ADVERTISING FOR DUMMIES: UNDERSTANDING ROBINSON KNIFE MANUFACTURING INC. V. COMMISSIONER'S EFFECT ON TRADEMARK LICENSING AND ADVERTISING

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I. INTRODUCTION

Will Rogers once said, "advertising is the art of convincing people to spend money they don't have, for something they don't need."[1] In the current competitive business climate, companies will do anything to influence consumer-spending habits, and the universally recognized, most effective way of influencing consumers is advertising. Advertising works because it creates positive feelings towards products. The accumulation of those positive feelings about a product, known as goodwill, strongly influences spending habits. The embodiment of advertising and goodwill is typically a trademark. Unfortunately, for some companies, a competitor's ownership of a well-recognized trademark can make competing in a particular market nearly impossible. To that end, some companies wisely look to alternate means of advertising, such as licensing a trademark. However, because of a Treasury Regulation and a recent Tax Court decision, there can be tax disadvantages to licensing a third party's trademark as compared to traditional advertising of one's own mark.

Traditionally, the Internal Revenue Service has allowed deductions for royalties paid to license trademarks.[2] Similarly, the Service treated most advertising expenses, marketing expenses, and selling expenses as immediately deductible business expenses under the

[1] BRYAN STERLING, THE BEST OF WILL ROGERS: A COLLECTION OF ROGERS' WIT AND WISDOM ASTONISHINGLY RELEVANT FOR TODAY'S WORLD, Fine Communications, New York (1997).
[2] JEFFREY A. MAINE & XUAN-THAO NGUYEN, INTELLECTUAL PROPERTY TAXATION: PROBLEMS AND MATERIALS, 161 (Carolina Press, 2004).

Internal Revenue Code section 162.[3] The Service clarified this standard when it issued Revenue Ruling 92-80[4] in response to the *INDOPCO, Inc. v. Commissioner* decision, which put into question the current deductibility of advertising expenses by requiring capitalization of expenses with future benefits.[5] Unlike the Internal Revenue Service, intellectual property experts recognize trademarks as manifestations of advertising and goodwill, and one would think the Service would treat royalties paid to license trademarks in the same way as advertising expenses.[6]

Recently, the Service and Tax Court employed a one-size-fits-all approach to the tax accounting of royalty costs,[7] concluding that the royalties paid to license a trademark required capitalization under section 263A.[8] The Tax Court found authority for royalty capitalization in Treasury Regulation section 1.263A-1(e)(3) (ii)(U) which states that licensing and franchise costs include "fees incurred in securing the contractual right to use a trademark, or

[3] I. R. C. § 162(a) (2008). Authorizes a deduction for ordinary and necessary expenses arising from the carrying on of a trade or business.

[4] Rev. Rul. 92-80, 1992-39 C.B. 57 (holding that *INDOPCO* does "not affect the treatment of advertising costs as business expenses which are generally deductible under section 162(a) of the Code.")

[5] *See* INDOPCO, Inc. v. Comm'r, 503 U.S. 79 (1992) (the Supreme Court held that certain legal and professional fees incurred by a target corporation in an acquisition, which had a future benefit beyond the current year, were capital expenditures.); *contra* Rev. Rul. 92-80. 1992-2 C.B. 57 (in response to INDOPCO, the Service issued Revenue Ruling 92-80 to clarify that most advertising costs are immediately deductible as business expenses.)

[6] *See* J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION, §2.15, 34 (4th ed. 2007). A different issue exists if instead of licensing a trademark a company outright purchases the trademark; *see also* Stokely USA, Inc., v. Comm'r., 100 T.C.M 439 (1993) (noting that both forms of trademark advertising, whether licensing a product, or spending money to advertise one's own mark, accomplish the same goal, which is to promote a product for sale.)

[7] FIRM COMMENTS ON TAX TREATMENT OF MANUFACTURES' POST-PRODUCTION ROYALTIES, 2008 TAX NEWS TODAY 120-26 (May 9, 2008) [hereinafter Firm, *Tax News Today*]. (arguing that the government needs to clarify a taxpayer's deductibility of royalties as selling expenses that arise during a taxpayer's sales activities.)

[8] I.R.C. § 263A (2008). Disallows an immediate deduction of capital expenditures.

other similar right associated with property produced or property acquired for resale."[9] This case note critically examines the Service and Tax Court approaches, and proposes a better method for determining the deductibility of trademark royalties. Specifically, this note calls for removal of the term "trademark" from section 1.263A-1, authorizing the Service and courts to allow immediate deductions of trademark royalty payments, as selling or advertising expenses.

A perfect case to examine the nuances of the recent treatment of trademark royalties is *Robinson Knife Manufacturing Co., v. Commissioner*,[10] (hereinafter "*Robinson*"). Robinson, the owner of a kitchenware manufacturing company, decided to license the right to use two well-known trademarks owned by Oneida and Corning;[11] Robinson paid the royalties as it sold products bearing Oneida or Corning trademarks, and then deducted the royalty payments as ordinary and necessary business expenses under section 162.[12] The Service issued a deficiency, and Robinson challenged the Service's decision, contending that the royalties did not benefit production, were not allocable to produced property, and were immediately deductible advertising and selling expenses. [13] The Tax Court sided with the Service holding that the trademark royalties provided for in the licensing agreement required capitalization as production income under section 263A,[14] and Treasury Regulation section

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[9] Treas. Reg. § 1.263A-(1)(e)(3)(ii)(U) (2007) (provides that licensing and franchise costs, including fees to secure the contractual right to use a trademark, corporate plan, manufacturing procedure, or other similar right associated with property produced are examples of indirect costs requiring capitalization.)
[10] *see* Robinson Knife Manufacturing Co., Inc. v. Comm'r, 97 T.C.M (CCH) 1037 (2009).
[11] *Id.* at 6; *see, e.g.,* Leisure Dynamics v. Comm'r., 494 F.2d 1340 (8th Cir. 1974). It is sometimes hard to delineate between a sale and a license.
[12] *Robinson,* 97 T.C.M 1037 at 6.
[13] *Id.* at 16.
[14] I.R.C. § 263A (2008).

1.263A-1,[15] as "indirect costs."[16]

Specifically, this note identifies several problems created by the Tax Court's holding in *Robinson*, and illustrates the dilemma with the current treatment of trademarks under the Internal Revenue Code section 263A and Treasury Regulation section 1.263A-(1)(e)(3)(ii)(U). In particular, this note analyzes: (1) the *Robinson* case; (2) the Code and Treasury Regulations; (3) and the history of trademark law. It concludes that the government should strike the word "trademark" from Treasury Regulation section 1.263A-(1)(e)(3)(ii)(U), allowing a deduction for trademark royalties as advertising expenses, pursuant to section 162 of the Code and Revenue Ruling 92-80. In reaching this conclusion, this note makes several arguments:

First, the Tax Court incorrectly applied past precedent when it assumed that the royalties paid to use a patent were identical to royalties paid to use a trademark.[17] Because of the inherent differences in patent licensing and trademark licensing, the owners of those intellectual properties deserve different tax treatment.[18]

Second, the regulation's requirement for capitalization of trademark royalties creates unfairness in the Tax Code by violating the principles of horizontal equity. Horizontal equity stands for the idea that people similarly situated should receive similar taxation.[19] In other words, it is unfair to allow a taxpayer who advertises a wholly owned trademark a

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[15] Treas. Reg. § 1.263A-1(e)(3)(ii)(U).
[16] *Robinson*, 97 T.C.M 1037 at 18.
[17] *Id.*
[18] ANDREA FAULK, HARMONIZATION OF THE PATENT ACT AND FEDERAL TRADE DRESS LAW: A CRITIQUE OF VORNADO AIR CIRCULATION SYSTEMS V. DURACRAFT, 21 J. Corp. L. 827, 828 (1996) (stating that patents are inseparable from the production process, and trademarks are the embodiment of advertising and goodwill.)
[19] JOHN A. MILLER & JEFFREY A. MAINE, THE FUNDAMENTALS OF FEDERAL TAXATION: PROBLEMS AND MATERIALS, 4-5 (Carolina Academic Press 2007).

deduction, while requiring a similar taxpayer to capitalize payments made to license another's trademark, when the transactions are simply different ways of advertising.

Third, the regulation violates the fundamental goal of tax accounting and matching. Congress intended expenses to match revenues of the taxable period to which the expenses were allocable.[20] The Internal Revenue Code section 471 expresses this goal stating that inventory methods should mirror the best accounting practices to reflect income.[21]

Finally, the *Robison* decision illustrates the policy problems with the current treatment of trademark royalties under the Treasury Regulation, and the only solution is to rewrite section 1.263A-(1)(e)(3)(ii)(U). The Service, through deduction incentives, is encouraging companies to expend money on traditional advertising, when in some instances, licensing a trademark would be economically more viable. Efficiency determines that we should seek a balance between maximizing tax revenues and minimizing the social costs of taxation, and the tax notion of neutrality demands that the tax system should avoid unnecessarily shaping economic behavior. [22]

In sum, the Treasury Regulation that the Service and the Tax Court relied on is overbroad, and requires redrafting. Although the one-size-fits-all approach may appear to simplify this area of the law for courts, an uncomplicated solution exists to ensure a proper deduction for trademark royalties, as section 162 business expenditures. This note proposes that the solution is to adopt a narrower construction of section 263A, and to remove the term

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[20] *Id.*
[21] I.R.C. § 471 (2008) ("Whenever in the opinion of the Secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting of the income.")
[22] MILLER & MAINE, *supra* note 19, at 4-5.

"trademark" from the Treasury Regulation section 1.263A-1(e)(3)(ii)(U).[23]

II. Robinson Knife Manufacturing Co., v. Commissioner

Robinson Knife Manufacturing Company, Inc. challenged an assessed income tax deficiency as determined by the Commissioner of the Internal Revenue Service.[24] The issues raised before the Tax Court were: whether the taxpayer was required to capitalize royalties paid for the licensing of a trademark under Internal Revenue Code section 263A and, whether the Commissioner properly allocated the royalties to the ending inventory using the simplified production method.[25] The Tax Court reasoned that acquiring the right to use Corning and Oneida's trademarks were part of Robinson's production process, even though Robinson produced its own kitchen tools, separately attached the trademark, and took advantage of the prior advertising and goodwill of the licensors.[26] This case was important because, for the first time, the Tax Court required capitalization for all types of royalties.[27]

A. Factual Background and Overview

Robinson is a corporation engaged in the business of selling kitchen tools and gadgets used in food preparation, and it sells its products to major retailers all over the United States

[23] Treas. Reg. § 1.263A-1(e)(3)(ii)(U).
[24] *Robinson,* 97 T.C.M. 1037 at 1.
[25] *see Id.* at 20 (stating that the simplified production method is a simplified method of accounting whereby additional costs (other than interest) are capitalized by allocating those costs to all the property produced.) For the purpose of this case-note, the simplified production method issue will not be discussed.
[26] *Id*. at 17; *see also* Newark Morning Ledger Co. v. United States, 507 U.S. 546, 555 (1993). ("Although the definition of goodwill has taken different forms over the years, the shorthand description of goodwill is the "expectancy of continued patronage," and provides a useful label with which to identify the total of all the imponderable qualities that attract customers to the business.")
[27] *see generally Robinson*, 97 T.C.M 1037.

and Canada.[28]

To more effectively promote, sell, and advertise its products, Robinson entered into licensing agreements to use the well-known trademarks of Corning, Inc., and Oneida, LTD; the agreements required payments of royalties based on the percentages of the net sales of products bearing the licensors' trademarks.[29] Robinson exclusively owns the products it develops and designs, regardless of what trademark attaches postproduction.[30] To manufacture the kitchen products, Robinson contracted with a third-party manufacturer; subsequently, Robinson or the manufacturer would apply the trademark to the front of the package.[31]

Clearly, Robinson's strategy was to license well-respected, high-quality trademarks to create sales, rather than engaging in traditional advertising.[32] The well-known trademarks enticed customers to purchase Robinson's kitchen tools.[33] The only promotion of the trademarked products Robinson undertook was on point-of-sale displays, on its web site, and in kitchen exhibits at trade shows.[34]

The reason the trademarks were so enticing is that over the past 80 years, Oneida and

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[28] *Id.*

[29] *Id.* at 7. Royalties attaching to sales, however, should be distinguished from royalties attaching to the overall production process, because royalties that connect directly to sales do not aid in production.

[30] Brief of Petitioner-Appellant, Robinson Knife Manufacturing Company, Inc., v Comm'r at 7, No. 21514-06 (T.C.M. Jan. 7, 2008) (stating Robinson had no legal obligation to Corning or Oneida in the manufacturing of products, the only obligation attached when Robinson decided to market a product with one of its licensed trademarks.)

[31] *Id*. (noting that on some occasions, Robinson or the manufacture attached labels directly to the products, but in most instances, the trademark was affixed only to the box.)

[32] *Id*. This is evident because Robinson did not take other advertising deductions for the period in question.

[33] *Id*. Both Corning and Oneida are well-known, and well-respected companies.

[34] *Id.* at 8-9. These advertising expenses were not deducted as traditional advertising, as they were included in overall licensing deduction.

Corning have accumulated substantial goodwill through marketing and advertising activities.[35] Both trademarks are recognized, and known to denote quality among retailers and consumers.[36]

Robinson's licensing agreement with Corning provided that in return for the use of the "Pyrex" trademark, Robinson would pay royalties equal to eight percent of the "net wholesale billing price," payable every three months.[37] Under the Oneida agreement, Robinson agreed to pay a royalty of 11 percent of the net sales until the sales exceeded a million dollars, and thereafter 8 percent.[38] Both licensing agreements contained provisions requiring Robinson to submit certain product materials to Oneida, and Corning, for inspection to make sure the materials met their standards of quality.[39]

In the years of 2003 and 2004, Robinson filed its U.S. Corporation Income Tax Returns using the accrual method,[40] and the first-in, first-out method.[41] On the forms for

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[35] *Id.* Over those 80 years, Corning and Oneida were allowed a deduction for their advertising expenses, under § 162, and 92-80.

[36] *See Id.; see also* Fed. Trade Comm'r v. Borden Co., 383 U.S. 637, 651 (1966) (holding "an important ingredient of the premium brand inheres in the consumer's belief, measured by past satisfaction and the market reputation established by Borden for its products, that tomorrow's can will contain the same premium product as that purchased today.")

[37] Brief of Petitioner, *supra* note 30, at 9.

[38] *Id.* The difference between the two licensing agreements in not discussed in this case note, and is absent from the court records.

[39] *Id.* (stating that the two companies inspected the products and sales material to ensure they met the high standards both companies require. This makes sense because of the quality of the trademark that both companies have, and both companies retained the right to deny the use of their trademark. Presumably, denial occurs when the quality, or product itself, does not meet the standards previously determined by Corning or Oneida.)

[40] *Robinson,* 97 T.C.M 1037 at 9; *see also Treas. Reg.* § 1.461-1(a)(2)(i); *see also* MILLER & MAINE, *supra* note 19, at 178 (stating that the accrual method allows deductions to be taken in the "year in which all events have occurred establishing the fact of liability and the amount of liability and in which economic performance has occurred with respect to the liability. . . . Under the accrual method, both income and deductions arising from the sale of

those years, Robinson reported that it paid royalties to Corning and Oneida of $2,184,252 and $1,741,415.[42] Robinson then deducted the royalty payments as necessary and ordinary business expenses under section 162 of the Internal Revenue Code.[43]

The Commissioner disallowed the deduction and issued a statutory notice of deficiency, requiring Robinson to capitalize the royalty payments under section 263A, and allocate $364,420 and $48,293 to its ending inventory.[44] Subsequently, Robinson brought an action to the Tax Court to contest the disputed amounts.[45]

B. The Tax Court Proceedings

As mentioned above, the issue in *Robinson* was whether the trademark royalty payments were deductible expenses in the nature of advertising, marketing, or selling expenses.[46]

The Service contended that the royalties paid to Corning and Oneida for the use of their trademarks were indirect costs paid in order to produce kitchen tools, as listed under § 1.263A-1(e)(3)(ii)(U).[47] The Tax Court agreed stating that Robinson "incurred royalties for licensing the right to use the Pyrex and Oneida trademarks in manufacturing the Pyrex and Oneida branded kitchen tools it produced, and the regulations under section 263A specifically require that licensing costs be capitalized to the extent they are properly

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inventory are taken into account for tax purposes when the goods change hands since that is when the all events test is satisfied." *see also* Treasury Regulation 1.446-1(c)(1)(ii)(A).

[41] *Robinson,* 97 T.C.M 1037 at 9*; see also* MILLER & MAINE, *supra* note 19, at 179 (noting that the first-in, first-out method of accounting assumes that the first products purchased are the first products sold.)

[42] *Robinson,* 97 T.C.M 1037 at 9.

[43] *Id*.

[44] *Id*.

[45] *Id.*

[46] *Id.* at 10.

[47] *Id.* at 16.

allocable to property produced."[48]

Robinson objected arguing that the royalties were not part of production, because the royalties did not directly benefit any production activities.[49] The court dismissed that argument because Robinson had "failed to address whether the royalties were incurred by reason of [Robinson's] production activities."[50] The court assumed that the license agreements gave Robinson the "right to manufacture" the products and to attach the trademarks.[51] The court opined that without the license agreement, Robinson could not "have legally manufactured" the products it sold.[52]

Robinson also argued that the trademark royalties attached only when sales occurred, so they should be deductible; however, the court refuted Robinson's contention by citing a past patent case, and stating that it was irrelevant that the royalties Robinson paid to Corning and Oneida were calculated on the net sales of the Pyrex and Oneida branded kitchen tools.[53] "We have held [in a patent case] that a taxpayer must capitalize royalties incurred for the right to use an intangible in a production process where the amount of the royalties was calculated on the basis of net sales."[54] The court neglected to discuss the general deductibility of royalty payments to procure the use of a trademark.[55]

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[48] *Id*.
[49] *Id*.
[50] *Id*. at 17.
[51] *Id.*
[52] *Id.*
[53] *Id.* at 18.
[54] *Id.*; Plastic Eng. & Technical Servs. INC, v. Comm'r, 82 T.C.M 1017 (2001).
[55] I.R.S. Priv. Ltr. Rul. 200137013 (Feb. 6, 2001) (holding that "the amounts paid by a taxpayer to a licensor pursuant to the technology agreement will not be chargeable to capital account under § 197, pursuant to § 1.197-2(f)(3)(iii), and will be currently deductible." However, § 263A and the Treasury Regulations require capitalization in certain circumstances.)

III. LEGAL & STATUTORY SUPPORT

A. Internal Revenue Code section 263A, and Treasury Regulation section 1.263A-1(e)(3)(ii)(U).

The current Code provision dictating how royalty payments are treated is section 263A of the Internal Revenue Code. Under that provision, a taxpayer is required to capitalize direct costs, and some indirect costs, of producing certain property.[56] "Direct costs" include materials used in the production process that become essential parts of the produced asset.[57] "Indirect costs" occur when a company pays purchasing costs, storage, depreciation, rent, or taxes. Those indirect costs require capitalization and allocation to the produced property;[58] however, a company is not required to capitalize other associated costs such as selling, distribution, and advertising.[59]

Conveniently, Treasury Regulation section 1.263A-1 provides a list of indirect costs[60] and lists examples of when the Code requires capitalization.[61] Interestingly enough, the regulations include, "fees incurred in securing the contractual right to use a trademark, or other similar right associated with property produced or property acquired for resale. These costs include otherwise deductible portion of the initial fees incurred to obtain the license or

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[56] Treas. Reg. § 1.263A-2(a)(3); *see* Suzy's Zoo v. Comm'r, 273 F.3d 875, 879 (9th Cir. 2001) (stating that in 1986 Congress amended the Internal Revenue Code, and added § 263A in an attempt to create a set of rules to govern capitalization of costs for "producing, acquiring, and holding property in order to more accurately reflect income and make the tax system more neutral.")
[57] Treas. Reg. § 1.263A-1(e)(2).
[58] Treas. Reg. § 1.263A-1(e)(3).
[59] *See Suzy's Zoo*, 273 F.3d. at 877 (noting that the Code considers property produced for the taxpayer by a third party as property produced by the taxpayer, to the extent that the taxpayer makes payments or otherwise incurs costs, for production of that property.)
[60] Treas. Reg. § 1.263A-1(e)(3).
[61] Treas. Reg. § 1.263A-1(e)(3)(ii)(U).

franchise and any minimum annual payments and royalties that are incurred by a licensee or a franchisee."[62]

To determine how to allocate license fees, courts look to the meaning of "produced property."[63] The definition of "produce" under section 263A(g)(1) is to "construct, build, install, manufacture, develop, or improve" and under section 1.263A(a)(1)(i) includes manufacturers who "create, raise, or grow."[64] Section 263A(g)(2) also states: "the taxpayer shall be treated as producing any property produced for the taxpayer under a contract with the taxpayer . . .."[65]

B. Revenue Ruling 92-80 and Section 162's Approach.

Section 162(a) allows a deduction for ordinary and necessary business expenses paid or incurred during the taxable year in carrying on a trade or business.[66] Traditionally, the Code has treated advertising expenses and other selling expenses as immediately deductible business expenses under section 162.[67] To demonstrate the effect of section 162, the Treasury Regulations under section 1.162-1(a) provides that "advertising and other selling expenses are examples of deductible business expenses."[68] Deductions, however, "are a matter of legislative grace, and the taxpayer bears the burden of proving its entitlement to the deduction it claimed."[69]

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[62] *Id.*; *Robinson*, 97 T.C.M. 1037 at 14.
[63] *Suzy's Zoo*, 273 F.3d at 879 (noting that courts have construed "produce" broadly in order to "give effect to legislative intent.)
[64] *Id.* at 878; I.R.C. § 263A(g)(1), (2); *see also* Treas. Reg. § 1.263A(a)(1)(i).
[65] I.R.C. § 263A(g)(2) (2008).
[66] Treas. Reg. § 1.162-1(a).
[67] Rev. Rul. 92-80, 1992-39 C.B. 57.
[68] Treas. Reg. § 1.162-1(a).
[69] *See* New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934); *see also* Welch v. Helvering, 290 U.S. 111, 115 (1933).

Additional support for the deductibility of advertising expenses is in Treasury Regulations section 1.471-3(c), which states that the costs of selling, advertising and marketing are not includable in the cost of inventory produced by a taxpayer.[70] Depending on the characterization of trademark royalties, this provision could contradict the wording in Treasury Regulation section 1.263A-1(e)(3)(ii)(U).

C. The History of Trademark Law.

Historically, the common law protected trademarks and trade names.[71] In 1870, Congress tried to codify trademark protection but the Supreme Court declared the act unconstitutional.[72] Over seventy years later, in 1946 Congress corrected its missteps and passed the Trademark Act, also known as the Lanham Act, which established a national trademark registration databank.[73] The Lanham act also created a federal cause of action for trademark infringement, and unfair competition when a competing mark caused significant confusion.[74] In the interest of clarity, the Lanham Act defined "trademark" as any word, name, symbol, or device or any combination thereof, used by a person, with the intention to

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[70] Treas. Reg. § 1.471-3(c).

[71] *See* MERGES, MENELL, LEMLEY, INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE, Aspend Publishers, 670. (2007).

[72] *See* The Trade-Mark Cases, 100 U.S. (10 Otto) 82 (1879); *see also,* MERGES, MENELL, & LEMLEY, *supra* note 70, at 6*34* (noting that the statute was struck down by the Supreme Court as beyond the powers of Congress, because trademarks were not considered to have the requisite novelty or originality for support by way of the copyright and patent clause of the Constitution.)

[73] *See* MERGES, MENELL, & LEMLEY, *supra* note 70, at 670 (noting that the Lanham act created a trademark registration databank in section 45, which included "any word, name, symbol, or device, or any combination thereof to identify and distinguish goods . . . from those manufactured or sold by others . . ..")

[74] *See generally* Abercrombie & Fitch Co. v. Hunting World, Inc., 537 F.2d 4 (2d Cir. 1976); *see also,* MERGES, MENELL, & LEMLEY, *supra* note 70, at 670; *see also* Lanham Act § 43(a) ("Any word, term, name, symbol, or device, or any combination, thereof . . .which . . .is likely to cause confusion . . .as to the origin, sponsorship, or approval of his or her goods . . . .")

use in commerce.[75] In 1995, Congress enacted the Federal Trademark Dilution Act, which provided a remedy for "another person's commercial use in commerce of a mark or trade name, if such use begins after the mark has become famous and causes dilution of the distinctive quality of the mark . . ..."[76]

The Lanham Act approached the treatment of trademarks differently than the common law; at common law, establishing a right in a trademark required an actual "good faith" use of the mark in the ordinary course of business of selling goods in the geographic territory of the claimed rights.[77] The Act changed the actual use doctrine and identified four new trademark categories.[78] In order to meet the designation prerequisite it had to meet three requirements: (1) the designation requirement,[79] (2) the distinctiveness requirement,[80]

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[75] *Abercrombie & Fitch Co.*, 537 F.2d at 4.
[76] *Id.; see also* Restatement (3d) of Unfair Competition § 20 (1995).
[77] *See Abercrombie & Fitch Co.*, 537 F.2d at 6*; see also* Conde Nast Publications Inc. v. United States, 575 F.2d 400, 407 (2d Cir. 1978) (holding that a taxpayer had no continuing interest in or control over the use of the Vogue name, when the aim was not to give the taxpayer any significant interest or participation in the business, but simply to protect the value of the name.)
[78] *Abercrombie & Fitch Co*., 537 F.2d at 9 (explaining that first, trademarks cannot be Generic. Generic trademarks have "come to be understood as referring, to the genus of which the particular product is a species." The Lanham Act provides for the cancellation of a mark if it becomes "the common descriptive name of an article or substance." No matter how much money or effort someone has spent promoting the sale of its product, it cannot deprive competitors of the right to call an article by its generic name. Secondly, although section 2(e) of the Lanham Act 15 U.S.C. section 1052 forbids the registration of a mark that is "merely descriptive," section 2(f) provides that, "nothing in the chapter shall prevent the registration of a mark used by the applicant which has become distinctive of the applicant's goods in commerce." Furthermore, a term is descriptive when it creates an immediate idea of the ingredients, qualities or characteristics of the goods. Thirdly, Suggestive trademarks are "suggestive if it required imagination, thought and perception to reach a conclusion as to the nature of goods." Fourth, if trademarks are arbitrary or fanciful, they enjoy all the rights of suggestive trademarks, without the debate about whether the term is "merely descriptive" and it is easier to establish infringement.)
[79] DAVID L. CAMERON, PHILIP F. POSTLEWAITE & THOMAS KITTLE-KAMP, FEDERAL INCOME TAXATION OF INTELLECTUAL PROPERTIES & INTANGIBLE ASSETS, 3.01 [3][b] (Warren,

and (3) the actual-use-or-intent-to-use requirement."[81]

IV. Trademarks are Advertising Expenses.

A. Thesis

In *Robinson Knife Manufacturing v. Commissioner*, the Tax Court held that Robinson had to capitalize royalties as indirect costs under section 263A. A better approach is treating the costs as immediately deductible, akin to advertising and selling costs under section 162. Furthermore, the wording of the Treasury Regulation section 1.263A, requiring capitalization of all royalties, is overbroad and removal of the word "trademark" is necessary.

B. The *Robinson* Decision and its Faulty Arguments

With an ever-shrinking line between profits and losses, and between debt and equity, an immediate deduction for business owners can amount to a successful or unsuccessful year, and ultimately to success or failure. Businesses are constantly trying to increase sales, and advertising is the accepted means for sales success. Accordingly, the Service acquiesced and allowed for the immediate deduction of advertising expenses.[82]

Similar to traditional advertising, licensing well-known trademarks is a process of spending money to increase sales and often offers a low risk alternative to traditional

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Gorham & Lamont, 1997) (noting that designation relates to the type of subject mater that is given protection as a trademark. The trademark designations that qualify for protection are quite broad.)

[80] *Id*. (stating that distinctiveness relates to the fundamental purpose of a trademark, which is to identify and distinguish a business or product. Trademarks can qualify as distinctive as long as they are "inherently distinctive" or if they have gained a "secondary meaning.")

[81] *Id*. at 3.01 [3] [c].

[82] Rev. Rul. 92-80, 1992-2 C.B. 57.

advertising of unknown products.[83] Concededly, some companies lack the financial wherewithal to enter into large license agreements with companies like Corning and Oneida.

For those companies with the means, however, allocating a percentage of each sale to the licensor in exchange for the use of that licensor's trademark is an attractive alternative to spending money on advertising. When a business decides to traditionally advertise, the amount of money necessary to accumulate goodwill and brand recognition is substantial.[84] For that reason, sometimes licensing a trademark is more attractive, and more profitable, than simply advertising the product on the open market.

It is this note's contention that the deductions allowed for advertising under section 162, and Revenue Ruling 92-80 require extension to trademark royalty expenditures.[85] To accomplish this end, the Service should rewrite the Treasury Regulation and the simplest solution is to the delete the word "trademark" from section 1.263A-1(e)(3)(ii)(U).

For example, the Tax Court in *Robinson* reasoned that licensing costs require capitalization as indirect costs in the year of expenditure pursuant to section 1.263A-1(e)(3)(ii)(U).[86] Essentially, the Tax Court and the Service treated all licensing costs the same,[87] rather than narrowly defining trademark royalties as advertising expenses.

Robinson argued that trademarks were advertising expenditures and were deductible

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[83] Well-known trademarks typically have years of goodwill, and advertising behind them.
[84] *See* RJR Nabisco Inc. v. Comm'r, 76 T.C.M. (CCH) 71 (1990), *nonacq*., (the Tax Court stated that there are questions of what benefits are associated with product advertising and with institutional goodwill advertising. There is no doubt that such traditional benefits include "not only patronage but also the expectancy of patronage," and even if advertising is directed solely at future goodwill, Revenue Ruling 92-80 indicates, that the costs are deductible.)
[85] Rev. Rul. 92-80, 1992-2 C.B. 57.
[86] *Robinson*, 97 T.C.M. 1037 at 20.
[87] *See* Firm, *Tax News Today, supra* note 7, at 120-26.

under section 162.[88] The Service disagreed and claimed that Robinson's royalties were not marketing, selling or advertising expenses, but instead were part of the production process, because Robinson could not lawfully produce a product bearing the Oneida or Pyrex trademarks without paying the contractually obligated royalties.[89] The Service contended that the licensed trademarks directly benefited Robinson's manufacturing contracts.[90]

The Service argued that just because the contractual liability attached itself to sales, that fact is not dispositive, because the payment was not a selling, marketing, or advertising expense.[91] "[U]nder section 263A, property produced for a taxpayer under contract with another party is treated as property produced by the taxpayer to the extent the taxpayer makes payments or otherwise incurs costs with respect to the property."[92]

The Service erred when they assumed the royalties directly benefited Robinson's manufacturing. Robinson had no contractual obligation to pay Corning or Oneida for the use of the trademark until they sold a product.[93] Robinson produced products and marketed them in two ways: first, under its own name; and second, under the Oneida and Corning trademarks.[94] How does that benefit Robinson's manufacturing?

The simple answer is that it does not. Robinson did not make royalty payments to secure the contractual right to manufacture Oneida and Pyrex products; rather, Robison those royalties to advertise its products, affixed trademarks to products after manufacturing, and

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[88] *Robinson*, 97 T.C.M. 1037 at 18.
[89] Brief of Petitioner, *supra* note 30, at 28.
[90] *See* Brief of Respondent, Robinson Knife Manufacturing Company, Inc., v. Comm'r of Internal Revenue at 14, No. 21514-06 (T.C.M. Jan. 4, 2008).
[91] *Id.*
[92] Treas. Reg. § 1.263A-2(a)(1)(ii)(B).
[93] *Robinson*, 97 T.C.M. 1037 at 6.
[94] *Id. at 4.*

only paid royalties when those products sold.[95] The only property Robinson licensed from Oneida and Corning was the trademarks.[96] Robinson chose the products sold under the Oneida and Pyrex name and would submit the products to Oneida and Corning for approval.[97] These facts demonstrate the actual use of the licensed trademark.

To illustrate the advertising power of the trademarks, one can simply examine the effect the trademark had on Robinson's sales. Because of the Oneida and Corning trademark name recognition, Robinson was able to place products for sale in stores like Target, Kohl's, Bed Bath & Beyond, and Linen & Things.[98] Under Robinson's wholly-owned trademark, "American Cooks," the company was unable to procure contracts with major retailers to sell identical products.[99]

The final argument the Service made was that royalties, unlike commissions paid to sales people, have nothing to do with generating a sale.[100] Webster's Collegiate Dictionary defines "selling" as "to cause or promote the sale."[101] The Service assumed that paying to use a trademark did not induce consumers to purchase a product; however, by this line of reasoning, Robinson would have no incentive whatsoever to pay Oneida or Corning for use of their trademark, because the trademark would have added nothing to the production and would not have increased sales; this is ludicrous.

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[95] Brief of Petitioner, *supra* note 30, at 15.

[96] *Id*. There were no product designs, no manufactured products, and no specifications.

[97] *Id*. at 13. Approval was necessary because a company with a well-known, well-respected trademark does not license it unless there is some measure of control.

[98] *Id*. at 14.

[99] *Id*.

[100] *Id.* at 16.

[101] *Id. at 17; see also* Webster's Collegiate Dictionary 19 (11th ed. 2005) ("Marketing" is defined as "the process of technique of promoting, selling, and distributing a product of a service").

1. The Incorrect Application of Past Precedent.

In *Robinson*, the court analogized the royalties paid to Corning and Oneida to the royalties paid under a patent agreement in *Plastic Manufacturing v. Commissioner*.[102] This approach was inequitable because patents and trademarks are legally distinct types of intellectual property.

To reach its conclusion, the *Robinson* court relied on the *Plastic Engineering* decision, which required capitalization of royalties paid to obtain a process patent for a new way of molding plastic.[103] The issue in *Plastic Engineering* was whether the taxpayer was required to capitalize royalties paid to license a patented "hot manifold assembly system." [104] The license agreement set the royalties at 10 percent of the net sales price of "all plastic modeled products manufactured through the use of the patented assembly system.[105] The taxpayer deducted the royalties as ordinary and necessary business expenses pursuant to section 162.[106] The Tax Court held that the royalties required capitalization because Plastic Engineering had entered into an agreement to pay royalties "for past and future use of the patent in petitioners assembly system."[107] Plastic Engineering had the "exclusive nontransferable license and the right to manufacture and sell the assembly system covered by the patent . . . ."[108] The court reasoned that Internal Revenue Code section 263A(a)(1) required all direct costs and certain indirect costs allocable to property to be included in

[102] Plastic Engineering & Technical Services, Inc. v. Comm'r., 82 T.C.M. 1017 (2001).
[103] *Robinson*, 97 T.C.M. 1037 at 18.
[104] *Plastic Engineering*, 82 T.C.M. 1017 at 1.
[105] *Id.* at 3.
[106] *Id* at 4.
[107] *Id* at 4.
[108] *Id.; see also* Allied Chemical Corp. v. United States, 370 F.2d 697, 698 (2d Cir. 1967).

inventory.[109] Similar to *Robinson*, the court went on to define indirect and direct costs, and cite section 1.263A-1(e)(3)(ii)(U) for the proposition that patent royalties are not immediately deductible.[110] In upholding the Commissioner's decision, the court required Plastic Engineering to capitalize the amount paid for the patent royalties to the property produced.[111]

Facially, the two cases are not analogous. As Justice Frankfurter once noted "[t]he protection of trade-marks is the law's recognition of the psychological function of symbols. If it is true that we live by symbols, it is no less true that we purchase goods by them. A trade-mark is a merchandising short-cut which induces a purchaser to select what he wants."[112] To extend that reasoning to its logical conclusion, a symbol, by itself is not patentable. The patent royalties paid in *Plastic Manufacturing* were for the use of a process to manufacture, and thus are inherently part of the production process, whereas the trademark in *Robinson* had no influence on production. Rather, trademarks, via television, radio, newspapers, magazines, and the Internet, bombard consumers and are a primary method of advertising a company's goods. [113]

On the other hand, patents are something quite different, and an overview of patent law illustrates this nicely. Article I of the United States Constitution gives Congress the

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[109] *Id.* at 6.
[110] *Id.*
[111] *Id*. at 7.
[112] Mishawaka Rubber & Woolen MFG. Co. v. S.S. Kresge Co., 316 U.S. 203, 205 (1942).
[113] *See* MCCARTHY*, supra* note 6*,* at 3-31; *see also* Northam Warren Corp. v. Universal Cosmetic Co., 18 F.2d 774, 775, (7th Cir. 1927) (arguing that "[a] trademark is but a species of advertising, its purpose being to fix the identity of the article and the name of the producer in the minds of people who see the advertisement, so that they may afterward use the knowledge themselves and carry it to others having like desires and needs for such article.").

authority to grant patent protection.[114] Pursuant to this authority, when inventors receive patent protection, they receive time-limited monopolies.[115] In order to receive protection, patents must fit within one of three categories: utility patents, plant patents, and design patents.[116] The statute requires the invention to be: non-obvious,[117] useful, and new.[118] When granted, the patent conveys the right to exclude others from making, using, selling, offering for sale, or importing the claimed invention for a designated time.[119] The brief history accounted above illustrates the stark difference between patents and trademarks.

For example, the patent requirement of non-obviousness is based on, "whether an invention is a big enough technical advance over the prior art."[120] A trademark would not qualify as a patent because a trademark is nothing more than a distinctive mark used in commerce.[121] Patents, needing to be a technical advance, could never completely separate themselves from a manufacturing process. A well-known common law trademark case distinguished trademarks from patents stating that a trademark does not "depend upon novelty, invention, discovery, or any other work of the brain. It requires no fancy or imagination, no genius, no laborious thought."[122]

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[114] U.S. CONST. art I, § 8, cl. 8 (stating: "The Congress shall have Power . . . to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.")
[115] FALK, *supra* note 18, at 3 (stating that the Act grants to the inventor the right to exclude others from making, selling, offering for sale, or using the invention for twenty years); *see also* 35 U.S.C. § 271.
[116] *Id.* at 12.
[117] 35 U.S.C. § 103 (1988).
[118] 35 U.S.C. § 101 (1988) .
[119] MERGES, MENELL, & LEMLEY, *supra* note 70, at 126; s*ee also* Leisure Dynamics, 494 F.2d at 1346; s*ee also* I.R.C. § 1235.
[120] *Id.* at 124.
[121] *Id.* at 635.
[122] *Id.; see also* Trade-Mark Cases, 100 U.S. at 94.

The Service's extension of the reasoning in *Plastic Engineering* to the *Robinson* case, based on the similarities of the license contracts, is legally and factually incorrect. Contractually the two licenses appear similar; however, by looking deeper into the properties behind the two contract agreements, it is evident that the properties (and therefore the contracts) are unrelated. This is because patents are part of the manufacturing process and trademarks are symbols of goodwill, advertising, and brand recognition.[123] Thus, the court incorrectly relied on distinguishable legal precedent as a basis for their holding against Robinson. Rather than examining the royalty payments and the properties they attached to, the court simply rubber-stamped the Service's zealous attempt to procure additional revenue streams.

2. Violating Horizontal Equity.

Principles of horizontal equity aver that people similarly situated should receive similar taxation.[124] In contrast, the Service's current approach, endorsed in *Robinson*, treats taxpayers engaging in the same activity, differently.[125] Regardless of how Robinson decided to promote itself, the goal was to successfully advertise and create sales.

For example, had Robinson expended the money paid to Oneida and Corning on television commercials, its expenses would have received an immediate deduction under section 162 and Revenue Ruling 92-80.[126] If instead Robinson had entered into a promotion contract with a third party advertising firm, Robinson would have received a deduction.

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[123] MCCARTHY, *supra* note 6, at 3-31.
[124] MILLER & MAINE, *supra* note 19, at 4-5.
[125] Brief of Petitioner, *supra* note 30, at 7 (stating that Robinson decided to advertise and sell its kitchen products using a well-known trademark, rather than conducting a traditional ad campaign.)
[126] Rev. Rul. 92-80, 1992-2 C.B. 57.

Previous jurisprudence supports the contention that trademarks are akin to advertising. The Seventh Circuit once stated, "[a] trademark is but a species of advertising, its purpose being to fix the identity of the article and the name of the producer in the minds of people who see the advertisement, so that they may afterward use the knowledge themselves and carry it to others having like desires and needs for such article."[127]

In addition, the plain meaning of "trademark" and "advertise" support the Seventh Circuit's reasoning. Webster's Collegiate Dictionary defines advertising, "as the action of calling something to the attention of the public."[128] Furthermore, it defines a trademark as "symbols of consumer recognition and of the incentive to purchase."[129] A well-known commentator supported the advertising and trademark likeness by writing, "[m]any billions of dollars are annually invested in advertising. The legally recognized symbol of such investments is a trademark."[130]

The court in *Robinson*, holding for the Commissioner, stated "[p]etitioner incurred royalties for licensing the right to use the Pyrex and Oneida trademarks in manufacturing the kitchen tools it produced, and the regulations under section 263A specifically require that those licensing costs be capitalized to the extent they are properly allocable to property produced."[131]

The court, however, misinterpreted the nature of the agreement that Robinson had with Oneida and Corning. The purpose of the license was not to incur "royalties for licensing the right to use the . . . trademarks in manufacturing," rather, the trademark was an

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[127] Northam Warren Corp. v. Universal Cosmetic Co., 18 F.2d 774, 775 (7th Cir. 1927).
[128] Webster's Collegiate Dictionary 19 (11th ed. 2005)
[129] *Id.*; *see also* MCCARTHY, *supra* note 6, at 2-34.
[130] MCCARTHY, *supra* note 6, at 2-34.
[131] *Robinson*, 97 T.C.M. 1037 at 16.

advertisement that attached after the production process to allow consumers to recognize the quality of the brand.[132] To illustrate this, Robinson could have produced the kitchen utensils without any licensing agreements and, in most instances; it produced identical products to which no licensed trademark attached.[133]

Furthermore, Robinson did not advertise in magazines, newspapers, in any broadcast media, through direct mail, or billboards.[134] In fact, the company did not claim another advertising deduction for the dates in question.[135]

Adhering to the concept of horizontal equity, the Service should rewrite Treasury Regulation section 1.263A-1 to exclude the term "trademark." This would allow the Tax Court to hold that, similar to traditional advertising, trademarks are another form of advertising and selling expenses, and as such are immediately deductible.

3. Unequal Matching of Income.

The Internal Revenue Code endeavors to match expenses with the revenues for the taxable period to which the expenses are properly allocable.[136] "Costs that cannot accrue before the related merchandise is sold should be deductible period costs, not inventoriable costs."[137] Similarly, section 471's requirement that inventory methods mirror the best

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[132] *Id.*
[133] Brief of Petitioner, *supra* note 30, at 7 (noting that Robinson marketed the manufactured products in three ways: (1) by marketing and selling them under a trade name with previously established brand recognition (Oneida and Pyrex); (2) by marketing and selling them under a trade name it owned, (American Cooks and Chip Clip); or (3) by marketing the units under the recognized branded name, and simultaneously marketing them under their own name.)
[134] *Id*.
[135] *Id*. at 8.
[136] *Id*. at 28.
[137] *Id.*

accounting practices to precisely reflect income, illustrates that principle.[138]

Adhering to matching principles, there should no difference from the accrual method of accounting and taking immediate section 162 deductions.[139] Typically, a company would annually add the amount of the royalties paid to the basis of the sold inventory, and then annually would offset any amount realized on the sale by their basis (including the royalty).[140] Treasury Regulation section 1.263A-1(e)(3)(ii)(U), however, has the effect of unequal matching of income because it requires the capitalization of royalties paid for sold products over the entire inventory.[141] In other words, the Service required Robinson to add up all the royalty payments for the year, and then required Robinson to add that amount to the basis of its entire inventory. This ignores the fact that the royalties only attached to the products that sold, and should increase only those products basis.

This violates section 471's requirement that inventory methods mirror the best accounting practices to precisely reflect income.[142] To effectively match income with costs, because the royalty payments only attach when a product sells, Robinson should be able to deduct the amount of the royalty payments from their amount realized. When taken in conjunction with Internal Revenue Code section 471, the Treasury Regulation section 1.263A-1(e)(3)(ii)(U) appears to directly conflict with the Code.

4. Bad Economic Policies.

Furthermore, it is this note's contention, that the tax policy adopted in *Robinson* is

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[138] I.R.C. § 471 (2008).
[139] Brief of Petitioner, *supra* note 30, at 28; *see also* MILLER & MAINE, *supra* note 19, at 179 (stating that the accrual method is required for companies for taxpayers who have inventory.)
[140] Brief of Petitioner, *supra* note 30, at 29.
[141] *Id.;* Treas. Reg. § 1.263A-1(e)(3)(ii)(U).
[142] I.R.C. § 471(a).

inefficient, and encourages less effective business strategies. The only remedy is rewriting the relevant Treasury Regulation and effectively overturning *Robinson*. With so much money invested in attaining trademark recognition, treating trademark license royalties differently from traditional advertising encourages ineffective use of resources, and unfair competition. For some companies, licensing a trademark is a more effective way of advertising their product.

For instance, hypothetically assume a mid-sized manufacturer of razor blades invents a disposable razor that supposedly is sharper than other razors on the market. The public, however, is not familiar with the company, because it only produces razor blades for third party manufacturers. The company believes this product has the potential to be a good competitive product, and does not wish to sell or license its patent. In order to compete in the highly competitive razor market, the company has a decision to make should it: a) pay to license a trademark; or b) pay to advertise its own trademark? Both strategies are attempts to build goodwill, familiarity, and brand recognition with consumers. There is no simple answer to this hypothetical; business decisions and advertising are far too complex to analyze in a bubble. The Treasury Regulation, however, takes that decision out of the hands of business people and creates an incentive to traditionally advertise, even in situations where licensing a trademark would be more profitable.

This incentive fosters unfair competition because well-entrenched companies, that own well-established trademarks, can advertise those trademarks and take large deductions based on that advertising. Treasury Regulation section 1.263A, however, penalizes smaller unknown companies, that license trademarks, for trying to find an avenue into a competitive

market. It should not be a goal of tax policy to penalize smaller companies that are trying to compete, for the benefit of larger companies.

It seems odd that a taxpayer can invest large sums of money in advertising and then immediately deduct those expenses, no matter how ineffective those activities; however, if a taxpayer licenses a trademark, deciding to take advantage of another's advertising, and goodwill, no immediate deduction is allowed.

Another problem with the Treasury Regulation section 1.263A-1(e)(3)(ii)(U) and the holding in *Robinson* is that they violate the principle of neutrality, which endeavors to ensure that the tax system should not attempt to shape economic behavior.[143] In order to be neutral, the Code should tax "economically equivalent activities, in the same fashion even though they may differ in form."[144] Gradually, over the years adherence to this principle has declined, and some tax rules do affect economic decisions making.[145] Yet, it still should be a goal not to directly interfere with business decisions, through the Tax Code, especially when the economic decision the taxpayer is making is more efficient then the alternative.[146]

In sum, Robinson's royalty expenditures did not "directly" benefit production activities. Rather, the royalties paid were identical to advertising expenses, and should receive the same treatment under the Tax Code. Furthermore, the Treasury Regulations and the *Robinson* holding violate horizontal equity and one of the principle aims of the Code, to match expenses and deductions. In addition, the Tax Court's reliance on *Plastic Engineering* was wrong, and the royalty payments Robinson made to license a trademark are

[143] MILLER & MAINE, *supra* note 19, at 4.
[144] *Id.*
[145] *Id.* at 5.
[146] *Id.*

factually distinctive from royalty payments to use a patent. There are also significant policy reasons, mainly efficiency, to overturn *Robinson*, and allow for the immediate deductibility of trademark royalties as advertising expenses pursuant to section 162 of the Internal Revenue Code, and Revenue Ruling 92-80.

V. SUGGESTED CHANGES

Under the Code, the regulations, and the plain meaning of trademark and advertising, one can infer that trademark royalty expenditures are selling or advertising expenses. One approach to allow trademarks to be deductible advertising expenses would be to allow the Service and the Tax Court to distinguish between trademark royalty contracts based on sales, and those based on manufacturing. In other words, whether a royalty requires capitalization or receives an immediate deduction would depend on the wording of the royalty agreement. If the Service adopts this distinction, taxpayers similarly situated to Robinson could take a deduction but, in the future, unwary licensees will fall into the non-deductible trademark royalty trap, simply by wording their contracts carelessly. It would be inequitable to tax individuals for not seeking the correct tax advice when entering a license agreement. For those reasons, the best approach is simply not to make a distinction between any trademark royalties, and declare all trademark royalties deductible, by simply eliminating the word "trademark" from Treasury Regulation section 1.263A-1(e)(3)(ii)(U).

Similarly, to create tax fairness in the Code, the Service should uphold the principles of horizontal equity. Adhering to horizontal equity when deciding the tax treatment of trademark royalties would immediately cure a few problems. There would no longer be disparate treatment between two types of advertising, and there would be no significant

policy drawbacks. By following this course of action, the Code would also be following principles of matching expenses with the revenues of the taxable period to which the expenses are properly allocable.

Significant economic incentives exist for allowing a deduction, and the Service should adhere to the principles of neutrality by adopting a less influential tax policy. More importantly, the decision and the Treasury Regulation would not affect future trademark licensing expenditures, and would adhere to principles of horizontal equity, and neutrality.

VI. CONCLUSION

When the Tax Court in *Robinson* cited a patent royalty case, the court failed to appreciate the difference between patent royalty payments, and trademark royalty payments. In addition, Treasury Regulation 1.263A-1(e)(3)(ii)(U) violates principles of horizontal equity and matching principles, creating inefficiency in the Tax Code.

The Robinson Manufacturing Company fell prey to an overbroad regulation, and a misapplication of a patent license case. In its zeal to create revenues, the Service ignored well-founded Code principles, and the Tax Court applied a rubber stamp to the Service's over-reach, and ultimately created inefficiency in the Code.

As suggested above, the Tax Court and the Service should adopt a new approach to trademark royalties, and allow for a deduction similar to ordinary advertising expenses under section 162, and Revenue Ruling 92-80. That response cures the disparate treatment, the inequity in the Code, and creates the same incentive for trademark licensing and regular advertising. The clarity this would provide and the correct matching of income reflects the Codes general purposes, and creates the right balance.

This note calls on the Service to right the wrong created in *Robinson*, and amend the Treasury Regulations, allowing taxpayers to treat trademark royalties as immediately deductible ordinary and necessary business expenses under section 162.

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