JURISDICTION: **OKLAHOMA TAX COMMISSION - DECISION**
CITE: **2001-09-04-038 / PRECEDENTIAL**
ID: **P9900254**
DATE: **09-04-01**
DISPOSITION: **DENIED**
TAX TYPE: **INCOME**
APPEAL: **OK SUP CT 96,883 / AFFIRMED**

FINDINGS OF FACT AND CONCLUSIONS OF LAW

NOW on this 23rd day of February, 2001, the above styled and numbered cause comes on for decision in accordance with the *Order Granting Motion for Reconsideration and/or Clarification of Findings, Conclusions and Recommendations* issued on February 12, 2001. The Order withdrew the *Findings, Conclusion and Recommendations* issued in this cause on December 28, 2000 which *Findings, Conclusions and Recommendations* were issued pursuant to a hearing held on June 28, 2000.

PROTESTANT is represented by AN Attorney at Law. The Audit Division of the Tax Commission (hereinafter "Division") is represented by Assistant General Counsels, General Counsel's Office of the Tax Commission.

Upon further review of the file and records, including the record of the proceeding, the partial stipulations, the exhibits received into evidence, the proposed findings, conclusions and recommendations, the *Motion for Reconsideration and/or Clarification of Findings, Conclusions and Recommendations, Taxpayer's Response to the Audit Division's Motion for Reconsideration and/or Clarification of Findings, Conclusions and Recommendations* and the *Findings, Conclusions and Recommendations* issued on December 28, 2000, the undersigned finds:

FINDINGS OF FACT

The parties stipulate to the following:

Procedural Facts

1. By letter dated June 7, 2000, THE Supervisor OF Corporate Income Tax OF the Commission proposed to adjust net distributable income claimed by PROTESTANT, and to deny each shareholder's claimed refund based on his or her percentage interest for the fiscal years 1993, 1994, 1995, and 1996, under the Commission's audit number XXXXXXX, in the following revised amounts:

Year & Period	1993 10/01/93 to 09/30/94	1994 10/01/94 to 09/30/95	1995 10/01/95 to 09/30/96	1996 10/01/96 to 09/30/97
Net Distributable Income Original	1,897,600	1,353,739	3,180,772	2,735,999
Royalty Exclusion 5064.7(A)(1)	- 0 -	- 0 -	- 0 -	- 0 -
Property Exclusion 5064.7(A)(2)	(15,600)	(52,981)	(46,300)	(913,342)
Revenue Agent Report		36,327		
Adjusted Net Distributable Income	1,882,000	1,337,085	3,134,472	1,822,657
Shareholders Net Distributable Income-Adjusted				
SHAREHOLDER A 1993 1994 1995 & 1996	1,618,675	1,078,029	2,396,950	1,393,797
SHAREHOLDER B 1993 1994 1995 & 1996	131,663	129,528	368,761	214,430
SHAREHOLDER C 1993 1994 1995 & 1996	131,662	129,528	368,761	214,430
	1,882,000	1,337,085	3,134,472	1,822,657

2. PROTESTANT timely filed a formal protest to the proposed assessment by letter dated September 21, 1999.

3. A prehearing conference was held on November 15, 1999. The Administrative Law Judge issued a *Prehearing Conference Order and Notice of Hearing* on November 19, 1999.

4. An *Agreed Motion to Strike Hearing Date and Request for Continuance* was filed on March 8, 2000.

5. The *Prehearing Conference Order and Notice of Hearing* issued on November 19, 1999, and the hearing scheduled for April 6, 2000, were canceled and a new scheduling order was issued on March 24, 2000.

6. The protest of PROTESTANT is properly before the Commission.

General Facts

7. PROTESTANT is located in ANONYMOUS, Oklahoma, and files as a Subchapter S Oklahoma Corporation.

8. PROTESTANT had three (3) shareholders for the periods at issue, whose interest were as follows:

A.	SHAREHOLDER A	86.008230% 80.625342% 76.470588%	1993 1994 1995 & 1996
B.	SHAREHOLDER B	6.995885% 9.687329% 11.764706%	1993 1994 1995 & 1996
C.	SHAREHOLDER C	6.995885% 9.687329% 11.764706%	1993 1994 1995 & 1996

9. Amended returns were also filed by PROTESTANT in 1998 claiming the inventor's credit under the Inventor's Assistance Act[1] for fiscal year 1993 through fiscal year 1995. PROTESTANT's fiscal year 1996 return, filed in 1998, also includes a claim for inventor's credit.

[1] 74 O.S. § 5064

10. The audit covers the fiscal year 1993 through fiscal year 1995 amended returns and the 1996 original return.

11. The Division allowed all property claimed for an instate manufacturer of a product developed in Oklahoma by an inventor under 74 O.S. Section 5064.7(A)(2). The credit is sixty-five percent (65 percent) of the cost of the depreciable property purchased and utilized in manufacturing the product developed in this state. The amounts allowed are as follows:

A.	FY 1993	$ 15,600.00
B.	FY 1994	$ 52,981.00
C.	FY 1995	$ 46,300.00
D.	FY 1996	$913,342.00

Facts Relating to the Inventor's Credit

12. The Division disallowed the royalty exclusion claimed by PROTESTANT under 74 O.S. Section 5064.7(A)(1) in three (3) separate categories as follows:

A. Patent numbers AAA and BBB. These patents were purchased from inventors or assignees living outside Oklahoma who had actually applied and received the patents. Credit claims were submitted, denied by the Division, and agreed to by PROTESTANT. Patent number CCC was submitted on June 1, 1992, by the inventor, Vice President of PROTESTANT, and approved on August 10, 1993. The royalty exclusion claimed is as follows:

A.	FY 1993	$127,862.00
B.	FY 1994	$127,214.00
C.	FY 1995	$191,718.00
D.	FY 1996	$163,976.00

The total royalty exclusion claimed for the audit period and denied by the Division was $610,770.00.

B. Patent number DDD. The patent was submitted on January 12, 1987, by the inventor, an employee of PROTESTANT, and THE President and majority stockholder of PROTESTANT, and approved on January 16, 1990. The product first sold in 1990. The royalty exclusion claimed is as follows:

A.	FY 1993	$1,077,811.00
B.	FY 1994	$1,110,275.00
C.	FY 1995	$1,663,469.00
D.	FY 1996	$1,533,920.00

The total royalty exclusion claimed and denied is $5,385,475.00.

C. The remaining patents: XXX; YYY; and ZZZ, and two pending patents primarily for pet water and food dishes, storage containers, and a bird house were submitted in various years by the inventor, Vice President of PROTESTANT. The royalty exclusion claimed and denied is as follows:

A.	FY 1993	$ 85,948.00
B.	FY 1994	$ 247,527.00
C.	FY 1995	$ 838,132.00
D.	FY 1996	$1,026,921.00

The total royalty exclusion claimed for the audit period and denied is $2,198,528.00.

13. THE VICE PRESIDENT-INVENTOR did not receive any compensation royalty payment for the assignments of the patents to PROTESTANT.

14. There is no royalty agreement present relating to the patent numbers at issue.

Additional findings:

1. Protestant is primarily a multi-product plastics manufacturing company. It earns income through the development and sale of such products (Testimony of WITNESS Q, Trans. pp. 51). Protestant has evolved from a gas can business to a mission statement of developing products for the automotive, pet and seasonal markets.

2. Products are developed by use of a team approach. Team members include employees from manufacturing, marketing, research and development, accounting, purchasing and warehouse and packaging. Currently, Protestant employs three (3) teams concentrating on the development of products along three (3) business lines consisting of automotive, pet and seasonal. No one individual employee creates or invents the products (Testimony of WITNESS R, Trans. pp. 22-25).

3. The product development teams meet at least every other week, but do not meet on an absolute verbatim schedule. None of the team members were specifically hired to invent or design products (Testimony of WITNESS Q, Trans. pp. 49-50). None of the members of the teams attempts to take credit for a particular idea or development which becomes a part of the patented products (Testimony of WITNESS R, Trans. pp. 24).

4. Protestant's employees are not compensated for an idea beyond their salary and benefits and do not receive a royalty (Testimony of WITNESS Q, Trans. pp. 48-49).

5. Protestant has a Product Development Department which primarily acts as the project coordinator of the project development teams (Testimony of WITNESS R, Trans. pp. 27). THE Vice-President of Product Development, is responsible for interfacing with Protestant's patent counsel, filing the patent applications and finalizing the approval of patents (Testimony of PROTESTANT'S VICE-PRESIDENT, Trans. pp. 65-66). THE VICE-PRESIDENT's name is listed on the patent applications as the inventor of the product as a formality because not only is he head of Product Development (Testimony of WITNESS R, Trans. pp. 25-26), but because under federal patent law a corporation cannot be an inventor (Testimony of PROTESTANT'S VICE-PRESIDENT, Trans. pp. 66). At the time a patent is applied for, THE VICE PRESIDENT executes an assignment of the product to Protestant also as a formality and without compensation because it is a component of the patent application and because the product belongs to Protestant (Testimony of PROTESTANT'S VICE-PRESIDENT, Trans. pp. 67-68).

6. Protestant does not have any employment contracts with its employees, it's merely understood or common knowledge that an employee is not compensated beyond his salary and benefits for his participation in the development of a product (Testimony of WITNESS Q, Trans. pp. 50-51).

7. During the periods at issue, Protestant did not report for federal or state income tax purposes any royalty income or royalty expenses related to the products in question (Testimony of WITNESS B, Trans. pp. 106-111). Protestant does not receive any royalty income (Testimony of WITNESS Q, Trans. pp. 52).

8. Protestant claimed total net income from the products in question as royalty for purposes of the royalty exclusion (Testimony of WITNESS B, Trans. pp. 87-98).

9. Protestant would not pay and it would be unreasonable for Protestant to pay One Hundred percent (100%) of its profits from a product over to an inventor as a royalty (Testimony of WITNESS Q, Trans. pp. 58 and 59).

ISSUES AND CONTENTIONS

Three issues are presented for decision. They are (1) whether Protestant was the inventor of the products at issue, (2) whether a corporation is allowed to claim the royalty exclusion under the Inventors Assistance Act ("Act")[2] and (3) whether a corporation who is the inventor of a patented product and who also is the manufacturer and seller of the product, can exclude as a royalty the net profit from the sale of the product.

Protestant contends that it was the inventor of the patented products. In support of this contention, Protestant relies on the evidence and cites ***Wehr Co. v. Winson***, 19 F.2d 231 (6th Cir. 1927), cert. denied 275 U.S. 558 (1927) for the proposition that an employer will own the rights to a patentable invention of an employee.

Protestant also contends that as the inventor of the patented products it can claim the benefits of the royalty exclusion. In support of this contention, Protestant asserts that federal patent laws are irrelevant with respect to claims allowed under the Act and that the Act clearly contemplates that a corporation can be an inventor.

Protestant further contends that the net profits from the sale of the patented products may be excluded as a royalty. In support of this contention, Protestant argues that royalty is a defined term under the Act and that such term does not exclude net profit.

The Division contends that Protestant is not the inventor of the patented products. In support of this contention, the Division relies on the evidence and argues that without specific employment contracts, Protestant only has a license to manufacture the products. The Division also contends that under federal patent law only the inventor can apply for a patent and that on the patent applications Protestant is not listed as the inventor, but the assignee.

The Division further contends that Protestant may not exclude its net profits as a royalty. In support of this contention, the Division argues that the definition of royalty under the Act is not outside the settled meaning of the term which term does not generally include net profits, but relates only to the transfer of patent rights.

[2] 74 O.S. 1991, § 5064.1 et seq.

CONCLUSIONS OF LAW

1. Jurisdiction over the parties and subject matter of this proceeding is vested in the Tax Commission. 68 O.S. 1991, Section 207.

2. Ownership springs from invention and an invention presumptively belongs to its creator. ***Teets v. Chromalloy Gas Turbine Corp.***, 83 F.3d 403 (C.A. Fla. 1996), citing ***Beech Aircraft Corp. v. EDO Corp.***, 990 F.2d 1237 (Fed.Cir. 1993). The law, however, recognizes that employers may have an interest in the creative products of their employees notwithstanding the absence of an express contract with the employee to assign all rights, where the employer specifically hires or directs the employee to exercise inventive faculties. ***Solomons v. United States***, 137 U.S. 342, 11 S.Ct. 88, 34 L.Ed. 667 (1890) and ***United States v. Dubilier Condenser Corp.***, 289 U.S. 178, 53 S.Ct. 554, 77 L.Ed. 1114 (1933). An employer may claim ownership of an invention notwithstanding the employee is hired for a general purpose if the employee is assigned a specific task of developing a device or process. ***State v. Neal***, 152 Fla. 582, 12 So.2d 59 (1943), cert. denied, 320 U.S. 783, 64 S.Ct. 191, 88 L.Ed. 470 (1943) and ***Goodyear Tire & Rubber Co. v. Miller***, 22 F.2d 353 (9th Cir. 1927).

3. The existence of an implied-in-fact contract to assign inventive rights is a question of fact. ***Teets***, supra at 408. Here, although the members of the product development teams are hired for other general purposes within the company, they are, while members of the team, assigned the specific task of developing new products. They utilize Protestant's resources for developing the new products. Protestant pays for the prosecution of the patent applications and in fact, the patents are assigned to Protestant as a mere formality or component of the patent process. Based on these facts Protestant is the owner of the patent rights.

4. Royalty earned by an inventor from a product developed and manufactured in this state shall be exempt from state income tax for a period of seven (7) years from January 1 of the first year in which such royalty is received as long as the manufacturer remains in the state. 74 O.S. 1991, Section 5064.7(A)(1). See, 68 O.S. 1991, Section 2359(E).

5. "Inventor" is defined by the Act to mean "any person who perceives a new concept which may result in a product or patentable process." 74 O.S. 1991, Section 5064.3(2). "Person" is defined to include a "corporation." 74 O.S. 1991, Section 5064.3(3). As argued by Protestant, the Act clearly contemplates and does not preclude a corporation from being an inventor.

6. "Royalties" is defined by the Act to mean "all things of value received by an inventor in connection with the licensing, rental or sale of a product patented, in patent pending, or trademarked pursuant to federal law." 74 O.S. 1991, Section 5064.3(6). A statutory definition of a term used in an Act supersedes commonly accepted, dictionary, or judicial definitions and is binding unless a contrary intention plainly appears. ***Oliver v. City of Tulsa***, 654 P.2d 607 (Okl. 1982).

Reference to legislative history is proper and permissible, however clear the language of a statute may appear to be, to make certain that the apparent clearness is not superficial in nature. ***Hunt v. Nuclear Regulatory Commission***, 611 F.2d 332 (C.A. Okl. 1979). Any doubt about the meaning of a statute may be resolved by reference to its history. ***Lekan v. P & L Fire Protection Co.***, 609 P.2d 1289 (Okl. 1980).

The Inventors Assistance Act, 74 O.S. 1991, Section 5064.1 et seq., was enacted in 1987[3] to encourage and assist inventors. 74 O.S. 1991, Section 5064.2. As originally enacted, the incentives provisions of the Act provided an exemption from state income tax of "[i]ncome earned by an inventor from a product developed", Section 5064.7(A)(1); and "[i]ncome earned by a business that manufacturers a product developed * * * that is directly attributable to such product", Section 5064.7(A)(2).

The incentives provisions of the Act were amended in 1988[4] to provide an exemption from state income tax of "[r]oyalty earned by an inventor from a product developed and manufactured in this state", Section 5064.7(A)(1); and a tax credit as provided in 68 O.S. 1991, Section 2357.4 and exclusion from income of "sixty-five percent (65 percent) of the cost of depreciable property purchase and utilized directly in manufacturing the product * * * not to exceed Five Hundred Thousand Dollars ($500,000.00)" to "[a]n instate manufacturer of a product developed in this state by an inventor", Section 5064.7(A)(2). The definition of "royalty", as found in Section 5064.3(6), has not been amended since the enactment of the Inventors Assistance Act.

The Division argues that the legislature by changing the statute in 1988 to its current wording specifically rejected Protestant's contention that net profit or income and royalty are equivalent. The undersigned agrees. By amending Section 5064.7(A)(2), the legislature expressly denied the exemption of "[i]ncome earned by the business that manufactures the product."

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[3]Laws 1987, c. 121, § 1, eff. Nov. 1, 1987.

[4]Laws 1988, c. 313, § 4, emerg. eff. July 1, 1988.

Here, Protestant claimed for purposes of the royalty exclusion the income earned by the business that manufactured the products. The legislature has expressly denied the royalty exclusion for such claims. See, ***Green v. Oklahoma Tax Commission***, 188 Okl. 168, 107 P.2d 180 (1940); ***In re Levy***, 185 Okl. 477, 94 P.2d 537 (1939). Further, Protestant admits that it did not receive any royalty income from the products. Accordingly, Protestant's protest to the disallowance of the royalty exclusion must be denied.

DISPOSITION

Based on the above and foregoing, it is DETERMINED that the income tax protest of PROTESTANT be denied. It is further DETERMINED that the amount in controversy, inclusive of any additional accrued and accruing interest, be fixed as the deficiency due and owing.

OKLAHOMA TAX COMMISSION