

## **Johns Hopkins Technology Transfer**

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### **INFORMATION FOR INVENTORS CONCERNING HANDLING OF EQUITY AND TAX TREATMENT OF DISTRIBUTIONS UNDER THE INTELLECTUAL PROPERTY POLICY**

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When Johns Hopkins University receives revenue from an intellectual property license agreement, the inventor of that intellectual property is entitled to receive a share of that revenue, as specified in the University's Intellectual Property policy. The full text of the JHU Intellectual Property policy can be obtained at <http://www.techtransfer.jhu.edu/resources/policies.html> or by contacting our Technology Transfer office.

Revenue received from license agreements can include license fees, royalty payments and proceeds from the sale of equity in the licensee company. The Technology Transfer office distributes license agreement revenue in accordance with the Intellectual Property policy. The University's central accounting office reports this income to the Internal Revenue Service on a 1099-MISC form as "Royalties."

#### **HANDLING OF EQUITY**

When JHU obtains equity shares from a licensee, it is the policy of the University to obtain title to and hold all shares until a liquidity event allows them to be sold, at which time all shares are sold. JHU receives the proceeds from the sale of these shares and distributes this Net Income according to the rules laid out in the JHU Intellectual Property policy. By this procedure: (i) the inventor receives cash and not shares of stock, (ii) the inventor incurs no tax liability until JHU distributes the Net Income, and (iii) because the inventor has an interest in the proceeds from the sale of stock and does not own the stock, the administration of related conflicts of interest is simplified. This does not apply to conflicts of interest arising when an inventor or a faculty member receives stock separate from the terms of a JHU license, for example, as a company founder or as payment for consulting services. As with other distributions, this income is reported by JHU to the IRS on a 1099-MISC form as "Royalties."

#### **TAX TREATMENT OF DISTRIBUTIONS**

We have completed an analysis that suggests that under current tax law, inventors may be able to obtain capital gains treatment for all income distributed to the inventor under the JHU Intellectual Property policy, including income arising from the sale by JHU of equity. Section 1235 of the Internal Revenue Code permits such treatment when the requirements of that section are met. In December 2002, the IRS issued a Technical Advice Memorandum, TAM 200249002, on this issue. The IRS identified the factors required for Sec. 1235 capital gains treatment to apply:



1. The professor was not specifically "hired to invent";
2. The university treated the payments as royalties, and not as salary; the professor received the payments separate from his salary and pursuant to a separate agreement with the university;
3. The professor and university executed written agreements to assign the patent rights and to agree on the royalties;
4. The payments would continue beyond the employment relationship for the patent's life;
5. The payments were connected to the transfer of the rights to the invention, rather than compensation for services; and
6. The payments received by the professor depended on the use or value of the licensing of the patent (the payments were a percentage of the university's receipts from its licensing of the patent), which varied substantially each year.

Although the JHU Intellectual Property policy seems to meet all of these requirements, JHU cannot provide tax advice and all tax analyses must necessarily be done in context of the specific facts applicable to the specific taxpayer. Please contact your individual tax advisor to determine if you may be entitled to capital gains tax treatment on distributions made to you by Technology Transfer.

**PLEASE NOTE:** THE ABOVE INFORMATION IS INTENDED TO PROVIDE FACULTY WITH INFORMATION THAT MAY APPLY TO THEIR SITUATION AND DOES NOT CONSTITUTE TAX ADVICE, NOR DOES IT CONSTITUTE AN ENDORSEMENT OR SUGGESTION THAT THE INFORMATION IS CORRECT OR ACCURATE OR THAT IT ACTUALLY APPLIES TO ANY SPECIFIC FACULTY MEMBER. RECIPIENTS OF INCOME DISTRIBUTIONS MADE BY JHU UNDER THE UNIVERSITY'S INTELLECTUAL PROPERTY POLICY SHOULD CONSULT THEIR OWN TAX ADVISORS.

Please contact our office if we can answer any questions or assist in any way.

Sincerely,

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