Brooklyn College have tremendous positive impact on communities and societies. See *id.* (“The Dershowitz papers are a tremendous addition to the Brooklyn College Library and will attract researchers and scholars for years to come.”).

applied research.¹⁶³ Applied research often leads to commercialization, whereas the main motivation for fundamental or pure research is the advancement of knowledge.¹⁶⁴ Favoring one type of intellectual property over another based solely on its capability for generating money shows that the government fails to comprehend that both types of intellectual property are important.

[M]ost scientists believe that a basic, fundamental understanding of all branches of science is needed in order for progress to take place. In other words, basic research lays the *foundation* for the applied science that follows. If basic work is done first, then applied spin-offs often eventually result from this research.¹⁶⁵

Moreover, the new law favors commercially-driven donees over other donees. The commercially-driven donees are those that can use the intellectual property in ways that will directly generate income. The troublesome implication from such favoritism is that donees that emphasize education and basic research are not as worthy as the commercially-driven donees because their utilization of the donated intellectual property will not directly generate income. This favoritism also rewards donees that are endowed with the physical facilities, financial resources, and personnel capability to exploit intellectually

¹⁶³ "Basic (aka *fundamental* or *pure*) research is driven by a scientist's *curiosity* or interest in a scientific question." Lawrence Berkeley Labs, What Is Basic Research? Webpage, <http://www.lbl.gov/Education/ELSI/Frames/research-basic-defined-f.html> (last visited Apr. 10, 2006) [hereinafter What Is Basic Research?]. "Applied research is designed to solve *practical problems* of the modern world, rather than to acquire [sic] knowledge for knowledge's sake." Lawrence Berkeley Labs, What Is Applied Research? Webpage, <http://www.lbl.gov/Education/ELSI/Frames/research-applied-defined-f.html> (last visited Apr. 10, 2006). The dichotomy of basic versus applied research has been a subject of controversial debate. Questions relating to the purpose of each type of research, the lack of funding availability for basic research, and the growth of industry funding to finance applied research are at the heart of the debate. See Lawrence Berkeley Labs, Basic v. Applied Research Webpage, <http://www.lbl.gov/Education/ELSI/research-main.html> (last visited Apr. 10, 2006).

¹⁶⁴ On the other hand, basic research has "no obvious commercial value to the discoveries that result from basic research" because the main motivation is "to *expand man's knowledge*." What Is Basic Research?, *supra* note 163.

¹⁶⁵ *Id.* ("People cannot foresee the future well enough to predict what's going to develop from basic research. If we only did applied research, we would still be making better spears."). Other commentators such as C.H. Llewellyn Smith, former Director-General of CERN have argued that "governments have a special responsibility to fund basic science while applied science can generally be left to industry." C.H. Llewellyn Smith, *What's the Use of Basic Science?*, <http://public.web.cern.ch/public/Content/Chapters/AboutCERN/WhatIsCERN/BasicScience/BasicScience2/BasicScience2-en.html> (last visited Apr. 10, 2006).

property solely for direct financial results.¹⁶⁶ In other words, the new law favors the “have-donees” over the “have-not donees.” This may serve to create and perpetuate the imbalance between the two groups of donees for intellectual property donations.

Ultimately, the new law places the burden on donors to search for donees capable of utilizing the intellectual property for the direct production of income. Donors must conduct their own research and due diligence to determine, with a high degree of certainty, whether a particular donee will use the intellectual property donation directly to yield monetary results. The new law assumes that all intellectual property donations have inherent earning potential that can be translated into immediate income for the donees. However, this assumption is false because many intellectual property donations are orphan and have very little immediate commercial value.¹⁶⁷ If these intellectual properties are commercially valuable, the donors would keep and use the intellectual property for their own benefit.¹⁶⁸ After all, the creators and owners of these intellectual properties are often more capable of exploiting the intellectual property than the potential donees are.¹⁶⁹ Furthermore, donors could have sold a valuable piece of intellectual property and given the money or part of it to donees, rather than make a charitable donation.

It is bad policy to create tax law that favors money-generating

¹⁶⁶ Moreover, universities that have the facilities and resources still devote much of their efforts to many valuable “innovations that fail to generate substantial income returns but nevertheless advance the greater public good and are therefore commensurate with university missions.” BethLynn Maxwell et al., *Overview of Licensing Technology from Universities*, 762 PLI/PAT 507, 513-14 (2004).

¹⁶⁷ Moreover, most non-orphan patents owned by universities do not directly generate much income. Kapczynski, *supra* note 69, at 1088 (stating that university technology offices’ management of patents “tend to remain money-losing endeavors”). Kapczynski further observes:

The number of schools that make money from technology transfer is small, and those that profit tend to do so from a limited number of highly successful patents. Licensing revenues are typically equivalent to just 4% of a university’s research funds, and this figure decreases significantly when the costs of patent and license management, as well as the inventors’ share of royalty income, are subtracted. When patent royalties are compared to total university revenue, they appear quite small, constituting only 0.5 to 2% of revenues, even for the subset of universities that are patent-productive.

Id.

¹⁶⁸ See Burk, *supra* note 2, at 8 (explaining that firms, as holders of intellectual property assets, possess knowledge and capability to coordinate development and exploit proprietary rights).

¹⁶⁹ *Id.*

intellectual property donations over non-money-generating intellectual property donations, as both types of donations contribute to society as a whole. The increased burden placed on donors to find commercially-driven donees is unwise, and many potential donors may choose to allow these intellectual properties to die out at the expiration of the legal protection term instead. Researchers, investigators, students, and society as a whole will suffer the loss because the tax system fails to encourage the dissemination of orphan intellectual property.

In addition, the new law's sole focus on future economic benefits imposes heavy administrative burdens, including modified and expanded record-keeping requirements, on both intellectual property donors and charitable donees. Because the new law allows donors to take deductions over a period of years that will be determined based on the income derived from the donated property, the donor and the donee organization must communicate with one another and the IRS for several years following a qualified contribution. The 2004 Act requires *donors* to inform charitable donees of their intent to treat the contribution as a "qualified intellectual property contribution" and take additional charitable deductions in subsequent years based on the income accrued from the donated property.¹⁷⁰ In turn, the 2004 Act requires charitable *donees* to provide donors with written substantiations explaining the amount of income derived from the donated intellectual property during the taxable year.¹⁷¹ Furthermore, charitable donees must file an annual information return reporting their qualified donee income and other specified information.¹⁷²

¹⁷⁰ I.R.C. § 170(m)(8)(B) (2004) (as amended by American Jobs Creation Act of 2004); H.R. REP. NO. 108-755, § 882 (2004), as reprinted in 2005 U.S.C.A.N. 1341. In May 2005, the IRS released new guidelines concerning the notification requirements that donors must follow to claim additional deductions for contributions of qualified intellectual property. I.R.S. Notice 2005-41, 2005-23 I.R.B. 1. Under Notice 2005-41, donors of qualified intellectual property must deliver to the charitable donee, at the time of donation, a written statement containing: (1) the name, address, and taxpayer information of the donor; (2) a description of the qualified intellectual property in enough detail that it can be identified by the donee; (3) the date of the charitable contribution; and (4) a statement saying that the donor intends to treat the contribution as a qualified intellectual property contribution under section 170(m) and section 6050L. *Id.* The IRS has asked for public comment on Notice 2005-41. See Comment Request for Notice 2005-41, 70 Fed. Reg. 32706 (June 3, 2005).

¹⁷¹ I.R.C. § 6050L(b).

¹⁷² *Id.* ("[E]ach donee with respect to a qualified intellectual property contribution shall make a return . . . with respect to each specified taxable year of the donee showing (A) the name, address, and TIN of the donor, (B) a description of the qualified intellectual property contributed, (C) the date of the contribution, and (D) the amount of net income of the donee for the taxable year which is properly allocable to the qualified intellectual property"). In May 2005, the IRS published proposed regulations, simultaneously released as temporary

By allowing future deductions based on income received or accrued by the charity from the donated property itself, rather than income stemming from the activity in which the donated property is used,¹⁷³ the new law places a difficult burden on charities to track specific intellectual property assets. Each donated patent or copyright may have a different legal protection period depending on when each was invented or created. Monitoring individual intellectual property assets and the extent to which each is generating income is a monumental task.

Moreover, considering the future tax deductions at stake under the new law, donors will incur substantial monitoring costs. Specifically, the new law will require donors to expand resources to monitor the donee's income-generating activities directly related to a specific donated patent or patents. The burden is on the donor to come to an agreement with the donee prior to donation to ensure that the donee will cooperate and submit all documents relating to the commercialization of the donated patents or financial documents to assist the donor in obtaining future deductions based on a specified percentage of the qualified donee income. Future costs associated with these monitoring activities may outweigh any future tax benefits, due to the sliding-scale nature of the

regulations, which provide guidance for the filing of information returns by recipients of qualified intellectual property contributions. See Information Returns by Donees Relating to Qualified Intellectual Property Contributions, 70 Fed. Reg. 29 460, (May 23, 2005) (to be codified at 26 C.F.R. pt. 1) (proposed regulations); T.D. 9206, 70 Fed. Reg. 29450-01 (May 23, 2005) (temporary regulations). The regulations, effective May 23, 2005, affect charitable donees receiving net income from qualified intellectual property contributions made after June 3, 2004. Under the regulations, a charitable donee is required to file an information return any taxable year of the donee that includes any portion of the 10-year period beginning on the date of the contribution, but not for taxable years after the expiration of the legal life of the qualified intellectual property. Temp. Treas. Reg. § 1.6050L-2T(a) (2005). The return must be filed on or before the last day of the first full month following the close of the donee's taxable year. Temp. Treas. Reg. § 1.6050L-2T(d)(2). See I.R.C. § 7701(a)(23) for the definition of "taxable year." The information required to be provided on the return includes: (1) the name, address, taxable year, and identification number of the donee; (2) the name, address, and taxpayer identification number of the donor; (3) a description of the qualified intellectual property; (4) the date of the contribution; (5) the amount of net income of the donee for the taxable year that is properly allocable to the qualified intellectual property; and (6) such other information as may be specified by the form or its instructions. Temp. Treas. Reg. § 1.6050L-2T(b)(1)-(6). The donee must provide a copy of the information return to the donor of the property on or before the date the donee is required to file the return with the IRS. Temp. Treas. Reg. § 1.6050L-2T(c)(1).

The IRS issued (and asked for public comment on) new Form 8899, on which charitable donees will report qualified donee income. See Comment Request for Form 8899, 70 Fed. Reg. 37006 (June 27, 2005). The donee must provide a copy of the information return to the donor. I.R.C. § 6050L(c) (1984), amended by Pub. L. No. 108-357, § 882(c)(1), (2004).

¹⁷³ I.R.C. § 170(m)(3) (amended by 2004 Act).

future deduction scheme, and discourage donors from giving their intellectual property.

IV. PROPOSAL FOR AN ELECTIVE CHARITABLE DEDUCTION REGIME

Concern over intellectual property valuation abuses is not adequate justification for a complete paradigm shift from a charitable deduction system that provides certain and immediate economic incentives to one that provides only uncertain future financial incentives. To prevent the foreseeable loss of dissemination of intellectual property for the maximum social good, it is critical that the government repeal the 1969 Act (which targeted copyright donations)¹⁷⁴ and the 2004 Act (which targeted all other intellectual property donations)¹⁷⁵ and adopt a fair market value deduction for all intellectual property contributions. A fair market value approach would necessarily require the imposition of strict statutory and administrative safeguards to minimize the potential for valuation conflicts but not discourage valuable intellectual property donations. Most importantly, the government should formalize and articulate a standard approach to determine the fair market value of different types of intellectual property for charitable deduction purposes.

With respect to donations of artistic works, the government has created a system for obtaining fair, objective valuations. For example, the IRS has set up an Art Advisory Panel.¹⁷⁶ Composed of twenty-five persons, including nationally prominent art dealers, museum curators, and auction house experts, the Panel reviews and evaluates the acceptability of art appraisals for income tax purposes.¹⁷⁷ The Art Advisory Panel conducts an automatic review of any work of art with a claimed value of \$20,000 or more.¹⁷⁸ The recommendation of value by the Panel thereby becomes the IRS's position as to valuation.¹⁷⁹ The IRS has

¹⁷⁴ For a summary of the 1969 Act, see *supra* notes 125-30 and accompanying text.

¹⁷⁵ For a summary of the 2004 Act, see *supra* notes 106-21 and accompanying text.

¹⁷⁶ Anne-Marie Rhodes, *Big Picture, Fine Print: The Intersection of Art and Tax*, 26 COLUM. J.L. & ARTS 179, 197 (2003) (describing the panel).

¹⁷⁷ The Art Advisory Panel conducts an automatic review of any work of art with a claimed value of \$20,000 or more. Rhodes, *supra* note 176, at 197. The Art Advisory Panel works in closed meetings so as to protect taxpayer privacy and ensure objectivity and reviews works in alphabetical order by artist so as to minimize recognition of a taxpayer's collection. *Id.*

¹⁷⁸ See *id.*

¹⁷⁹ The Panel recommendation is reviewed by the Appraisal Service Office and then sent to the IRS. In 2003, the Panel reviewed 637 works of art with an aggregate claimed valuation over \$200 million. The panel recommended adjustments on 51% of the reviewed appraisals (total adjustments equaled \$68 million). ART ADVISORY PANEL OF THE COMM'R

also implemented a valuation safeguard procedure whereby a taxpayer can request a "Statement of Review" for a work of art that has been appraised at \$50,000 or more.¹⁸⁰ Although significant guidelines exist for valuing works of art, few guidelines exist for valuing intellectual property intangible assets such as copyrights and patents.¹⁸¹ The government would necessarily have to formulate valuation guidelines to back up the fair market value approach.¹⁸² Such guidelines could, for example, require appraisers of donated patents to take into consideration, and document, the existence of related inventions or "prior art," which can decrease a patent's value.¹⁸³

To enforce proper valuations and to prevent fraudulent or collusive behavior, the government should require increased accountability on the part of charitable donees. The government's approach, historically, has been to place accountability on individual and small corporate donors. Prior to the enactment of the 2004 Act, if an individual or small corporate donor claimed a charitable deduction in excess of \$5000, the donor was required to obtain a "qualified appraisal" for the property contributed,¹⁸⁴ obtain and attach a fully completed "appraisal summary" to the tax return on which the deduction was first claimed (which described the fair market value of the property on the date of contribution),¹⁸⁵ and maintain the records prescribed by the regulations.¹⁸⁶ Further, if the IRS identified a situation in which a taxpayer abused his right to a charitable

OF THE INTERNAL REVENUE, ANNUAL SUMMARY REPORT FOR 2003 (2003).

¹⁸⁰ Rev. Proc. 96-15, 1996-1 C.B. 627. The statement can be requested after the donation but before the filing of the tax return reporting the transfer and must be submitted with a qualified appraisal and appropriate user fee. *Id.*

¹⁸¹ See *Parkwood Corp. v. Comm'r*, 9 T.C.M. (CCH) 748 (1950). For IRS guidelines on valuing intangibles, see Rev. Rul. 79-432, 1979-2 C.B. 289; Rev. Rul. 59-60, 1959-1 C.B. 237 (providing methods of valuing intangibles of a business); see also Rev. Rul. 68-609, 1968-2 C.B. 327 (discussing allocation of basis on purchase of lithograph and copyrights thereto).

¹⁸² See, e.g., Drennan, *supra* note 144, at 1093-1106 (recommending special considerations when valuing patent, and describing possible modifications to current valuation rules).

¹⁸³ See *Patent Sting*, NEW SCIENTIST, Oct. 18, 2003, at 6; see also Michael S. Fuller, *The Create Act Will Undo the Federal Circuit's Construction of 35 U.S.C. § 103 in Oddzon, and Help Promote Research Collaborations*, 5 CHI.-KENT J. INTELL. PROP. 106, 106 (2000) (citing DONALD S. CHISUM, CHISUM ON PATENTS, Scope (2005) (stating prior arts are "documentary sources (patents and publications from anywhere in the world) and non-documentary sources (things known, used, or invented in the United States)").

¹⁸⁴ Treas. Reg. § 1.170A-13(c)(1), (c)(2)(i)(A) (1996). For the definition of "qualified appraisal," see Treas. Reg. § 1.170A-13(c)(3).

¹⁸⁵ Treas. Reg. § 1.170A-13(c)(1), (c)(2)(i)(B). For the definition of "appraisal summary," see Treas. Reg. § 1.170A-13(c)(4).

¹⁸⁶ Treas. Reg. § 1.170A-13(c)(2)(i)(C).

deduction, the taxpayer and appraiser could be subject to penalties,¹⁸⁷ while the charity could escape government penalty. While it is true that a charitable donee must sign and date an appraisal summary, such an act merely acknowledges receipt of the donated property and does not indicate that the charity agrees with the amount claimed as a deduction by the donor.¹⁸⁸ Legislative reform is needed to ensure that both the donor and charitable donee are responsible for accurate valuation.¹⁸⁹ The government provides tax exempt status to charitable organizations. What the government giveth, the government can taketh away in cases of valuation abuses.

A fair market value standard for charitable deduction purposes is based on what the market dictates in an arm's-length transaction.¹⁹⁰ To encourage in-kind philanthropic giving of intellectual property as opposed to sales or licenses of intellectual property in the private market, a fair market value standard could utilize valuation premiums.¹⁹¹

¹⁸⁷ See I.R.C. § 6662 (donor penalty provision) (2006); *id.* §§ 6694, 6700, 6701 (appraiser penalty provisions).

¹⁸⁸ Treas. Reg. § 1.170A-13(c)(4).

¹⁸⁹ Although charitable donees should have increased accountability, the government should also continue to impose restraints on donors, but apply such restraints equitably to all donors of intellectual property. As discussed above, the restraints historically imposed on donors (e.g., the requirement to obtain qualified appraisal and attach an appraisal summary) were imposed only on individuals and small corporations. See *supra* notes 184-86 and accompanying text. Any restraints to minimize valuation conflicts should be imposed on corporate donors as well.

¹⁹⁰ See *supra* note 124 and accompanying text.

¹⁹¹ Premiums for interests in property are not uncommon in determining fair market value under a willing-buyer, willing-seller standard. For example, a "control premium" for estate and gift valuation is common in valuing controlling interests in a business entity. That means a willing buyer will often pay a greater amount for a controlling interest in a business entity than for its proportional value because it provides the buyer unfettered control over business affairs. RICHARD B. STEPHENS ET AL., FEDERAL ESTATE & GIFT TAXATION ¶ 10.02[2][c], 10-57 (7th ed. 1997). For example,

[W]hen the subject property is an 80% interest in a closely held business, a willing buyer might pay more than 80% of the total fair market value of the business. The willing buyer will pay extra to guarantee unfettered control over the business. With an 80% interest, the willing buyer would control the election of officers, the timing and amount of distributions including liquidation, all votes of the owners, hiring and salary decisions, and all other aspects of the business.

Id. ¶ 4.02[4][B], 4-33 (citing *Estate of Murphy v. Comm'r*, 60 T.C.M. (CCH) 645, 658-59 (1990)).

Likewise, a "swing vote premium" for estate and gift valuation may be appropriate in valuing a minority interest (e.g., 2% interest) of stock of a closely-held business under the presumption that a willing buyer might be willing to pay a premium above the price that would normally be paid for a minority interest if the owner of the minority interest would have the opportunity to have a significant part in management and distributions. *Id.* ¶

Valuation premiums would provide donors with additional economic incentives, recognizing that intellectual property is very important to the development and growth of the economy and society; that donating intellectual property rights to charitable organizations is significantly valuable for future research, investigation, education, and publication purposes; and that giving up intellectual property rights prematurely through philanthropy is more profound than the donation of tangible property. Tangible, physical property can be quickly destroyed or damaged whereas rights to intellectual property cannot.¹⁹² A patent or a copyright is the confluence of limited monopolistic rights recognized in the Constitution for a certain duration of time and scope as decided by Congress.¹⁹³ Patents and copyrights are the foundations that give rise to copies of the physical embodiments of the invention, replications of methods, or reproductions of creative works of authorship.¹⁹⁴ Giving up

4.02[4][B], 4-36.

Unlike these control and swing vote premiums, which are designed to determine what a willing buyer should pay a willing seller in an arm's length transaction, the valuation premiums recommended here would encourage the donations of intellectual property with modest market value.

¹⁹² Further, when the copyrighted or patented object is destroyed, the firm can use the copyright or patent to create more copies of the physical objects embodying the intellectual property. The firm's rights, however, are not absolute, as clearly dictated in the Constitution and the relevant federal statutes and regulations. See Herbert Hovenkamp, *Antitrust and the Regulatory Enterprise*, 2004 COLUM. BUS. L. REV. 335, 336-37 (considering intellectual property rights as form of government regulation as evidenced by federal statutes and "the maze of technical rules promulgated under them. . . . The range of government estimation that goes on in the IP system is certainly as great as in regulation of, say, retail electricity or telephone service.").

¹⁹³ See Mark A. Lemley, *Property, Intellectual Property and Free Riding*, 83 TEX. L. REV. 1031, 1031 (2005) (stating that intellectual property rights are granted under federal law only when inventors and authors have met statutory requirements and rights are limited in time and scope).

¹⁹⁴ For example, the copyright owner has the exclusive reproduction right without limitation to the quantity of the copies. See 17 U.S.C. §106 (2006) ("[T]he owner of copyright under this title has the exclusive rights to do and to authorize [individuals] to reproduce the copyrighted work in copies or phonorecords."). Any copies made without the authorization of the copyright owner infringe the exclusive right. The copyright statute defines "copies" as "material objects . . . in which a work is fixed," where "fixed" means embodied for "a period of more than transitory duration." 17 U.S.C. § 101 (2004). In the software context, a copy is made when the user downloads the copyrighted software, which then functions in the service of the computer or its user so that the copying is no longer of a transitory nature. See, e.g., *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255, 260 (5th Cir. 1988). With the arrival of the Internet, copies of copyrighted content "[have] move[d] from an unwieldy, fixed, tangible form to easily manipulated, flexible digital formats." Craig A. Grossman, *From Sony to Grokster, The Failure of the Copyright Doctrines of Contributory Infringement and Vicarious Liability to Resolve the War Between Content and Destructive Technologies*, 53 BUFF. L. REV. 141, 170 (2005).

a patent or a copyright relinquishes the monopolistic rights recognized under the Constitution. Hence, donors could receive a deduction equal to fair market value, but with an added premium, for their intellectual property donations. Moreover, when a potential donor is contemplating a donation of its intellectual property that is of little commercial use or value to the donor, the fair market price for such intellectual property at the time of donation is most likely modest. However, such intellectual property may be important to a potential donee and its researchers due to the unquantifiable knowledge value of the intellectual property. Valuation premiums, which equate that knowledge value, could serve as the enhancement that encourages the donor to give up its monopolistic legal rights in the intellectual property, despite losing the positive signals these assets send about the firm.¹⁹⁵

Although not advocated here, the government could choose to apply different premiums depending on the type of intellectual property donated and the type of charitable recipient. The government might choose, for instance, to apply a higher premium to gifts of patents as opposed to copyrights, add a higher premium to gifts of art held by collectors or investors as opposed to creators, or apply a higher premium to gifts to public charities as opposed to private foundations. With a fair market value standard that incorporates appropriate premiums, the government could incentivize social giving and, at the same time, maintain some of the distinctions that it recognized prior to the enactment of the 2004 Act.¹⁹⁶

As an alternative to a system that solely provides current incentives, a charitable deduction system could give donors a choice: allow them to elect to take a single fair market value deduction in the year of contribution or, instead, take future deductions based on income. Congress has a history of enacting economic stimulus provisions that allow taxpayers to elect to enjoy early the amount of their otherwise allowed deductions to encourage desired behavior. For example, the government has developed an elaborate cost-recovery system, under

¹⁹⁵ See *supra* note 5 and accompanying text.

¹⁹⁶ As noted above, the 1969 Act created a distinction between patents and copyrights. See *supra* notes 128-29 and accompanying text. It maintained a fair market value deduction for donations of patents, but eliminated the fair market value deduction for donations of self-created copyrights. *Id.* The 1969 Act also created a distinction between copyright creators and collectors. Tax Reform Act of 1969, Pub. L. No. 91-172, § 201(a), 83 Stat. 487, 555. In contrast to copyright creators (who could receive little or no charitable deduction for gifts of their creations), investors who purchased copyrights or received copyrights from decedents and who did not hold the copyrights primarily for sale in the ordinary course of trade or business remained eligible for a full fair market value deduction. *Id.*

which taxpayers deduct the cost of acquiring various assets over prescribed recovery periods through applicable depreciation and amortization allowances.¹⁹⁷ The goal behind permitting taxpayers to take depreciation or amortization deductions over time is to achieve a fair allocation of the costs of acquiring an asset to the period in which the taxpayer realizes income from the asset.¹⁹⁸ The government has been willing to give up this tax policy goal of clear reflection of income by creating accelerated methods of cost recovery to incentivize taxpayer behavior for maximum social good. For example, to encourage acquisitions of certain tangible property for certain utilizations that would stimulate the economy, the government has authorized more rapid cost recovery by permitting taxpayers to elect larger deduction allowances in early years and smaller deduction allowances in the later years of an asset's statutory recovery period.¹⁹⁹ To provide even greater, immediate financial incentives to taxpayers who engage in certain acquisitive transactions, the government has enacted provisions allowing taxpayers to elect to immediately expense 100% of the acquisition costs, rather than to capitalize and deduct those costs over time.²⁰⁰ Consistent

¹⁹⁷ See, e.g., I.R.C. § 167 (2005) (authorizing cost recovery deductions, such as depreciation and amortization allowances, for certain types of property); *id.* § 168 (prescribing depreciation methods and applicable recovery periods for depreciable tangible property); *id.* § 197 (providing ratable, 15-year amortization method for "section 197 intangibles").

¹⁹⁸ See, e.g., *Comm'r v. Idaho Power Co.*, 418 U.S. 1, 11-12 (1974) (explaining purpose of cost recovery system).

¹⁹⁹ The default "applicable depreciation method" for most tangible property is the 200% declining balance method (which permits more rapid cost recovery than, for example, the straight-line method). I.R.C. § 168(b)(1). Section 168(k), enacted in 2002, allows a purchaser of "qualified property" to take an additional cost recovery deduction equal to 30% of the property's cost in the first year (commonly known as "additional first year depreciation"). *Id.* § 168(k)(1). In 2003, section 168(k) was amended to allow a taxpayer to elect to increase the amount of the additional first-year cost recovery deduction under section 168(k)(1) to 50% of the cost of "qualified property" (commonly known as "50% bonus depreciation"). *Id.* § 168(k)(4). As a result of these immediate financial incentives, a taxpayer who purchases qualified property, otherwise recoverable over long statutory recovery periods, could elect to immediately deduct 50% of the cost in the first year and deduct the unrecovered remaining 50% over time through the applicable depreciation method.

²⁰⁰ Section 179 of the Code, for example, allows taxpayers to elect to deduct currently the cost of acquiring certain depreciable business assets (e.g., computers, equipment, and off-the-shelf software) rather than deduct those costs over statutorily prescribed recovery periods. *Id.* § 179(a) (2004). The maximum allowable deduction for all qualifying property placed in service is \$100,000 (for taxable years beginning after 2002 and before 2008). I.R.C. § 179(b) (as amended by American Jobs Creation Act of 2004). The \$100,000 amount is reduced dollar-for-dollar (but not below zero) by the amount by which the cost of qualifying property placed in service during the tax year exceeds \$400,000 in the case of

with its historical approach of incentivizing desired behavior, the government could allow donors to elect to take an immediate tax deduction for their donations in lieu of taking future tax deductions based on income generated by the donated intellectual property.²⁰¹

By providing an election, the proposal implicitly recognizes that donors, especially the new breed of donors today, are sophisticated and results-oriented. Today's donors want maximum social impact in return for what they donate.²⁰² The donors want to be in control of their decisions and have choices, such as to elect to take a large deduction in the year of contribution or take future, post-contribution deductions based on income in subsequent years. The donor is the party with the intimate knowledge about the value of the intellectual property that it wants to donate. The proposed election regime would allow the donor to decide whether to incur the risks and monitoring costs associated with the future deduction option based on the value of the intellectual property to the donee or to incur the appraisal costs and overvaluation risks associated with the certain current deduction option. While the election regime would provide an option to donors that give applied research to commercially-driven donees, it would create a necessary, economic incentive to donors that give basic, purely scientific research to noncommercially-driven donees.

CONCLUSION

The intersection between intellectual property and taxation meets at the act of giving by the firm. Giving intellectual property must be encouraged for the benefit of the firm as the donor, the charitable organization as the donee, and society as the ultimate benefactor. As economists have advocated, the best way to encourage giving is not by relying solely on moral or social incentives, but by providing strong, economic incentives as well.²⁰³

taxable years beginning after 2002 and before 2008. *Id.*

²⁰¹ The examples provided above deal with tangible property acquisitions. Another example relates to research and development. Section 174 allows taxpayer to elect either (1) to deduct research and development costs in the year paid or incurred or (2) to defer and amortize ratably such costs over five years. I.R.C. § 174(a)-(b) (1989).

²⁰² See *supra* notes 24-28 and accompanying text (describing new breed of donors).

²⁰³ See generally STEVEN D. LEVITT & STEPHEN J. DUBNER, FREAKONOMICS: A ROGUE ECONOMIST EXPLORES THE HIDDEN SIDE OF EVERYTHING 19-23 (2005) (discussing three basic flavors of incentive — economic, social, and moral — and noting that “[v]ery often a single incentive scheme will include all three varieties”; also noting problems with substituting

