Tax Basics of Intellectual Property

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Like most assets developed, used, and sold in business, intellectual property (IP) is subject to important tax considerations. For purposes of U.S. federal tax law, intellectual property is part of a broader category of assets called "intangible assets." Intellectual property specifically addressed in the Internal Revenue Code (I.R.C.) includes patents, copyrights, formulas, processes, designs, patterns, know-how, format, trade secrets, trademarks, trade names, franchises, and computer software. [1] This article presents a brief overview of the basic U.S. federal tax considerations of events that may occur over the life cycle of intellectual property, from its creation to its acquisition, exploitation, licensing, and transfer. It begins by discussing important general tax concepts such as tax basis, capitalization, amortization, and asset characterization, in the context of intellectual property. Certain new rules introduced by the Tax Cuts and Jobs Act of 2017 (TCJA) [2] are also addressed, including a new tax regime applicable to offshore intellectual property.

Tax Basis as the Starting Point

A taxpayer's tax basis in an asset generally reflects the economic cost of the asset to the taxpayer. For example, if a company acquires a patent from an unrelated patent inventor for cash, the company's tax basis in the patent will be the amount paid to the inventor. The tax basis will be the company's starting point for computing any amortization deductions, which involves computing the annual amortization deduction as a percentage of the company's tax basis in the intellectual property over its useful life. If the company sells the intellectual property, its gain or loss on the sale generally is computed by reference to its tax basis or its adjusted tax basis if the basis was adjusted, for example, downward to reflect amortization deductions. To compute any gain or loss, the company would subtract its adjusted tax basis from the consideration received on the sale. As for the inventor in the example, its tax basis in the intellectual property depends on whether it was allowed to deduct or required to capitalize the costs attributable to creating the intellectual property. These issues are considered in more detail below.

Tax Basis in Self-Created IP: Deduction or Capitalization?

A taxpayer that creates and utilizes intellectual property as part of a profitable ongoing business likely will prefer deducting the costs attributable to creating the intellectual property because that allows the taxpayer to receive a current tax benefit for the tax year during which the research and development

(R&D) costs were paid or incurred. I.R.C. § 162 permits a current deduction for all the ordinary and necessary expenses paid or incurred during the tax year in carrying on any trade or business. To be deductible under § 162, a business expense must not be subject to any provision of the I.R.C. that requires capitalization, as discussed below.

I.R.C. § 174 provides a current deduction for certain types of research and experimental (R&E) expenses. R&E expenses are R&D costs in the experimental or laboratory sense; that is, activities intended to discover information that would eliminate uncertainty concerning the development or improvement of a product. [3] Thus, for example, the cost of creating a patentable pharmaceutical product, including the costs of obtaining a patent such as attorney fees, may be currently deducted under § 174. [4] Under § 174, a taxpayer may elect to (1) currently deduct all R&E expenses made in connection with the taxpayer's trade or business, or (2) amortize the expenditures over a period of not less than 60 months beginning with the month in which the taxpayer first realizes benefits from the expenditures. For taxpayers operating at a loss, such as a new venture starting up operations, the deferral of the 60-month amortization period may provide a more valuable tax benefit than a current deduction. Further, § 174 applies more broadly than § 162 because it is available to taxpayers that are not yet engaged in a trade or business. [5] As a result, it may be a valuable deduction for startups that may not yet be considered "engaged in a trade or business" within the meaning of I.R.C. § 162. Note, however, a § 174 deduction likely is not available to a taxpayer that invests in IP development by funding the R&E expenses of a third party because such expenses likely would not be considered connected with the trade or business of the investor.

Under the TCJA for any tax year starting in 2022, I.R.C. § 174 expenses will not be deductible, but will continue to be amortizable as described above, and foreign R&E expenses (i.e., research conducted outside the United States, Puerto Rico, or any U.S. possession) will have to be amortized over a 15-year period. [6]

Another useful provision for startups is I.R.C. § 195, which allows taxpayers to elect to defer deducting certain expenses incurred before the business becomes active and to deduct such expenses over a 15-year period beginning with the month in which the active business begins. Startup expenses are limited to costs that would be deductible if the business was already an active trade or business.

If the costs paid or incurred by a taxpayer in the creation of intellectual property are currently deductible under the I.R.C., the accelerated tax benefit prevents the expenditure from being part of the taxpayer's basis in the intellectual property. Consequently, a taxpayer may have zero basis in self-created intellectual property if all the costs were deducted. If the I.R.C. requires the costs paid or incurred by a taxpayer in the creation of intellectual property to be capitalized, the capitalized costs will form the taxpayer's tax basis in the self-created intellectual property.

Case law and I.R.C. § 263 require the capitalization of a business expense if that expense will create or enhance a separate and distinct intangible asset or create or enhance a future benefit beyond the tax year in which the expense is incurred. The Treasury Regulations (Regulations) under § 263 generally require that amounts paid to create or acquire an intangible asset must be capitalized. [7] Amounts paid to facilitate the creation or acquisition of an intangible asset also must be capitalized. [8] The Regulations list some of the costs related to self-created intangible assets that must be capitalized. Some of the most significant in the context of intellectual property are (1) costs incurred to obtain rights from a governmental agency, such as costs to obtain, renew, renegotiate, or upgrade rights under a trademark, trade name, or copyright; and (2) costs to defend or perfect title to an intangible asset, such as the cost to settle a patent infringement lawsuit. [9]

I.R.C. § 263A requires the capitalization of a variety of costs attributable to property produced by a taxpayer or acquired for resale in a trade or business or an activity conducted for profit. For the purposes of § 263A, "property" is defined to include tangible property, which would seem to exclude intellectual property. However, tangible property under § 263A includes films, sound recordings, videotapes, books, and similar property that is intended to be produced on a tangible medium and mass distributed in a form that is not substantially altered. Thus, for example, the cost of writing a book, including the cost of producing a manuscript and obtaining a copyright or license for the project, must be capitalized pursuant to § 263A.

Under the TCJA, certain property, referred to as "qualified property," is eligible for a temporary 100 percent bonus deduction under I.R.C. § 168(k). The term "qualified property" was expanded to include "qualified film or television productions," which generally means a film or television production in which 75 percent of the total compensation is paid to actors, directors, and producers for services performed in the United States and which meets the placed-in-service requirement, i.e., its initial release or broadcast is before December 31, 2026.

Tax Basis in Acquired IP: How to Allocate Purchase Price among Assets

A taxpayer's tax basis in an acquired asset generally is the amount paid for the asset. In an arm's length transaction, the amount paid should be the acquired asset's fair market value (FMV). In such case, if the taxpayer acquires a single asset, the basis of that asset will be the purchase price. In the case of an acquisition of multiple assets, the acquirer must determine the FMV of each asset, typically by having the assets appraised. If the assets comprise a trade or business, the I.R.C. provides rules for allocating the purchase price among the assets of the trade or business, as described below.

Direct Asset Acquisition

The assets of a business may be acquired directly through an asset acquisition or indirectly through a stock acquisition, as discussed below. Although more complicated to execute than a stock acquisition, an asset acquisition offers the benefit of receiving FMV basis in the assets, often referred to as a "stepped-up" basis because the acquirer's tax basis is stepped up to FMV. A stepped-up basis maximizes the new owner's amortization deductions and reduces the potential gain on a subsequent sale of the assets.

When a taxpayer acquires an intangible asset as part of the direct acquisition of assets comprising a trade or business, the bases of the acquired assets are determined under the rules of I.R.C. § 1060, which applies to any direct or indirect transfer of a group of assets that constitutes a trade or business in the hands of either the acquirer or the seller, and the acquirer's basis in the assets is determined wholly by reference to the consideration paid.

The acquired assets are divided into seven classes, referred to under the Regulations as Class I through Class VII. Intangible assets, such as intellectual property, typically would fall into Class VI. The basis is allocated among the assets under a method by which the consideration is first reduced by the amount of Class I assets, and any remaining consideration is then allocated among the assets by ascending class number in an amount generally not in excess of FMV of the assets within each class. Thus, after the allocation of the purchase price to Class I assets is completed, the purchase price is allocated to Class II assets to the extent of their respective FMVs, and so forth until the balance of the purchase price is allocated to Class VII assets.

Stock Acquisition

In an acquisition of stock, the acquirer generally will have a tax basis in the acquired corporation's stock equal to the consideration paid for the stock and a carryover basis in the acquired corporation's underlying assets. Thus, for example, if the consideration paid by a taxpayer to acquire all of the stock of a corporation exceeds the aggregate bases of the corporation's assets (often referred to as the stockholder's "inside basis" in the corporation), neither the acquirer nor the acquired corporation will be entitled to increase the bases in the corporation's assets.

The inability to obtain basis step-up in the usual stock acquisition makes stock acquisitions less advantageous than asset acquisitions, especially if the corporation's assets have desirable tax attributes such as amortization deductions. On the other hand, asset acquisitions can be complicated because some assets, such as permits and licenses, may be difficult to transfer. Under a special election regime in I.R.C. § 338, taxpayers may elect to treat certain stock acquisitions as asset acquisitions for the purpose of obtaining basis step-up in the underlying assets of the acquired corporation. The basis is allocated among the assets of the acquired corporation under rules similar to the rules described above, in which basis is first allocated to one class of assets and will continue to be allocated among the assets by ascending class number.

The basis step-up is achieved through a hypothetical sale of the target corporation's assets. There are two types of elections: a § 338(g) election, which may be made by a corporation acquiring another corporation and is made at the election of the acquirer; or a § 338(h)(10) election, which may be made by a corporation acquiring a corporate subsidiary and is made at the election of both the acquirer and the seller. Under the § 338(g) election, the tax cost of the deemed sale is borne by the acquirer; under the § 338(h)(10) election, the tax cost is borne by the seller and will be reflected in the purchase price.

Acquisition Costs

The costs to acquire an intangible asset, including many IP assets such as patents, copyrights, franchises, trademarks, trade names, or computer software, must be capitalized. [10]

Amortization of IP: Recovering Tax Basis

Property used in a trade or business or held for the production of income may be eligible for a depreciation or amortization deduction in an amount that represents a reasonable allowance for the exhaustion, wear and tear, and obsolescence of the property. [11] As a general rule, self-created intellectual property may be amortized under I.R.C. § 167 to the extent that the taxpayer has a tax basis in the self-created intellectual property. If the taxpayer acquired the intellectual property, it generally may be amortized under I.R.C. § 197. Under certain circumstances, acquired intellectual property may not be amortized under § 197 and the rules of § 167 must be consulted to determine whether the property is amortizable. Further, certain self-created intellectual property such as trademarks and trade names must be amortized under § 197.

Amortization under I.R.C. § 167

If property, including an intangible asset, is known from experience or other factors to be useful in a business or in the production of income for only a limited period, and that period can be reasonably estimated, the property may be amortizable under I.R.C. § 167. Thus, two threshold issues must be addressed to determine whether intellectual property is amortizable: (1) whether it has a useful life, and if so (2) the length of the useful life. Although these issues have been the subjects of litigation, some relatively clear statutory rules exist. For example, the Regulations under § 167 specifically state that patents and copyrights have a useful life that can be reasonably estimated. [12] In contrast, trade secrets and know-how generally have been held to not have limited useful lives because they remain valuable as long as they remain confidential.

A safe harbor permits a taxpayer to treat an intangible asset, including intellectual property, as having a useful life of 15 years, unless (1) another useful life is specifically prescribed or prohibited under the tax law, (2) the intangible asset is acquired from another person or is a financial interest, (3) the intangible asset has a useful life that can be reasonably estimated, or (4) the intangible asset relates to certain benefits arising from real property. [13] Under the safe harbor, tax basis must be amortized ratably over the 15-year period. [14]

Amortization under I.R.C. § 197

I.R.C. § 197 generally applies to acquired intangible assets, including intellectual property, typically in connection with the acquisition of a business as part of an asset purchase transaction. It permits a taxpayer to amortize any "amortizable § 197 intangible" ratably over a 15-year period starting with the month in which the intangible asset is acquired. The 15-year amortization period applies regardless of the taxpayer's ability to establish the asset's limited useful life.

An amortizable § 197 intangible is any "§ 197 intangible" held in connection with the conduct of trade or business or the production of income. A § 197 intangible is defined to specifically include any and all of the following items:

- Patents;
- Copyrights;
- Formulas;
- Processes;
- Designs;
- Patterns;
- Know-how;
- Formats or other similar items; and
- Franchises, trademarks, or trade names.

As discussed above, § 197 also applies to a limited class of self-created intangible assets that are not part of an acquisition of a business, including trademarks and trade names. [15] Thus, to the extent that costs incurred to create such assets must be capitalized under general tax principles (e.g., I.R.C. § 263, discussed above), § 197 will apply to determine the period over which the capitalized costs will be amortized for income tax purposes.

Special Rules for Licenses of § 197 Intangibles
If the rights to use a § 197 intangible are acquired in a bona fide license that is part of the acquisition of a trade or business, payments made pursuant to the license must be capitalized and amortized under § 197. In contrast, if the rights to use a § 197 intangible are acquired in a bona fide license that is not part of the acquisition of a trade or business, payments made pursuant to the license may be deducted rather than capitalized. As discussed in detail below, under certain circumstances, the IRS may challenge a purported license as a sale of an intangible asset.

"Separately Acquired Assets" Excluded from Application of § 197
Separately acquired assets are intangible assets acquired in a transaction or a series of related transactions that do not involve the acquisition of the assets constituting a trade or business or a substantial portion of a trade or business. Typically, the fact pattern includes the expansion of an existing business, rather than the acquisition of an entirely new business. These assets may include patents, copyrights, computer software, and any interest in a film, sound recording, video tape, book, or similar property. They are excluded from the application of § 197. As a result, they generally are not amortizable unless they meet the requirements of § 167.

Nonrecognition Transactions
If a § 197 intangible is acquired in a nonrecognition transaction—for example, a shareholder contributes intellectual property to a corporation that it controls within the meaning of I.R.C. § 351 (governing the tax-free contribution of capital to a controlled corporation) in exchange for stock, or a comparable transfer of property by a partner to a partnership under I.R.C. § 721 (governing the tax-free contribution of property to a partnership) in exchange for a partnership interest—the transferee generally will receive a carryover basis in the § 197 intangible. That is, the transferee will step into the shoes of the transferor with respect to tax basis and the remaining recovery period for amortization.

Transfers of IP

The transfer of property used in a trade or business or held for the production of income raises many tax issues. In the intellectual property context, these issues may include:

- Whether gain or loss must be recognized on the transfer;
- The character of such gain or loss;
- The recapture of amortization deductions; and
- Whether a transfer will be treated as a sale or license for tax purposes.

Under general tax principles, a taxpayer will realize gain on the sale of property to the extent that the amount realized on the sale exceeds the taxpayer's adjusted tax basis in the property. The taxpayer will realize loss to the extent that the adjusted tax basis in the property exceeds the amount realized on the sale. The gain or loss generally must be recognized in the current tax year. In certain instances, a nonrecognition rule of the I.R.C. may defer immediate recognition of the gain or loss.

Ordinary or Capital?

Whether property is a capital asset in the hands of a taxpayer is determined under I.R.C. § 1221 or § 1231. The sale or exchange of a capital asset will result in either capital gain or loss, subject to recapture rules discussed below. An individual taxpayer is subject to tax on capital gains at preferential rates; the maximum rate is 20 percent, and thus is significantly lower than the maximum individual tax rate of 37 percent. Corporations are not entitled to preferential rates on capital gains. Their ordinary income and capital gains are taxed at 21 percent. Capital losses of individuals and corporations are available to reduce only capital gains (with the exception of a minor amount that can be applied to reduce ordinary income when the taxpayer is an individual).

I.R.C. § 1221 defines a capital asset by what it is *not*: under § 1221(a), a capital asset is property owned by a taxpayer, whether or not connected with the taxpayer's trade or business, that is not specifically excluded from the definition of capital asset under § 1221(a)(1) through (8).

Property that is used in a trade or business and subject to depreciation under I.R.C. § 167 is not a capital asset under § 1221(a)(2). Thus, intellectual property depreciable under § 167, i.e., generally self-created intellectual property, will not be a capital asset under § 1221. Certain property held by an individual taxpayer whose personal efforts created the property (or a person in whose hands the basis of the property is determined, in whole or in part, by reference to the basis of the property in the hands of the person who created it) is not a capital asset, including a copyright or a literary, musical, or artistic composition, under § 1221(a)(3). This exclusion prevents creators that are not engaged in a trade or business from receiving capital gains treatment when the same type of person engaged in a trade or business would not receive such treatment. Under the TCJA, the exclusion for certain self-created intellectual property from the definition of capital asset under § 1221 now includes self-created patents. [16]

I.R.C. § 1231 generally applies to property used in a trade or business, subject to the allowance for depreciation under § 167 and held for more than one year. However, like § 1221, § 1231 excludes (1) inventory, (2) property held for sale to customers in the ordinary course of a trade or business, and (3) certain property, including a copyright or a literary, musical, or artistic composition, held by the taxpayer whose personal efforts created the property (or a person in whose hands the basis of the property is determined, in whole or in part, by reference to the basis of the property in the hands of the person who created it) is not a capital asset. [17] Under the TCJA, the exclusion for certain self-created intellectual property from the definition of capital asset under § 1231 now includes self-created patents. [18]

As discussed above, acquired intellectual property will be either an amortizable § 197 intangible asset or an intangible asset excluded from § 197 but possibly amortizable under § 167. Such intellectual property generally will not be a capital asset under § 1221, but if it is used in a trade or business, held for more than one year, and otherwise not excluded from § 1231, any gain or loss on the sale of the intellectual property may be treated as capital gain or loss under § 1231.

A special statutory rule applies to persons characterized as "holders" of patents. Under I.R.C. § 1235, a holder of a patent (or an undivided interest in the patent) is any individual whose efforts created the invention and any other individual who acquired his or her interest in the property right in exchange for consideration in money or money's worth, provided the price is paid prior to the actual reduction to practice of the invention. In the latter set of circumstances, the acquirer cannot be the employer of the creator of the invention nor related to the creator. This provision was enacted to address an unwarranted benefit enjoyed by amateur inventors that was denied to professionals. The former class of individuals benefited from capital gains tax rates on the sale of a patent while the latter was subject to U.S. tax at ordinary income tax rates.

Under § 1235, a transfer consisting of "all substantial rights" to a patent, or a transfer of an undivided interest in the patent, which includes a part of all the rights, is considered to be a sale or exchange of a capital asset held for more than one year. The actual holding period is irrelevant. Consequently, an individual who qualifies as a holder is entitled to compute tax on the gain from a sale of all substantial rights at favorable long-term capital gains rates. The consideration may be payable periodically with the transferee's use of the patent or contingent on the productivity, use, or sale of the patent. The Regulations establish certain hurdles that must be overcome for a transfer by license or sale to be considered a transfer of all substantial rights. [19]

Recapture as Ordinary Income

Depreciable or amortizable property generally will be subject to a recapture provision, such as I.R.C. § 1245, which will require the taxpayer to characterize some or all of the gain (but not the loss) on a transfer of the property as ordinary gain. The recapture rules of § 1245 apply to tangible and intangible assets that may be amortized under § 167 and to § 197 intangibles. Under the mechanics of § 1245, any gain attributable to a decrease in adjusted basis attributable to previously taken amortization deductions must be characterized as ordinary income. After applying the recapture rules of § 1245, any remaining gain recognized on the sale—or the loss, if the property is sold for less than the amortized basis immediately prior to the transaction—must be analyzed under the rules of § 1221 and § 1231, discussed above, to determine its character.

Is the Transfer a Sale or License?

Intangible assets, particularly intellectual property, are frequently licensed, resulting in royalty income to the licensor, which is characterized as ordinary income. If the underlying intangible asset is amortizable, the licensor will continue to be able to amortize the asset notwithstanding the license agreement. As a result, the licensor will recover its tax basis in the licensed intangible asset over the recovery period, e.g., 15 years in the case of many intellectual property assets.

In contrast, if the transaction has the economic effect of a sale but is legally characterized as a license, the seller can recover its full tax basis in the property right it transferred in the transaction. This is a better outcome for the seller because it can immediately offset any gain from the transfer against its tax basis, rather than over an amortization period.

A key question to consider in the taxation of a licensor transferring an exclusive license is whether, notwithstanding the form, the transfer should be treated as a sale of the intangible asset. Under an objective test known as the "substantial rights test," a transfer of a license can be treated as a sale if the licensor relinquishes all substantial rights to the licensee. On the other hand, a transfer by sale can be treated as a license if it involves a transfer of a nonexclusive right to use an intangible asset, particularly for a period less than the estimated useful life of the asset.

Selected Tax Issues of Transfers to Startups

At some point in the development process, the inventors of an IP asset may decide to form a company in order to start exploiting the intellectual property in a trade or business. They may choose to form a corporation, or they may prefer a partnership or limited liability company subject to tax like a partnership.

Under I.R.C. § 351, a shareholder's contribution of property, including intellectual property, to a corporation will be tax-free if:

- The transfer is solely in exchange for stock of the transferee corporation; and
- The transferor is in control of the transferee corporation immediately after the exchange, which for this purpose means ownership of 80 percent or more of the total value and 80 percent or more of the total voting rights with respect to the corporation's stock.

If the § 351 requirements are not met, the shareholder will recognize gain (but not loss) to the extent that the value of the stock exceeds its adjusted basis in the intellectual property. Here, value of shares is closely associated with the value of the intellectual property at the time of transfer. The transferee corporation's basis in the contributed intellectual property will be the same as that of the transferor shareholder. Any gain recognized by the transferor shareholder will be added to the transferee corporation's adjusted basis in the contributed intellectual property.

In the past, there was some doubt as to whether intangible assets, such as intellectual property, constituted "property" for purposes of § 351. Though the issue has been settled in favor of the taxpayer, an issue that is not clear is whether a transfer of less than all substantial rights in the property, such as a transfer of a license to use the intellectual property, is a tax-free transfer under § 351. In Revenue Ruling 69-156, the IRS determined that the transfer by a domestic corporation of an exclusive right to import, make, use, sell, and sublicense a patent involving a chemical compound to its foreign subsidiary was not a transfer of "property" within the meaning of § 351. It stated that tax-free treatment under § 351 is only available when the rights transferred by the shareholder would constitute a sale, not a license, if the transfer were a taxable transfer. In contrast, in *E.I. DuPont de Nemours & Co. v. United States*, [20] the Court of Claims held that a carved-out right to a nonexclusive license would qualify for tax-free treatment under § 351 and that there was no basis for limiting tax-free treatment under § 351 to transfers that would constitute sales or exchanges if they were not subject to a nonrecognition provision. The IRS has recognized that this case has precedential value and must be strongly considered, although it has not withdrawn the ruling. [21]

A shareholder's receipt of stock in exchange for services does not meet the requirements of § 351. However, if intellectual property is transferred and it constitutes property for the purposes of § 351, the transfer will be tax-free under § 351, even though the shareholder performed services to produce the property. Further, where the transferor shareholder agrees to perform services in connection with a transfer of property, the IRS determined that tax-free treatment under § 351 will be accorded if the services are "merely ancillary or subsidiary" to the transfer. These ancillary and subsidiary services could include promoting the transaction by demonstrating and explaining the use of the property, assisting in the "starting up" of the property transferred, or performing under a guarantee relating to the effective starting up.

The contribution of property by a partner to a partnership is governed by I.R.C. § 721, which states that neither the partner nor the partnership generally will recognize gain or loss on the transfer of property in exchange for an interest in the partnership. Unlike § 351, § 721 does not require the partner to be in "control" of the partnership. Thus, a transfer to a partnership is generally tax-free even if only one person transfers property to the partnership and that person ends up owning a small interest in the partnership after the transfer.

The question of whether a partner transferred "property" for the purposes of § 721 may arise in the case of a partner that transfers to the partnership less than all of its interest in intellectual property. This transaction is akin to transfer of a right to use intellectual property and is analogous to the grant of a license to the corporation by a controlling shareholder. The tax treatment is governed by the same authorities that are applicable to transfers under § 351, discussed above. Similarly, the question of whether a partner may provide services with the transfer of intellectual property and still preserve tax-free treatment under § 721 is governed by the same authorities applicable to transfers under § 351.

New Tax Regime for Offshore IP

The TCJA introduced a new tax regime applicable to "global intangible low-taxed income" (GILTI) [22] with the purpose of discouraging U.S. taxpayers from transferring or maintaining their IP income offshore. The GILTI regime applies to U.S. persons (e.g., U.S. citizens, residents, corporations, partnerships) who are "U.S. shareholders" of a controlled foreign corporation (CFC). A U.S. shareholder is a U.S. person who owns 10 percent or more of a foreign corporation's voting stock or 10 percent or more of the foreign corporation's stock by value. [23] A CFC is any foreign corporation in which U.S. shareholders own more than 50 percent of the foreign corporation's stock by value or vote. [24]

In greatly simplified terms, GILTI is gross income earned by a CFC with certain exclusions and deductions, including a deduction attributable to tangible property used in the CFC's trade or business. The GILTI regime requires U.S. shareholders to include GILTI in current income. That is, the income is taxable to the U.S. shareholder in the current year regardless of whether the CFC makes a distribution to the U.S. shareholder. GILTI generally is taxable at ordinary income tax rates, except that in the case of a corporate U.S. shareholder, GILTI income is eligible for a statutory deduction under I.R.C. § 250. As a result of the deduction, the tax rate on GILTI may be as low as 10.5 percent (although the rate will increase to 13.125 percent for tax years starting on or after January 1, 2026). The effective tax rate may be further reduced by an indirect foreign tax credit for the foreign taxes paid or accrued by the CFC.

Conclusion

The tax considerations of intellectual property are numerous and depend upon several factors, such as whether the intellectual property was self-created or acquired, or whether the taxpayer's objective is to use the intellectual property in a business or transfer it through a license or sale. As with most tax planning, it is better to consider the tax issues during the endeavor's early stages and to tailor the tax planning to the taxpayer's immediate and future plans.

Endnotes

1. *See* I.R.C. § 197.

2. Pub. L. No. 115-97, 131 Stat. 2111 (2017).

3. Treas. Reg. § 1.174-2(a)(1).

4. *Id.*

5. Snow v. Comm'r, 416 U.S. 500 (1974).

6. I.R.C. § 174(a) (as amended by TCJA § 13206(a)).

7. Treas. Reg. § 1.263(a)-4(b)(1).

8. *Id.* § 1.263(a)-4(b)(1)(v).

9. *Id.* § 1.263(a)-4(d)(5), (9).

10. *See id.* § 1.263(a)-4(c)(vii), (viii), (xiv).

11. I.R.C. § 167(a).

12. Treas. Reg. § 1.167(a)-3.

13. *Id.* § 1.167(a)-3(b)(1).

14. *Id.* § 1.167(a)-3(b)(3).

15. I.R.C. § 197(c)(2), (d)(1)(F). Other self-created intangible assets that may be amortized under § 197 include (1) licenses, permits, and other rights granted by a governmental unit; and (2) any covenant not to compete entered into in connection with the acquisition of a trade or business. *See id.* § 197(c)(2), (d)(1)(D), (d)(1)(E).

16. I.R.C. § 1221(a)(3) (as amended by TCJA § 13314(a)).

17. *Id.* § 1231(b)(1)(C).

18. *Id.* § 1231(b)(1)(C) (as amended by TCJA § 13314(b)).

19. Treas. Reg. § 1.1235-2(b).

20. 471 F.2d 1211 (Ct. Cl. 1973).

21. I.R.S. Field Serv. Adv. 1998-481.

22. I.R.C. § 951A (as added by TCJA § 14201(a)).

23. *Id.* § 951(b).

24. *Id.* § 957(a).