

## PREVENT OVERVALUATION OF CHARITABLE INTELLECTUAL PROPERTY DONATIONS OR INCENTIVIZE SUCH DONATIONS?

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### I. INTRODUCTION

Many scholars have criticized the American Jobs Creation Act of 2004 (AJCA) for leaving little incentives for corporations to donate their intellectual property (“IP”) to charities.<sup>1</sup> A careful examination of the enactment of the AJCA and its associated problems, however, reveals that the critics are overstating the problems that currently exist.

Most of the critics’ concerns can be alleviated with only a slight modification to the current system: allowing additional deductions for any monetary expenditure that corporations spend in preparing the donation. Further, if Congress is willing to invest a little more effort into addressing the concerns, it can allocate a moderate fund to create a government-sponsored third party whose sole purpose would be to maintain a public “donation bank” of all donated IP rights. Not only would this minimize the waste of government resources, but it would also be a much simpler and more efficient way to deal with the critics’ concerns.

### II. BACKGROUND – THE CREATION OF THE AJCA AND ITS ANTECEDENTS

The AJCA was enacted to prevent corporations from abusing the tax deduction system when donating their IP rights to nonprofit organizations.<sup>2</sup>

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1. See Nancy Kilson et al., *New Tax Law Limits Charitable Deductions of Intellectual Property*, CYBERSPACE LAW, Nov. 2004, at 14, (reporting opposition to AJCA by academic and other nonprofit organizations who fear the new system will “discourage” donations).

2. See Ron Layton & Peter Bloch, *Please Donate Patents on the Shelf: Tax Benefits Can Be Focused for Greater Good*, LEGAL TIMES MAG., Mar. 15, 2004, at 30 (citing abuses of the tax system pre-AJCA and noting a then-considered law change to remedy the

Prior to the AJCA, corporations had been allowed to deduct fair market value for their donations.<sup>3</sup> As a result, they typically took excessive deductions for their donations.<sup>4</sup> Corporations were clearly taking advantage of the fact that IP rights were inherently very difficult to value.<sup>5</sup> Further, only non-quantifiable benefits were found in the system prior to the AJCA.<sup>6</sup> Therefore, many policy considerations and proposals were taken into account when reforming this tax deduction system.<sup>7</sup>

#### A. *Pre-AJCA Era*

Prior to the enactment of the AJCA, corporations had great tax-based incentives to donate their “orphan” patents.<sup>8</sup> Orphan patents are characterized as patents that: 1) are not consistent with a company’s core technology or mission; 2) are not appropriate for licensing to third parties; and 3) have no value for defensive purposes in competitive markets.<sup>9</sup>

Corporations were allowed to revalue their patents before making donations and had the patents’ fair market value deducted from their taxes for the donations.<sup>10</sup> They were allowed to ignore the patent’s book value, which in most cases was zero, and estimate the present value of future potential income stream.<sup>11</sup> Because this system was subjective and unreliable, corporations began to abuse the system. Instead of abandoning their inactive, but potentially useful IP rights, corporations simply donated

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problem).

3. 26 U.S.C.S. § 170(e)(1)(B)(iii) (2009) (“The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the sum of, in the case of a charitable contribution, of any patent, copyright . . . trademark, trade name, trade secret, know-how, software . . . or similar property, or applications or registrations of such property . . . the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).”).

4. See Layton & Bloch, *supra* note 2, at 30 (noting that corporations are permitted to disregard the book value of a patent and make subjective valuations of present value of future revenue).

5. Richard F. Riley, Jr. & Terri W. Cammarano, *New Restrictions (and Opportunities) in Donating Patents and Other Intellectual Property*, 16 TAX’N OF EXEMPTS 216, 217 (2005) (“The basis of donated intellectual property may be relatively easy to determine if the taxpayer purchased the property from a third party, but computing the basis in self-created patents, trademarks, and other types of intellectual property may involve difficult issues of allocating research and development expenses and other internal costs.”).

6. See Layton & Bloch, *supra* note 2, at 30 (stating that non-quantifiable benefits include: the expansion of university-corporate relationships, boosts to inventor morale, and greater opportunities for faculty).

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

them to nonprofit organizations, such as universities.<sup>12</sup>

Corporations were able to save substantial amounts of money through these deductions. For example, when Dow Chemical discovered that 25% of their patents had no business value, they were able to save more than \$40 million in five years by downsizing their portfolio by over 10,000 patents.<sup>13</sup> In addition, the donations of the unused IP rights have resulted in a tremendous amount of money in tax credits over the past several years.<sup>14</sup> According to calculations by M-Cam, who specializes in valuing and auditing patents, corporations received \$3.8 billion in tax deductions for donating patents that may have had no commercial value at all.<sup>15</sup>

These numbers speak volumes. The money saved by these corporations, for doing nothing more than donating their unused and useless patents, is money lost by the government because of its inability to collect taxes on such items. The government estimates that the decreased deductions with the AJCA will increase tax revenues by over \$300 million per year.<sup>16</sup>

#### B. Policy Considerations and Congress' Concerns

The concern for overvaluation, along with other policy considerations, eventually led to the enactment of the AJCA. One of those policy considerations was a desire to increase the number and size of research grants accompanying donated patents by allowing higher level bonus tax deductions for such grants.<sup>17</sup> The rationale was to give universities and other similar nonprofit organizations flexibility in developing donated patents and to encourage corporations to donate to them.<sup>18</sup> An option that Congress considered was to limit deductions to the book value of the orphan IP rights.<sup>19</sup>

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12. *Id.*

13. *Id.*

14. See, e.g., Ashlea Ebeling, *Washington Blocks Patent Tax Breaks*, FORBES.COM (Jan. 7, 2004), [http://www.forbes.com/2004/01/07/cz\\_ae\\_0107beltway.html](http://www.forbes.com/2004/01/07/cz_ae_0107beltway.html) (showing that DuPont donated patents valued at \$64 million to Penn State, the University of Iowa and Virginia Tech; Caterpillar donated \$50 million in patents to Mid-America Commercialization Corporation; and Kellogg donated \$49 million).

15. Lesley Craig & Lindsay Moore, *Making Patent Donations Work*, INTELL. ASSET MGMT., [http://www.buildingipvalue.com/05\\_NA/167\\_170.htm](http://www.buildingipvalue.com/05_NA/167_170.htm) (last visited Oct. 25, 2010).

16. John Dubiansky, Comment, *Tax Treatment of Patent Donations in Post-JOBS Act World*, 18 HARV. J.L. & TECH. 295, 303 (2004).

17. Layton & Bloch, *supra* note 2, at 30.

18. *Id.*

19. See *id.* (suggesting that “we should not . . . eliminate a policy that encourages invention without considering” the kinds of donations that will increase innovation, the likely costs those policies would impose, and other alternatives that could salvage the loss of technologies through patent abandonment).

Ultimately, however, Congress focused on two main concerns when they decided to modify the tax deduction system by enacting the AJCA.<sup>20</sup> The first concern was the inherent difficulty in determining the fair market value of IP rights.<sup>21</sup> The second concern was that nonprofit organizations receiving the donated patents or other IP rights would not have the expertise or the resources to effectively utilize such rights, even if the rights were substantially valuable.<sup>22</sup>

### C. *The AJCA*

In addressing the difficulty of valuing IP rights, Congress limited the tax deduction for donated IP to either the lesser of the taxpayer's basis in the contributed property or the fair market value of the property.<sup>23</sup> By promulgating this new rule for the initial deduction, Congress was trying to balance the benefits of donating IP rights with the unjustifiable gains of the donors. Apparently, in Congress' mind, the gains did not match the benefits to the donees or to society.

To maintain corporations' incentives to continue donating to nonprofit organizations, however, Congress allowed additional deductions over the following nine years.<sup>24</sup> This secondary deduction is proportionate to the actual benefits produced by the charity, such as royalties, in subsequent years.<sup>25</sup> Some technicalities include the requirement of obtaining a qualified appraisal if the deduction is greater than \$5000, and the requirement that the taxpayer attach the appraisal to his return if the deduction is greater than \$500,000.<sup>26</sup>

Nevertheless, even with this added incentive, there have been many criticisms of the AJCA's ability to incentivize corporations to donate.

### III. PROBLEMS WITH THE AJCA

After the enactment of the AJCA, many academics and nonprofit organizations have criticized the AJCA for creating problems of its own. As previously noted, these critics believe that the corporations now have very little incentive to donate their IP rights because of the severe limitations on the tax deductions placed by the AJCA.<sup>27</sup>

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20. Riley, Jr. & Cammarano, *supra* note 5, at 216.

21. *Id.*

22. *Id.*

23. *Id.* at 216-17.

24. *Id.* at 217.

25. Wendy C. Gerzog, *From the Greedy to the Needy*, 87 OR. L. REV. 1133, 1143 (2008).

26. *Id.*

27. Kilson et al., *supra* note 1, at 14.

On the contrary, others argue that the current AJCA system encourages donors to find a charity that is a good fit so that they can take advantage of the secondary deductions, which are less limited than the initial deduction.<sup>28</sup> However, finding a good fit would require the donors to conduct due diligence on the prospective donees to ensure that they have the desire and capability to effectively use the donated IP.<sup>29</sup>

In light of these criticisms, many scholars have made proposals focused on changing the current AJCA deduction system and fixing the overvaluation and incentive problems associated with it. Unfortunately, none of these proposals are very convincing. With only a slight modification to the current system, however, all the major concerns of the academics would cease to exist. Additionally, if Congress is willing, a more substantial reformation through the creation of a third party institution would help solve the problems in contention even more effectively.

#### A. *Incentive Problems in Donating IP*

Some scholars argue in favor of the old deduction system: allowing fair market value deduction for donated patents in order to encourage beneficial donations.<sup>30</sup> Even though the purpose of the legislation was to prevent corporations from overvaluing charitable IP donations, some scholars believe that fair market value charitable deduction is necessary “to encourage donations of IP to museums, libraries, universities, hospitals, research institutions, and other charities.”<sup>31</sup> These scholars believe that the current system does not provide enough incentive for corporations to donate their unused IP rights.<sup>32</sup> They believe the administrative burden, along with the uncertainty of the value of tax deductions, would disincentivize corporations from donating their IP rights to charities.<sup>33</sup>

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28. Riley & Cammarano, *supra* note 5, at 218 (“These new rules should provide a powerful incentive for patentholders and owners of other intellectual property to ensure that they donate property that is likely to generate real monetary value to the charity in the form of a stream of royalties or other income.”).

29. *Id.* at 218.

30. William A. Drennan, *Charitable Donations of Intellectual Property: The Case for Retaining the Fair Market Value Tax Deduction*, 2004 UTAH L. REV. 1045, 1131 (2004) (arguing that if a “big company” could obtain fair market value deduction for contributing the patent to a charity, such as UC-Berkeley, that is ready to develop the beneficial product, such as disease resistant rice, the tax deduction could encourage the beneficial donation).

31. *Id.* at 1053.

32. Kilson, *supra* note 1, at 14.

33. Xuan-Thao Nguyen & Jeffrey A. Maine, *Giving Intellectual Property*, 39 U.C. DAVIS L. REV. 1721, 1762-63 (2006) (noting that requiring donors to “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

Proponents of the pre-AJCA system go even one step further in arguing that the previous deduction system “allowed developing corporations to save money” and that “more research on other projects could be conducted with the tax dollars saved due to the donation[s].”<sup>34</sup> Others have argued that Congress only focused on dollar signs to recapture the tax deductions, but did not take other factors into considerations.<sup>35</sup> Some critics, for example, argue that corporations may actually lose money by making donations because there are certain costs for determining the value of IP rights and finding the right fit, both of which are necessary precursors for donating.<sup>36</sup>

In other words, the argument is that administrative costs of donating may exceed the amount saved through the tax deductions. If this were true, simple economics tells us that corporations would obviously not donate. Further, the total amount saved through the deduction process may still not be worth both a corporation’s time and effort to pursue the donation if the net gain were minimal. So even without a net negative result per se, corporations may still be discouraged from donating their IP rights.

#### B. *Burdens on the Donees*

Further complications arise because the AJCA assumes that universities or other nonprofit organizations would be willing to accept donations even though the AJCA requires more paperwork and reporting.<sup>37</sup> Critics thus argue that under the new system, charities would not want to accept any unmarketable interests.<sup>38</sup> The additional administrative burdens placed on the donees, along with the uncertainty of the value that the donated IP rights may potentially bring to the donees, would discourage the donees from accepting the donations.<sup>39</sup>

Critics believe that other means beside the AJCA were available in resolving these issues.<sup>40</sup> They believe that Congress could have dealt with the problems and concerns without completely revamping the pre-existing

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results[] . . . imposes heavy administrative burdens.”).

34. Nicholas C. Tomlinson, *Tax Abuse Halting Progress? An Inside Look at Patent Donations and Their Tax Deductibility*, 35 SW. U. L. REV. 183, 203 (2006).

35. *Id.* (arguing that Congress did not estimate the costs to businesses, charities and the economy that will result from the AJCA).

36. *Id.* at 203-04.

37. *Id.* at 204.

38. Gerzog, *supra* note 25, at 1174.

39. See Nguyen & Maine, *supra* note 33, at 1763 (requiring the charitable donee to file an annual information return reporting their qualified donee income and other specified information.).

40. Tomlinson, *supra* note 34, at 206 (“More structured reporting and standards for valuation would go far to prevent future abuse without discouraging donation or impeding progress.”).

tax deduction system that provided significant incentives for corporations to donate their IP rights.<sup>41</sup>

### C. *Waste and Relationships*

Critics also argue that the AJCA will effectively end the opportunity for nonprofit organizations to develop potentially valuable but unused technology, forcing it to go to waste.<sup>42</sup> They believe the aforementioned incentive problems, in particular, would lead to this result.<sup>43</sup>

Critics of the AJCA have also suggested that the current tax deduction system could potentially have a negative impact on the relationship between the nonprofit university donees and the corporation donors.<sup>44</sup> For example, with the current AJCA structure, corporations that continue to donate would spend a significant amount of resources in performing due diligence on the donees in hope of more substantial tax deductions in the subsequent years.<sup>45</sup> The corporation would be displeased if the nonprofit organizations did not use such donations in the best possible way because that would in essence eliminate the corporations' chance of obtaining more deductions in the years to follow.<sup>46</sup>

## IV. DO THE PROBLEMS REALLY EXIST?

Before creating solutions to fix the problems, we need to first examine whether the AJCA system really does provide less incentive for companies to donate and whether it really does create waste; and if so, to what extent those problems exist.

### A. *Incentive Problems – Revisited*

Although the critics' arguments all have valid points, donating patents may still provide benefits of their own. Thus, the incentives for corporations to donate may still exist, even under the current AJCA structure.

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41. *Id.*

42. See Nguyen & Maine, *supra* note 33, at 1755 (“[E]liminating 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.’” (quoting CCH, AMERICAN JOBS CREATION ACT OF 2004: LAW, EXPLANATION AND ANALYSIS 432 (2004))).

43. *Id.*

44. Riley & Cammarano, *supra* note 5, at 218.

45. *Id.*

46. *Id.*

As noted before, the IP rights that are being donated are mostly “orphan” IP rights.<sup>47</sup> If such rights had not been donated, they would most likely have been abandoned because of the sheer cost associated with maintaining their portfolios.<sup>48</sup> Empirical evidence even suggests that a majority of the patents prove to be worthless and impose the largest costs toward the end of the patent’s life.<sup>49</sup> Before the tax deduction system was realized, avoiding the majority of such costs simply meant allowing the patents or other IP rights to lapse into the public domain.<sup>50</sup> This is often referred to as an abandonment of IP rights.

In fact, one study shows that between 70% and 80% of patents owned by U.S. corporations are considered orphan technology.<sup>51</sup> In 2003, the Internal Revenue Service also reported that approximately two-thirds of all U.S. patents were allowed to lapse and were ultimately abandoned within 12 years of their issuance.<sup>52</sup> This merely reemphasizes the patents’ uselessness and lack of commercial value.<sup>53</sup>

Many of the donated patents are simply defensive patents that corporations developed to protect their original holders when the patents were competitive.<sup>54</sup> Thus, many of the donated patents have no value outside of that competitive role.<sup>55</sup> Further, if the patent or other IP right did have any commercial value, corporations would license the patents for profit, as opposed to donating them.<sup>56</sup>

Not surprisingly, in many cases, the recipient universities found that the patents received could not be developed or used, and thus, abandoned them to avoid maintenance and enforcement expenses.<sup>57</sup> In such cases, the corporations would receive an excessive tax deduction, in addition to the elimination of their maintenance fees, in exchange for something that had no value to the universities or society. The donated patents would have been abandoned and passed into the public domain, because the cost of commercialization would have been too high while the probability of

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47. Layton & Bloch, *supra* note 2, at 30.

48. *Id.*

49. Dubiansky, *supra* note 16, at 297.

50. *Id.*

51. RON LAYTON & PETER BLOCH, INT’L INTELLECTUAL PROP. INST., IP DONATIONS: A POLICY REVIEW 9 (2004).

52. Craig & Moore, *supra* note 15, at 3.

53. *See id.* (“[T]he majority of [donated] patents possessed no potential for commercialisation or social benefit.”).

54. *Id.*

55. *Id.*

56. *See* Dubiansky, *supra* note 16, at 303-04 (stating that the only patents that corporations would consider giving away for donations are IP rights that lack a ready commercial application).

57. Craig & Moore, *supra* note 15, at 3.



success too low.<sup>58</sup>

Additionally, some critics even contend that many of the current IP rights are mere “functional forgeries.”<sup>59</sup> Their contention is that some patents are based on the uniqueness of the words used to describe the invention rather than on the uniqueness of the invention itself.<sup>60</sup>

Receiving tax deductions through donations, however, was a more attractive means of disposing unneeded patents to corporations rather than simply abandoning them.<sup>61</sup> Therefore, even with the AJCA, the money that the corporations save from not having to incur costs of maintaining patents, along with the moderate deductions still allowed by the current system, may possibly continue incentivizing corporations to donate their IP rights to nonprofit organizations.<sup>62</sup> Furthermore, corporations may even donate IP rights that are capable of being licensed if the value of the allowable tax deduction exceeds the value of achievable licensing fees.<sup>63</sup>

#### B. *Waste Problems – Revisited*

Viewed another way, the tax deduction system allows corporations to gain a windfall through donations of IP rights that they otherwise would have abandoned. Donating such patents or other IP rights constitute a cost to society. The donations essentially lower the number of patents or other IP rights that would have naturally passed into the public domain through abandonment. This, in effect, “robs” society of property that could have belonged to it. Although there may still be problems associated with locating the abandoned IP rights, if those rights passed into the public domain, any nonprofit organization would at least have had the right to utilize them.

Giving credit to the waste argument, however, the benefits realized through donated IP rights have been and still are very real. In fact, DuPont, Eastman, and Proctor & Gamble have donated patents to universities, hospitals, and nonprofit organizations that enabled commercialization of

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58. LAYTON & BLOCH, *supra* note 51, at 7-8.

59. *Patent Donations and the Problem of Orphan Technologies: A Policy Forum on The Intangible Economy with David Martin & Peter Bloch at the Woodrow Wilson International Center for Scholars*, ATHENAALLIANCE.ORG (Apr. 14, 2004), <http://www.athenaalliance.org/pdf/PatentDonationSumm.pdf>.

60. *See id.* (noting that a significant amount of patents may be granted regardless of their ultimate validity due to the fee-based system of the Patent and Trademark Office).

61. Dubiansky, *supra* note 16, at 297.

62. *Id.* at 304 (“[A]ny deduction amount that exceeds the transaction costs associated with locating and managing a patent donation would be sufficient to motivate that donation.”).

63. *Id.* at 304 n.57.

significant products.<sup>64</sup> Many such success stories of donated IP rights exist.<sup>65</sup>

Some university staffs have also confirmed the positive effects and impact of IP donations on the quality of educational opportunities for students.<sup>66</sup> Further, donated patents could provide an avenue for improving the lives, safety, and health of not only Americans, but people around the world.<sup>67</sup>

The reason for this could be attributed in part to the fact that academic and corporate industries hold vastly different goals and interests, causing them to operate in very different ways.<sup>68</sup> Most of the nonprofit organization donees are in the realm of the academic world, while the donors are in the corporate world. It is, therefore, not difficult to imagine that some IP rights only find their way into the marketplace or prove to be useful through nonprofit organizations.<sup>69</sup> Lending further credence to the waste argument, donated patents could also provide an avenue for commercialization.<sup>70</sup>

For these reasons, it is clear that there are many potential benefits associated with donated IP rights. Therefore, stripping away the possibility of such benefits could be viewed as social waste. Even with such great potential, however, there is room to argue that robbing society of those rights, by choosing donation over abandonment, is more “wasteful.” Stated differently, preventing the IP rights from passing into the public domain in order for corporations to abuse the tax deduction structure may be more

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64. See Craig & Moore, *supra* note 15 and accompanying text (noting that there have been successes along the way as a result of the donated patents).

65. See, e.g., DAVID MARTIN, SPECIAL REPORT: PATENT DONATIONS – THE TALE OF INTANGIBLES 14-19 (2003), available at [http://www.mcam.com/downloads/20030108\\_donation-whitepaper.pdf](http://www.mcam.com/downloads/20030108_donation-whitepaper.pdf) (stating that DuPont’s donations of new papermaking patent right to the University of Maine may reduce operating costs and improve environmental performance for paper mills; Boeing’s patent donation to the University of Pennsylvania could help treat bone disease and injuries; patent donation websites could help buy computers for local youth; General Motors and Delphi’s display technology donation could be explored by Brown researchers; Kellogg’s patent donation could strengthen research; and Procter & Gamble’s patent donations could lead to new medicines).

66. See LAYTON & BLOCH, *supra* note 51, at 16 (“Students and teachers are often afforded opportunities to pursue research that would not be possible without donated patents.”).

67. See *id.* (using the Institute for One World Health, a nonprofit pharmaceutical company, to illustrate the possibilities for development in such an arena).

68. *Id.* at 8.

69. *Id.*

70. See Jeremy Bond, *Leveraging Patent Donation to Grow Technology-Based Businesses*, ECON. DEV. NOW, May 21, 2007, at 1, available at [http://www.thecati.com/news/IEDC\\_EDNow\\_052107.pdf](http://www.thecati.com/news/IEDC_EDNow_052107.pdf) (explaining the potential for patent donations to enhance the commercialization of technology-based businesses, such as one that produces fumigant technology).

wasteful than preventing the IP rights from falling into the hands of nonprofit organizations. This argument still holds ground regardless of whether the IP rights would have fallen into the hands of the “right” donees.

In light of the fact that most donated patents would have been abandoned anyway, some critics may even argue that donating patents to a singular university harms society by preventing other universities from using those patents.<sup>71</sup> After all, if the IP rights were abandoned, any nonprofit organization would be justified in utilizing the rights to create the previously noted benefits. Such use would not be limited to the one specified donee. Therefore, the potential benefits of a corporation’s abandonment of IP rights could be even greater than its specified donation to a “good fit” nonprofit organization.

Additionally, proponents of the AJCA have argued that the AJCA itself gives enough incentive to donors to place the patent or other intellectual property into the right hands and prevents waste in doing so.<sup>72</sup> As noted before, the potential for future deductions would provide some incentive for corporation to find good fit donees.

Notwithstanding these arguments that support the AJCA, however, there are still many flaws and much waste associated with the current system. First of all, many resources are wasted in calculating the value of the IP. The only easy case for calculating the taxpayer’s basis is when the taxpayer buys the IP from a third party.<sup>73</sup> Otherwise, calculating the basis of a self-created IP can be very difficult.<sup>74</sup> For example, calculating such a basis would involve attempting to allocate the research and development expenses as well as other internal costs.<sup>75</sup>

The same holds true for valuing the IP right’s fair market value, which may be necessary to compare to the taxpayer’s basis. For example, patents can involve untested technology, which gives no ready market that allows setting of comparables as is the case with real property.<sup>76</sup> The unique nature of most IP rights causes havoc in trying to set comparison values to any given specific IP.

A commonly used valuation method for IP rights consists of

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71. See Dubiansky, *supra* note 16, at 304 (“Abandonment, in contrast, would open up the innovation race to other universities as well, putting pressure on all institutions to develop the technology.”).

72. Riley & Cammarano, *supra* note 5, at 217.

73. *Id.*

74. *Id.*

75. *Id.* (stating that computing the basis in self-created patents, trademarks, and other types of intellectual property may involve difficult issues of allocating research and development expenses and other internal costs).

76. Craig & Moore, *supra* note 15, at 5.

measuring the income generated by a mid-size company in the same field.<sup>77</sup> However, even with such a model, risk factors are often underestimated and appraising the value requires building hypothetical models.<sup>78</sup> Critics also point to the fact that patents in most cases cannot be commercialized until a significant amount of research and development has been conducted.<sup>79</sup> Further, in order to commercialize the patent, the research and development efforts must also yield success.<sup>80</sup>

In addition to waste associated with valuing IP rights, a large amount of business resources are wasted in researching nonprofit organizations in an effort to place the IP rights into the right hands.<sup>81</sup> As some critics have mentioned, such resources could be spent on developing new products instead.<sup>82</sup>

One may argue that the social value of placing the IP into the right hands outweighs the administrative costs associated with finding the right match. However, if the value of donating, which is uncertain at best, does not exceed the cost of donating, the corporation would simply not donate. This exemplifies the incentive problem discussed above.

#### V. CRITICS SPEAK – EFFORTS TO SOLVE THE AJCA PROBLEMS

Both the pre-AJCA and post-AJCA proponents have valid arguments. Several scholars have therefore attempted to combine the two systems and develop a fix-all solution to the current debates. Many of the proposals, however, do not address the main issues. Additionally, the proposals that do address these issues produce added waste components due to an inefficient use of government resources.

For example, several scholars propose that the government require increased accountability on the part of charitable donees.<sup>83</sup> They want Congress to ensure that both the donors and the donees are responsible for accurate valuation.<sup>84</sup> A requirement that puts an additional burden on the donees, however, would discourage them from accepting the donations. This in turn decreases the chances of a university or other nonprofit organization from utilizing potentially valuable IP rights, and thus may deprive society of potential benefits and impede the progress of future science.

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77. LAYTON & BLOCH, *supra* note 51, at 7.

78. *Id.*

79. *Id.*

80. *See id.* (“The uncertainties include the possibility the patents will expire before the necessary R&D is finished.”).

81. Tomlinson, *supra* note 34, at 203.

82. *Id.*

83. Nguyen & Maine, *supra* note 33, at 1766.

84. *Id.*

Other scholars have suggested giving valuation premiums to provide donors with additional economic incentives.<sup>85</sup> They suggested an alternative system that gives donors a choice between taking a single fair market value deduction in the year of contribution and taking future deductions based on the donee's income resulting from the donated IP.<sup>86</sup> In their view, encouraging donations through economic incentives ultimately benefits society by giving purely scientific research to non-commercially-driven donees.<sup>87</sup> This would, however, allow corporations to receive tax deductions which are, at a minimum, the same amount as the pre-AJCA era and potentially a lot more. Such a proposal, therefore, completely ignores Congress' overvaluation concerns prior to the enactment of the AJCA.

These proposals also fail to balance the benefits of encouraging donations while minimizing the abuse committed by big corporations. Bear in mind that the corporations are donating patents or other IP rights that are useless to them; they are not actually "sacrificing" anything, but rather dumping their unused property onto nonprofit organizations.

Nevertheless, the American Society of Appraisers (ASA) suggested that the IRS improve the previous fair market value donation system by: 1) strictly defining a "qualified appraiser" since the current regulation allows almost anyone to appraise the value of the IP without professional training; 2) establishing a mandatory valuation guideline for the appraisal of property; and 3) monitoring for high value donations.<sup>88</sup> It argues that this proposal solves the overvaluation problem, even though there is difficulty in setting a workable standard for valuing IP. If this were true, such a proposal would still fail to create incentive for the donor to find donees that would best use the donated IP rights.<sup>89</sup>

In criticizing the ASA's suggestion, one scholar offers a "hybrid" policy that would purportedly address and solve both the overvaluation and incentive problems, while allowing the IP rights to fall into the hands of a suitable donee.<sup>90</sup> He proposes the use of the original fair market value deduction with an additional component of a broker to help ensure that the best suited donee gains access to the donated IP.<sup>91</sup> In other words, he wants

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85. *Id.* at 1767.

86. *Id.* at 1769.

87. *See id.* at 1770 (stating that the best way to encourage giving is not by relying solely on moral or social incentives, but by providing strong economic incentives to do so).

88. Don MacBean, *Better to Give Than to Receive: Evaluating Recent IP Donation Tax Policy Changes*, 2005 DUKE L. & TECH. REV. 19, ¶ 18 (2005), available at <http://www.law.duke.edu/journals/dltr/articles/2005dltr0019.html>.

89. *See id.* ¶¶ 19-20 (critiquing ASA's suggestion for stopping short of creating incentives for the donor to find the best suited donee for their donations).

90. *Id.* ¶¶ 25-29.

91. *Id.* ¶ 25.

to allow full fair market value deductions as determined by a qualified appraiser, only if the corporations use a third party broker whose primary goal is matching donors with appropriate donees.<sup>92</sup>

This scholar also proposes that there be strict requirements for appraiser qualifications and that the broker be a government entity or a government-funded nonprofit organization for the particular purpose of matching donors to donees.<sup>93</sup> Although the scholar recognizes that assigning a broker with expertise in a wide variety of IP fields who is also able to regularly maintain contact with universities and other donees is not an easy task, he believes that it is still possible.<sup>94</sup> He even suggests having professionals do the work on a pro bono basis and monitoring conflicts of interest carefully.<sup>95</sup>

There are several problems with this scholar's suggestions. First of all, using professionals on a pro bono basis would be neither practical nor consistent. Finding brokers who would be willing to do such tasks in exchange for monetary payment would prove to be a challenging task in and of itself, due to the variety of specializations that are required for the job. Having professionals address these tasks as a pro bono assignment would not offer enough incentive for most brokers to remain committed to the program.

This leads us to another problem regarding the use of government resources. The "hybrid" proposal would require two separate organizations: 1) a qualified appraiser that is strictly defined; and 2) a matchmaking broker to find suitable donees for the donated IP rights. If one or both of these organizations prove to be infeasible on a pro bono basis, which is the more likely scenario, the government would have to utilize its own resources to create such organizations.

Having such a system in place, however, is not impossible. For example, using already existing third party organizations to find donation suitors could help bring about this reform. Some charities have already established programs to exploit patents so that beneficial products may be developed.<sup>96</sup> Other charities simply sell or license the patents to other companies that can better utilize the patents.<sup>97</sup>

Thus, the ideas of this "hybrid" proposal are worth noting, especially

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92. *Id.*

93. *Id.* ¶ 30.

94. *Id.* ¶ 26.

95. *Id.*

96. See Drennan, *supra* note 30, at 1131 (stating that "Think Detroit" established a website allowing businesses to donate unused patents to universities that will be most capable of using the patent).

97. See *id.* at 1131-32 (stating that Ohio IP Collaborative takes donated patents and "sells or licenses [them] to small manufacturers interested in commercializing the technology") (internal quotation marks omitted).

since using such a third party broker would most likely decrease the probability that the IP rights would go to waste.<sup>98</sup> There are, however, more efficient ways of utilizing government resources. The “hybrid” proposal would lead to a significant waste of time and resources in valuing IP rights, regardless of whether it is through a “qualified appraiser” or not. Third party brokers, whose only purpose is matching donees with donors, would also require a lot of time, effort, and resources. In sum, the administrative costs associated with the hybrid proposal would most likely result in a tremendous waste of government resources.

#### VI. TWO PROPOSALS AND WHAT THE CRITICS OVERLOOKED

Admittedly, there will always be some problems and costs associated with valuing IP rights because of the inherent difficulty of this task, regardless of whether we are calculating the taxpayer’s basis or the fair market value.<sup>99</sup> If possible, however, the government should try to minimize the amount of administrative and transaction costs associated with each donation. Adding more agencies or third party organizations would only inhibit this objective.

Critics tend to overlook that the current AJCA system already makes an effort to solve the overvaluation problem, while also addressing the policy of incentivizing corporations to donate to the proper donees. Congress dealt with the overvaluation problem by only allowing the lesser of the tax payers’ basis or the fair market value of the IP right.<sup>100</sup> As a result, the AJCA has very limited immediate benefits and most of the real benefits, if any at all, are only realized in years following the donation.<sup>101</sup> This was Congress’ way of encouraging corporations to donate to the “appropriate” donees.

Some may still argue that the incentives to donate are only realizable if the benefits for donating are immediate.<sup>102</sup> Thus, critics are still able to argue that corporations do not have much incentive to donate under the current AJCA system. As noted before, however, the critics may have over-exaggerated the incentive problem that exists with the current system.

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98. MacBean, *supra* note 88, ¶ 30.

99. *Id.* ¶ 19.

100. Gerzog, *supra* note 25, at 1143.

101. *Id.*

102. See Drennan, *supra* note 30, at 1130 (“[A] firm may prefer to donate the invention to a public charity, avoid the transaction costs, and claim an immediate fair market value tax deduction.”).

A. *Practical Fix – Addressing the Incentive Problem*

The most practical fix is simple and addresses most of Congress' concerns as well as the concerns of AJCA's critics. The main criticism of the AJCA seems to be that corporations would no longer be incentivized to donate to charities,<sup>103</sup> thus wasting potentially valuable patents or other IP rights that could be used by nonprofit organizations. Critics argue that administrative costs associated with finding a charity that would be able to effectively use the IP—thus allowing corporations to take advantage of the AJCA system—would be considerable.<sup>104</sup> They reason that corporations would not likely want to expend such efforts and resources in finding a good fit, especially in light of the uncertain future benefits in having any worthwhile tax deductions.<sup>105</sup>

These concerns do not seem to take into consideration that corporations would still be incurring costs by maintaining the IP rights.<sup>106</sup> As previously mentioned, the patents or other IP rights that corporations donate are typically ones that would have passed into the public domain via abandonment—they essentially hold a negative value to the corporation.

However, assuming *arguendo* that these considerations do not exist, most of the aforementioned concerns could still be addressed without taking any drastic measures. In other words, we could still maintain the basic structure of the current AJCA system and minimize the administrative and transaction costs associated with creating new agencies, without completely revamping the existing tax deduction structure yet again.

We could substantially mitigate the concerns of the various scholars without incurring the associated costs by maintaining the current system of the AJCA and simply allowing additional deductions to corporations for any expenditures they incur in preparing the donation. The additional deductible monetary costs would include administrative costs, transaction costs, and any other costs incurred in finding an appropriate donee.

Given this relatively minor, yet cost-effective fix, companies would not be at a “loss” when donating their IP rights to nonprofit organizations. At the very least, they would be able to recover any costs associated with finding a suitable donee and at the same time be given a moderate tax deduction for the IP rights that they would have abandoned anyway.

There could be, however, some possible limitations to this proposal as

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103. Riley & Cammarano, *supra* note 5, at 216.

104. Nguyen & Maine, *supra* note 33, at 1762.

105. *Id.*

106. See Layton & Bloch, *supra* note 2, at 30 (stating that IP portfolio auditors were largely concerned with the overhead wasted on paying maintenance fees for “orphan” patents).



well. Critics may argue, for example, that the proposal still does not give enough incentive for corporations to donate to the same extent as during the pre-AJCA era. Although these critics might claim that compensating fair market value is the only way to incentivize corporations to donate their IP rights, this article solution should be sufficient to solve most of the incentive problems.

Critics on the opposite end of the spectrum, however, may argue that under this proposal corporations are still getting a windfall for their useless patents. This is certainly true. A cost-benefit analysis, however, may reveal that the benefits of incentivizing corporations to donate to good fit donees could outweigh the benefits of having the IP rights fall into the public domain. While this proposal is not the best solution possible, it would be the easiest fix to the current system without having to completely redo the entire tax deduction system.

#### *B. Drastic Fix – Donation Bank*

If Congress is willing to take more drastic measures by creating third party institutions, there is another proposal that would better address these problems. Many of the previous proposals have suggested monitoring overvaluation of IP, having appraisers determine the fair market value of the IP rights, or having third party brokers match donors to donees. All of these proposals naturally have transaction and administrative costs associated with them.

However, rather than using such extensive government resources in these efforts, we could create a government-sponsored third party organization with a moderate fund whose sole purpose would be to maintain a public “donation bank” of all donated IP rights. This third party institution would not enforce the donated IP rights, but merely be assigned the task of keeping track of the donated IP and organizing them in a manner that would facilitate searches.

With the rapid development of software technology, it would be relatively cheap and easy to create a system that could keep track of all the donated IP rights in an orderly fashion, including information regarding the nature and substance of the rights. Although this may not be a simple task, creating such an institution would provide a more well-defined, less costly solution that would be easier to implement than creating the organizations proposed by the above critics.

##### 1. How it Works

With such a third party in place, the corporations would simply submit their donations to this “donation bank,” and would still be able to deduct

the appropriate administrative costs spent in preparing the donation, in addition to the deductions offered by the current AJCA system. These administrative costs, however, should be held to a minimum with the proposed system, due to the effortless process of submitting donations. The corporations also would not need to use brokers or spend additional resources in researching nonprofit organizations that would be a good fit; neither would they have to use qualified appraisers as proposed by some of the critics to value their IP rights.

On the donees' side, nonprofit organizations would be allowed to independently access, search, and obtain the IP rights that they think are potentially beneficial to their respective organizations in this "donation bank." The search should be relatively interactive and easy, especially since all the IP donations would be going to one central location.

With this proposed system, the IP rights would essentially be distributed on a first-come, first-serve basis. The first nonprofit organization to claim a particular IP right from the donation bank would obtain the rights to it. Before handing over the rights, however, the nonprofit institution would have the burden of proving that it has the expertise and resources to effectively use the right. The unclaimed IP rights from the donation bank would pass into the public domain after a period of time, just like any other abandoned IP.

The original donor of the IP right would also be able to obtain the same benefits in a similar manner as the donor would under the current AJCA system. This includes the deductions in subsequent years, if and when the nonprofit organizations gain revenue associated with the donated property. As a result, the nonprofit donees would also be required to submit the appropriate paperwork associated with the subsequent deductions. Critics have indicated that such a system places additional burdens on the donees, and thus would deter them from accepting the IP rights. That criticism may only hold true for the current AJCA system.

With this new proposal, corporations are not simply dumping all their useless IP rights onto the laps of the nonprofit organizations. Rather, the donees are the ones actively searching for the IP right that they need or want because of its potential utility to their organization. Therefore, in their minds, the minimum amount of required paperwork would not likely be a deterrent, but be outweighed by the benefits associated with obtaining the IP right.

## 2. Policy Considerations

Critics of the AJCA have constantly argued that good policy should not only target the known abusers, but create appropriate incentives for IP holders to donate their property to nonprofit organizations that are capable

of putting the IP to good use.<sup>107</sup> The proposed system would benefit society by doing just this.

Naysayers may argue that, without a fair-market-value-type incentive structure, corporations would be unwilling to donate and it would be unlikely that good fits would be found for the IP rights. The main criticism that corporations would be disincentivized from donating, however, was based on the costs that the corporations had to incur, such as costs in finding appropriate nonprofit organizations.<sup>108</sup> Not only are most of these costs eliminated with the proposed system, but as previously mentioned, corporations are still better off without their orphan IP rights due to the costs of maintaining and enforcing them.<sup>109</sup>

Further, many of the proposals suggested by the AJCA critics yield a large amount of costs in wasted resources. The simplified donation procedure of the proposed system would minimize the transaction costs, administrative costs, and overall societal costs that are associated with the other proposals. The corporations simply have to donate their IP rights to one place: no searching required, no valuation required, and no non-deductible cost incurred.

This simplified donation process, along with the other benefits associated with donating, ought to be sufficient incentive for corporations to donate. These associated benefits include a moderate initial tax exemption, elimination of maintenance costs, deductions on donation costs, and even potential for future deductions. This system could be implemented without having to waste resources or carrying the costs, burden, and hassle of finding a “good fit” charity, as is the case under the current AJCA system.

In addition to all the advantages of this proposal, the fact that the “unclaimed” donations would essentially pass into the public domain as abandoned property allows society to enjoy the abandoned IP rights freely as well.<sup>110</sup> In short, this proposal benefits corporations by providing them with tax deductions, benefits nonprofits by allowing them to claim and obtain suitable IP rights, and benefits society by adding to the public domain. Nonprofit organizations would therefore be allowed to utilize their newly acquired potentially valuable IP rights while contributing to the advancement and progression of science.

This proposal may initially have a slow start. Once the system is in place, however, corporations would know where to donate and nonprofit organizations would know where to turn for potentially valuable IP rights.

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107. MacBean, *supra* note 88, at ¶ 15.

108. Riley & Cammarano, *supra* note 5, at 218.

109. Layton & Bloch, *supra* note 2, at 30.

110. In practice, however, these abandoned rights are not likely to be useful nor are they likely to be capable of commercialization.

Such a system would be a much more efficient and effective way of placing IP rights into the appropriate hands, as opposed to using third party brokers or incentivizing corporations through fair market value deductions. History has already proven that the latter choice is subject to abuse.

Furthermore, the proposed system would not deter the corporation-university relationships, which has been the concern of some critics.<sup>111</sup> With such a system, corporations may still build relationships with the universities and notify them of an available and suitable IP right if such opportunities arise. This proposed system would merely prevent corporations from having to proactively search for such organizations and wasting resources in the process. More importantly, there would be no pressure for the nonprofit organizations to make use of IP rights that they may not find useful, and no room for corporations to resent the nonprofits for failing to do so.

## VII. CONCLUSION

Although Congress attempted to address the corporations' abuse of the tax deduction system through the AJCA, the legislation has created new problems of its own. By implementing minor fixes to the current system or through the creation of a simple third party organization, however, most of these problems can be resolved. If empirical evidence later shows that corporations have been donating significantly less after the enactment of the AJCA, Congress should seriously consider these proposals in revising the tax structure.

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111. Riley & Cammarano, *supra* note 5, at 218.