Patent Transfers Subject to Field-of-Use Limitations: Can Corporations Get Capital Gains Treatment

James A. Kearns

Follow this and additional works at: http://scholarship.law.nd.edu/ndlr

Part of the Law Commons

Recommended Citation
Available at: http://scholarship.law.nd.edu/ndlr/vol48/iss5/9

This Note is brought to you for free and open access by NDLScholarship. It has been accepted for inclusion in Notre Dame Law Review by an authorized administrator of NDLScholarship. For more information, please contact lawdr@nd.edu.
PATENT TRANSFERS SUBJECT TO FIELD-OF-USE LIMITATIONS:
CAN CORPORATIONS GET CAPITAL GAINS TREATMENT?

I. Introduction

The great majority of commercially useful patents are held, not by individual inventors, but by corporations, ordinarily pursuant to assignment clauses in contracts with their inventor-employees. When a transfer of rights under such patents is made, it is often subject to a field-of-use limitation; that is, the transferor corporation grants a license covering less than all of the uses to which the patent may be applied. For example, certain patented devices and processes may be useful in the production of both nylon and dacron fabrics. A license allowing another to use the devices and processes in the manufacture of nylon, but not dacron, would be a transfer of the patent rights subject to a field-of-use limitation.¹

Usually the transferor corporation will wish the payment it receives from the transferee to be taxed at capital gains rates, rather than at the higher ordinary income tax rates. It is the purpose of this note to determine whether, and under what circumstances, such treatment can be obtained under present statutory and case law.

II. Statutory Analysis

An initial examination of the Internal Revenue Code of 1954 draws one's attention to § 1235 dealing with the “Sale or Exchange of Patents,” which provides:

(a) General.—A transfer (other than by gift, inheritance, or devise) of property consisting of all substantial rights to a patent, or an undivided interest therein which includes a part of all such rights, by any holder shall be considered the sale or exchange of a capital asset held for more than 6 months, regardless of whether or not payments in consideration of such transfer are—
   (1) payable periodically over a period generally coterminous with the transferee’s use of the patent, or
   (2) contingent on the productivity, use, or disposition of the property transferred.²

It is clear from the statute,³ the legislative history of this section,⁴ and from the regulations,⁵ that corporations do not qualify as “holders” under § 1235. Corporations can, however, still invoke the other provisions of the Code to obtain capital gains treatment for the transfer of a patent.⁶

---

¹ E.I. duPont de Nemours and Co. v. United States, 432 F.2d 1052 (3d Cir. 1970).
³ Id. § 1235(b).
⁵ Treas. Reg. § 1.1235-2(d) (1960).
It has long been established that patents are "property" for tax purposes; thus, they have the potential to qualify as capital assets under § 1221. However, § 1221 specifically excludes from capital assets "property, used in [the taxpayer's] trade or business, of a character which is subject to the allowance for depreciation provided in section 167..." Because patent property held by a corporation is generally used in a trade or business, and is subject to an allowance for depreciation under § 167, it does not qualify as a capital asset under § 1221. However, for the same reasons, such patent property may qualify as a "1231 asset." Section 1231 allows "capital gain-ordinary loss" treatment for depreciable property used in a trade or business. This section requires that there be a "sale or exchange" of the property. It is here that problems arise when a field-of-use limitation is involved. The cases are in conflict over the issue whether a field-of-use limitation precludes the transfer of a patent from being a "sale or exchange" under the general capital gains provisions, § 1222 and § 1231.

III. Case Law

A. The Carruthers Case and Its Progeny

*United States v. Carruthers* begins a line of several cases holding that capital gains treatment may be accorded the transfer of a patent subject to a field-of-use restriction. In *Carruthers* the taxpayer assigned to a corporation all the rights under a patent owned by him, but limited their use "to the tuna industry." The Commissioner contended that the rights retained by the taxpayer were such that the transfer was a mere "license" rather than an "assignment" for tax purposes. Both sides looked to *Waterman v. Mackenzie*, a case concerning the right to sue for infringement of patent rights and not the taxation of their transfer. The Supreme Court in *Waterman* set forth a test for determining whether a transfer of patent rights is a license or an assignment for patent infringement purposes:

The patentee or his assigns may, by instrument in writing, assign, grant and convey, either, 1st, the whole patent, comprising the exclusive right to make, use, and vend the invention throughout the United States; or, 2d an undivided part or share of that exclusive right; or, 3d the exclusive right under

9 INT. REV. CODE OF 1954, § 1221(2).
10 Id. § 167; see Treas. Reg. § 1.167(a)-6 (1956).
11 INT. REV. CODE OF 1954, § 1231. It should be noted that § 1249 applies in the case of the sale or exchange of a patent, invention, or similar property right to a controlled foreign corporation. Under § 1249, if the gain thereon would otherwise be gain from the sale of property described in § 1231, then it shall be considered as gain from the sale or exchange of property which is neither a capital asset nor a "1231 asset." Similarly, capital gains under § 1231 may be subject to depreciation recapture under § 1245. INT. REV. CODE OF 1954, §§ 1245, 1249.
12 219 F.2d 21 (9th Cir. 1955).
The Commissioner urged that a transfer limited to an industry rather than to a geographical area did not strictly comply with the Waterman test; therefore, he contended that the transfer was a license and not a "sale or exchange." The court, however, was "not convinced that it would be reasonable or necessary for this court in the tax case now before us, to strictly and literally apply the test announced in an infringement suit in the nineteenth century." The court found that a transfer encompassing an industry was sufficiently similar to a transfer encompassing a geographical area, to justify receiving similar tax treatment as an assignment.

It is important to note that this finding was not necessary to decide the case. For the court went on to point out that although there were words of limitation "to the tuna industry," there was in fact a transfer of "whole" patent rights since the patents had no established value for any purpose other than processing tuna fish, and no attempt had ever been made to use the patents outside of the tuna industry. Therefore, the Carruthers court found that the taxpayer would have met even the traditional Waterman test.

This distinguishing feature was relied upon by the court in American Chemical Paint Co. v. Smith. The taxpayer there held patents on certain paints. He transferred the exclusive right to manufacture, use and sell the paints, but reserved to himself the exclusive right to manufacture, use and sell the paints for use on hot-rolled structural steel used in specified types of construction. The court held that, because the transferee's rights were limited to "some species" of the patented inventions, "... the agreement did not convey to the licensee the entire and unqualified monopoly which the patentee had." In concluding that the agreement was not an assignment, the court distinguished Carruthers:

There was in fact a transfer of the whole patent rights, since the tuna industry included the full scope of the patents. In the instant case, the patent rights were not designed for use solely in any particular industry. Therefore, the reservations in the agreements constituted substantial limitations on their use, so that there was not a transfer of whole patent rights. Consequently, the agreement was a mere license.

Shortly after American Chemical Paint Co., and notwithstanding that decision, Carruthers was followed in First National Bank v. United States. The taxpayer had obtained a patent on an invention to be used in the manufacture

---

14 Id. at 255 (emphasis added). The Supreme Court claimed to derive its threefold test from the patent laws then in effect. Similar language is contained in the present statute, 35 U.S.C. § 261 (1954):

The applicant, patentee, or his assigns or legal representatives may in like manner grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States.

15 219 F.2d at 24.
16 Id.
17 Id. at 25.
19 Id. at 738, citing Waterman v. Mackenzie, 138 U.S. 252 (1891).
of brushes. He granted to the transferee corporation the exclusive right to apply
the patent solely for the production of toothbrushes, retaining the right to use the
invention on other kinds of brushes. Relying upon Carruthers, the court stated
that "even with the reservation of rights for use in other industries, the grant . . .
may still qualify as a sale for tax purposes." As in Carruthers, though, the
evidence indicated that the reserved rights had only a "highly speculative" monetary value; thus, even with a field-of-use restriction, the grant conveyed
"substantially all of [the taxpayer's] valuable interests in the patent." The court
cited American Chemical Paint Co., but did not discuss it.

A significant step was taken three years later by the United States Court of
Appeals for the Third Circuit in Merck & Co. v. Smith. The taxpayer there
had obtained a patent for a class of chemical compounds known as sulfonamido
pyrimidines, more popularly known as "sulfa drugs." In the transfer in question
the taxpayer granted an exclusive license covering only 2-sulfonamido pyrimidine,
one of several species claimed in the original generic patent. The court set forth
an "all substantial rights" test as determinative of whether an assignment has
been made for capital gains purposes:

[A] transfer of all of the substantial rights in a patent is deemed an assign-
ment and qualifies the transferor for capital gains treatment. A transfer of
anything less is called a license with a resultant assessment of the tax at
ordinary income rates.

Under this test, the transfer of anything less than the entire generic patent—
one species, for example—would appear not to qualify as an assignment taxable
at capital gains rates under § 1231. Yet the court held for the taxpayer, on the
theory that where one generic patent covers several species, the separate members
of the class, having separate identities, can be separately sold. Apparently the
other compounds covered by the patent were of equal value to the one trans-
ferred; they were separate entities themselves. Thus, although not a transfer
subject to a field-of-use restriction in the strict sense, the separability-of-species
language would call for at least a reconsideration of American Chemical Paint
Co. The latter case, while stating that a transfer of some species of the patented
article was a transfer of less than the whole patent, actually confused the transfer
of a right to a species with the transfer of a right to a use of the same patented
item. American Chemical Paint Co. involved the retention of the right to use the
same patented article as that transferred for another purpose in a certain in-
dustry. Thus, American Chemical Paint Co. is strictly a field-of-use case, and is
therefore not applicable to the "species" theory propounded in Merck & Co.
This would explain why the court in Merck & Co. made no reference to that

22 Id. at 824.
23 Id.
24 261 F.2d 162 (3d Cir. 1958).
25 Id. at 164.
26 Id. at 165. A single patent may issue for two or more separate inventions. Special
decision, and allowed the transfer to be treated as a sale for capital gains purposes, citing Carruthers and First National Bank as "analogies."

The issue of license-versus-assignment arose again in a slightly different context in Redler Conveyor Co. v. Commissioner, with the court reaching a conclusion opposite to that in Merck & Co. In Redler, the taxpayer had received payments under agreements involving some of its United States and Canadian patents and applications. The Commissioner claimed that the agreements were not assignments but only licenses, such that the payments received were royalties, subject to the personal holding company tax under the applicable statutes. In reaching its conclusion, the court considered several factors, including the form of the agreement and depreciation treatment, but considered the most important fact to be that "... the agreements do not purport to transfer either entire or undivided interests in the patents but instead only segregated rights to some but not all of the uses of the patents." The court found that the evidence indicated that the rights reserved were of substantial value: "So far as we can tell they detract materially from the whole bundle of patent rights which might have been transferred." Directly applying the traditional threefold Waterman test, and without referring to any of the cases discussed above, the court held that the transfer of "only segregated rights to some but not all of the possible uses of the patents" could not be considered an assignment for tax purposes.

In Allied Chemical Corp. v. United States, a more recent case, arising under the predecessor of § 1231, the "all substantial rights" test enunciated in Merck & Co. was applied to the transfer of rights in a patented wrapper, restricted to use in the "cheese field." Because the transferor had retained the "substantial right" to license others in the same field in which it had allegedly "sold" the patent, the transfer was held not to qualify as a "sale." With no apparent necessity for doing so, the lower court noted further that "a transfer of a single claim or a single field of use covered by a patent may be accorded capital gains treatment ..." On appeal, the United States Court of Appeals for the Second Circuit affirmed, but explicitly refrained from deciding "whether the District Court was correct in its holding that the transfer of less than all the valuable claims of a patent may be a sale."

There is, then, a clear conflict of views on the question of whether capital gains treatment is available for transfers of patent rights limited to particular fields of use. The support found in Carruthers and First National Bank is weakened by the consideration that in both cases the field-of-use restriction did in fact encompass all valuable rights in the patent. On the other hand, the strict

---

27 261 F.2d at 165.
28 303 F.2d 567 (1st Cir. 1962).
29 INT. REV. CODE OF 1939, § 502(a).
30 303 F.2d at 569.
31 Id.
32 Id.
34 INT. REV. CODE OF 1939, § 117(j).
36 Id.
37 370 F.2d 697 (2d Cir. 1967).
38 Id. at 700.
application of the Waterman criteria in American Chemical Paint Co. and Redler is subject to the criticism set forth by the Carruthers court; namely, that it does seem anomalous to permit geographic restrictions, while discouraging limitations to a particular industry, or field-of-use. Merck & Co. is important for its implication that capital gains treatment of field-of-use restricted transfers may be allowed, even when the rights retained are of "substantial" value, based on the analogy of the separability of various "species" encompassed by a single generic patent.

B. Impact of § 1235: Confusion and Conflict

In the past several years the dispute over field-of-use restrictions has been further complicated by cases arising under § 1235. This is in spite of the express congressional intent that corporate taxpayers should be wholly unaffected by § 1235: "[T]he tax consequences of the sale of patents . . . by corporations, is to be governed by the provisions of existing law as if this section had not been enacted." However, in citing precedent for their holdings, the courts have failed to discriminate between cases decided under § 1235 and those decided under the general capital gains provisions. The following paragraphs trace this development and its effects on the present state of the law.

1. What Did Congress Intend?

Section 1235 speaks not in terms of a "sale or exchange," as do § 1221 and § 1231, but rather requires the transfer of "property consisting of all substantial rights to a patent." One apparent reason for this difference is that the special character of a patent often requires that the transferor retain some control over the property in order to insure against default by the transferee in paying the purchase price, which is usually in periodic "royalty" payments over an extended period of time. For example, a security interest, or a reservation in the nature of a condition subsequent (e.g., a forfeiture on account of nonperformance), is often included in the terms of a transfer of patent rights. The legislative history makes it clear that such rights are not to be considered "substantial rights to a patent," the retention of which would defeat the applicability of § 1235.

Furthermore, Congress's main concern was not the "sale or exchange" question, but the method-of-payment issue. § 1235 was enacted primarily to settle the dispute between the Commissioner and the courts over the issue whether the purchase price conditioned on the use or profitability of the invention—that is, in the form of "royalty" payments rather than in a lump sum—was taxable as ordinary income or as capital gain. The transfer of "all substantial rights" requirement was meant simply as a restatement of the existing test for a "sale or exchange":

40 Id. at 5083.
41 Id. at 5082.
The section does not detail precisely what constitutes the formal components of a sale or exchange of patent rights beyond requiring that all substantial rights evidenced by the patent (other than the right to such periodic or contingent payments) should be transferred to the transferee for consideration. This requirement recognizes the basic criteria of a "sale or exchange" under existing law, . . . .

This reference to "existing law" led the courts to look outside the scope of § 1235 for standards concerning the effect of field-of-use limitations on the "sale or exchange" requirement. Since the cases were not in agreement on this question, as discussed above, the way was open for continued conflict. This is what in fact developed, with the Commissioner adopting the stand taken by American Chemical Paint Co. and Redler, while the Tax Court took the view expressed in Carruthers, First National Bank, and Merck & Co.

2. The Tax Court Versus the Commissioner

In Estate of Milton P. Laurent, Sr.,43 for example, the taxpayer sought § 1235 treatment for a transfer which gave the transferee "all the rights in the patent to the extent of their use for the manufacture of gate valves; and [gave] no other rights, if any, which existed in the devices covered by the original patent."44 The court found that whether the rights retained by the taxpayer were of value or not, the transfer was entitled to capital gains treatment. On the one hand, if the transfer did not actually leave any "substantial" rights with the transferor, then the court held it would be covered by Carruthers. Alternatively, if the field-of-use restriction was a meaningful one, then capital gains treatment would be allowable on the authority of Merck & Co. Whether these two decisions accurately reflected the "all substantial rights" test enunciated in § 1235 was not discussed at all by the Laurent court.

In a subsequent case, William S. Rouverol,45 the court did recognize that § 1235 required a resolution of whether there had been "[a] transfer . . . of property consisting of all substantial rights to a patent."46 The taxpayer’s patent on a multiple-ball transmission covered a "basic generic invention" with potential application in several fields. The taxpayer had granted to each of two transferees an exclusive license to make, use and sell the invention throughout a specified geographic territory, within a given field of use. The court held that "the decided cases, both prior and subsequent to the enactment of section 1235(a), . . . are favorable to petitioner’s view that in these agreements he transferred to the transferees ‘all substantial rights’ to his patents.”47 The “decided cases” cited by the court were Carruthers, First National Bank, and Merck & Co. (non-1235 cases), and Milton P. Laurent (a 1235 case, but based

42 Id. at 5082-83 (emphasis added).
44 34 T.C. at 397.
45 42 T.C. 186 (1964).
46 Id. at 190.
47 Id. at 194.
The court did not discuss the rationale of these cases, nor did it make any mention of the opposite holdings of American Chemical Paint Co. and Redler.

The Commissioner responded to the Rouverol decision by amending the regulations under § 1235 to provide:

The term "all substantial rights to a patent" does not include a grant of rights to a patent—

(iii) Which grants rights to the grantee, in fields of use within trades or industries, which are less than all the rights covered by the patent, which exist and have value at the time of the grant; or

(iv) Which grants to the grantee less than all the claims or inventions covered by the patent which exist and have value at the time of the grant.\(^49\)

The Tax Court, in turn, declared the regulation invalid, in Thomas L. Fawick.\(^50\) In a factual situation similar to that of William S. Rouverol, the taxpayer transferred the exclusive right to make, use and sell his patented invention (a "one-to-one" clutch), restricted to marine use only, and claimed capital gains treatment under § 1235. In holding that a transfer of only one field of use amounts to a transfer of "property consisting of all substantial rights to a patent," the court relied on its Rouverol decision.\(^51\) Rouverol, it will be recalled, had been based primarily on non-1235 cases. But by the time Thomas L. Fawick was decided, this distinction was no longer being made clear.

The distinction between § 1235 and other patent transfers was further confused by E.I. duPont de Nemours & Co. v. United States,\(^52\) which involved the transfer of patent rights with a restriction that they be used only in the production of nylon. Because the taxpayer-transferor was a corporation, § 1235 was not applicable. The court still applied the "all substantial rights" test, on the authority of Merck & Co., which had been decided by the same court 12 years earlier. Capital gains treatment was allowed because the court found that the rights retained by the taxpayer were of little value, so that "all substantial rights" in the patent were in fact transferred.\(^53\) Although it appears not to have been necessary, the court went on to affirm the lower court's conclusion "that, for capital gains purposes, the nylon rights, considered independently, were proper subjects for a sale. For such purposes, patent rights are divisible between different industries and different industrial products."\(^54\) In support of this gratuitous statement the court cited not only Carruthers and First National Bank, which were in point, but also Laurent, Rouverol, and Fawick, without distinguishing these as having arisen under § 1235.\(^55\)

\(^{48}\) Id. at 192-93.


\(^{50}\) 52 T.C. 104 (1969).

\(^{51}\) Id. at 112.

\(^{52}\) 432 F.2d 1052 (3d Cir. 1970).

\(^{53}\) Id. at 1057.

\(^{54}\) Id. at 1057. This is precisely the same kind of unnecessary step which the Court of Appeals for the Second Circuit refused to take in Allied Chemical Corp. v. United States, 370 F.2d 697 (2d Cir. 1967); see text accompanying note 38, supra.

\(^{55}\) 432 F.2d at 1057.
3. The Fawick Reversal

Following E.I. duPont, an attempt to set forth an independent rationale for § 1235 was made in Fawick v. Commissioner, reversing the Tax Court’s decision discussed above. The court of appeals held that the “all substantial rights” test could not be satisfied when there was a field-of-use limitation, giving as its reason, not the traditional Waterman criteria, but the nature of a patent itself:

The monopoly right granted by the patent is the right to exclude others from making, using, or selling the invention. This necessarily encompasses the rights to exclude others from any particular industrial field in which those others might choose to use the invention. This is the right that must be sold to the transferee, and the transfer must cover all practical fields-of-use for the invention.57

The court apparently felt some necessity to discuss Carruthers and E.I. duPont, although Carruthers had not been decided on the “all substantial rights” test, and E.I. duPont had applied that test outside of § 1235. Nevertheless, the court in Fawick was careful to point out that in both of these cases no “substantial” rights had actually been retained. In contrast, said the court, the Fawick patents were shown to have value outside the marine service industry at the time of the license. The field-of-use restriction, therefore, disqualified the transaction from capital gains treatment under § 1235.58

After noting that a division of opinion existed among the courts,59 the court approved the reasoning of Redler Conveyor Co. v. Commissioner,60 which did not allow assignment treatment of a field-of-use restricted transfer. The court’s reliance on Redler, however, was inconsistent with that decision in two respects. First, the court considered Redler to have interpreted § 1235, when in fact that section had not been involved in Redler at all, but rather only the provisions of the personal holding company tax.61 Second, the court in Fawick stated that “whether [a] transfer falls within the Waterman definition of an assignment is of no consequence to the operation of the statute [§ 1235].”62 However, it had been solely upon the Waterman definition that the Redler court had based its rejection of field-of-use limitations.63 Thus, although the court of appeals in Fawick attempted to clarify and settle the field-of-use question, it only added fuel to the fire, both by further intermingling 1235 and non-1235 cases in considering the “all substantial rights” test, and by endorsing the Redler decision inconsistently with the actual reasoning of that case. By thus undermining the

---

57 436 F.2d at 662.
58 Id. at 665.
60 303 F.2d 567 (1st Cir. 1962).
61 See text accompanying note 29, supra.
62 436 F.2d at 665.
63 See text accompanying note 32, supra.
predominant field-of-use doctrine, the Fawick decision can only encourage the Commissioner to continue attacking field-of-use limitations, even outside of § 1235.

An indication that this may occur appeared in Donald C. MacDonald, in which the Commissioner contended that the regulations under § 1235—interpreting “all substantial rights to a patent”—should apply “by analogy” to the general capital gains provisions. The Tax Court rejected that argument on the grounds that the question of “all substantial rights” did not even arise in the case at hand, and that moreover those regulations had been declared invalid in its own Fawick opinion.

Following MacDonald, the Tax Court in Albert A. Mras declined to accept the Court of Appeals opinion in Fawick as controlling, and repeated its “acceptance of the legal principle that a grant of the exclusive right to a patented invention in a particular geographic area or field of use could qualify as a transfer of ‘all substantial rights’ under section 1235.” The court cited numerous cases, holding those decided under § 1235 to be “in accord with the reasoning of other cases decreeing capital gain treatment for restricted field-of-use transfers falling outside the confines of [§ 1235].” The court recognized that American Chemical Paint Co. and Redler had reached the opposite result, but still concluded that its own position was in “accord with controlling judicial analysis.”

IV. Conclusion

Because of the confusion and conflict among the various decisions, both under § 1235 and under the general capital gains provisions, over the treatment of patent transfers with field-of-use restrictions, resolution of the question may require a decision by the Supreme Court or additional legislation by Congress. The question then arises as to what form that resolution should take.

To begin with, it appears that the “all substantial rights” test has the support of both sides, and is a reasonable criterion given the special characteristics of patent transfers. This test seems to have sprung from the criteria of Waterman v. Mackenzie, which expressly allowed limitation by geographic area. Given the rationale of Waterman as a basis, the result in United States v. Carruthers is quite persuasive; namely, that a field-of-use limitation is not suf-

---

64 55 T.C. 840 (1971).
65 Id. at 858.
67 Id. at ¶ 71,123, 542-71.
68 William S. Rouverol, 42 T.C. 186 (1964); Estate of Milton P. Laurent, Sr., 34 T.C. 385 (1960).
71 See, e.g., E.I. duPont de Nemours & Co. v. United States, 432 F.2d 1052 (3d Cir. 1970); Fawick v. Comm'r, 436 F.2d 655 (6th Cir. 1971).
74 219 F.2d 21 (9th Cir. 1955).
sufficiently different from a geographical limitation to justify discouraging the one while allowing the other.\footnote{Id. at 24.}

Moreover, the *Waterman* standards also permit the transfer of an undivided part or share of the patent right.\footnote{138 U.S. at 255.} The transfer of all rights under a patent as used in a particular industry may represent as complete and unequivocal relinquishment of rights as the transfer of an undivided interest. Here again, because the economic consequences of the two kinds of transfer are very similar, the allowance of capital gains treatment in one area argues strongly for like treatment in field-of-use limitations.\footnote{See Comment, *Capital Gains Treatment on Proceeds from Patent Transfers*, 34 Mo. L. Rev. 98, 108 (1969).}

On the other hand, *Waterman* may be considered weak authority because it dealt with the procedural issue of whether the transferee could bring an infringement suit in his own name, and did not involve the tax consequences of the transfer.\footnote{Fawick v. Comm'r, 436 F.2d 655, 665 (6th Cir. 1971).} For this reason, it has been held that the monopoly right of a patent is an indivisible whole, and must be conveyed on an "all or nothing at all" basis in order to receive capital gains treatment.\footnote{Id. at 662. Treas. Reg. § 1.1235-2(b)(1).} Although this rigid approach has the benefit of being theoretically more "pure," it lacks the economic and commercial flexibility which would be available otherwise. Here the rationale of *Merck & Co. v. Smith*\footnote{261 F.2d 162 (3d Cir. 1958).} is helpful. Just as one generic patent may cover a class of inventions, the various members of which are salable separately, so may a patent on a single invention be thought of as covering a class of uses of the invention. In this way, the "members" of the "class" covered by the patent are the various "as-used" identities which the invention has. If such fields-of-use are both clearly identifiable and readily distinguishable, then it is logical to allow them to be individually transferred with the same capital gains treatment accorded to transfers of entire patents. This assumes that other basic requirements of a "sale or exchange" are met; for example, any license granted must be "exclusive" and subject only to such reservations as are necessary to guarantee payment of the purchase price.\footnote{See text accompanying note 40, supra.}

Thus, the "all substantial rights" test could be applied to the transfer of fields of use with consistency under both § 1235 and the general capital gains provisions. \textit{James A. Kearns}