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Intellectual Property Law Solutions to Tax Avoidance

Andrew Blair-Stanek

ABSTRACT

Multinational corporations use intellectual property (IP) to avoid taxes on a massive scale, by transferring their IP to tax havens for artificially low prices. Economists estimate that this abuse costs the U.S. Treasury as much as $90 billion each year. Yet tax policymakers and scholars have been unable to devise feasible tax-law solutions to this problem.

This Article introduces an entirely new solution: change IP law rather than tax law. Multinationals' tax-avoidance strategies rely on undervaluing their IP. This Article proposes extending existing IP law so that these low valuations make it harder for multinationals to subsequently litigate or to license their IP. For example, transferring a patent for a low price to a tax-haven subsidiary should make it harder for the multinational to demonstrate the patent's validity, a competitor's infringement, or entitlement to any injunctions. The low transfer price should also weigh toward lower patent damages and potentially even a finding of patent misuse. Extending IP law in such ways would thus deter multinationals from using IP to avoid taxes. Both case law and IP's policy justifications support this approach.

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62 UCLA L. Rev. 2 (2015)

TABLE OF CONTENTS

Introduction....4
I. The Problem: IP as a Tax-Avoidance Vehicle....9
 A. The Simplest Case: A Low-Price License of the IP....9
 B. Variations in Structure: Sale, Services, and Cost-Sharing Arrangements....12
 C. The Magnitude of the Problem....14
 D. Tax-Law Proposals and Tax-Law Impotence....16
II. IP Law Solutions....18
 A. Invalidity....20
  1. Patents: Obviousness via Secondary Considerations....21
   a. Better Evidence Than Commercial Success....22
   b. Low Transfer Prices Negate Commercial Success Evidence....23
   c. Better Evidence Than Licensing Success....24
  2. Trademarks: Lack of Secondary Meaning....25
 B. Limiting Scope....27
  1. Patents: The Doctrine of Equivalents....28
  2. Copyrights: Fair Use....29
  3. Trademarks: The Strength of a Mark....31
  4. Trademarks: Not "Famous" Enough to Be Diluted....32
 C. Lower Damages....35
  1. Patent Damages....36
  2. Copyright Damages....40
  3. Trademark Damages....41
 D. Harder to Receive Injunctions (Both Preliminary and Permanent)....43
  1. Lower Likelihood of Prevailing on the Merits....44
  2. Lack of Irreparable Harm....46
  3. Unfavorable Balance of Hardships....47
 E. Misuse....48
III. Consistent With IP Policy....51
 A. Not Undermining IP Rights....52
 B. Reducing Distortion of Creative Professionals' Employment....52
 C. Economic Grounds....53
 D. Philosophical Grounds: Lockean Just Deserts and Kantian Autonomy....55
 E. Counterargument: Second-Best Way to Increase IP-Creation Incentives....57
 F. Counterargument: Application to Transactions Between Unrelated Parties....59
 G. Consistency With IP Law's Extensive Use of Estoppel....60
IV. Further Applications....63
 A. Non-Litigated IP: "Tainted" for Licensing....63
 B. Non-Traditional Intangible Property....63
 C. International Usage....65
 D. IP Defendants as Whistleblowers to the IRS....65
V. IP Law and Tax Law's Failure to Interact....67
Conclusion....72

INTRODUCTION

Intellectual property (IP) has become the leading tax-avoidance vehicle. Front-page articles in the *New York Times* and *Wall Street Journal* have detailed how multinational corporations use creative IP transactions to avoid taxes on a massive scale.[1] The Obama Administration,[2] congressional Republicans,[3] and scholars[4] have proposed tax law changes to combat this abuse. One leading tax scholar has concluded that the problem is "intractable" without a radical, disruptive reordering of international tax law.[5]

This Article proposes an entirely new approach: Instead of modifying tax law, existing IP law should be extended to discourage multinationals from using IP to avoid taxes. Scholars have observed that nontax considerations like securities law and financial accounting create disincentives that constrain tax avoidance.[6] This Article proposes, for the first time, using IP law in this way.

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1. Charles Duhigg & David Kocieniewski, *How Apple Sidesteps Billions in Taxes*, N.Y. TIMES, Apr. 29, 2012, at A1; Janet Hook & Danny Yadron, *Apple CEO Tim Cook, Lawmakers Square Off Over Taxes*, WALL ST. J., May 22, 2013, at A1; *see also* Jesse Drucker, *Google 2.4% Rate Shows How $60 Billion Lost to Tax Loopholes*, BLOOMBERG (Oct. 21, 2010), http://www.bloomberg.com/news/print/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-to-tax-loopholes.html; Sam Schechner, *Google's Tax Setup Faces French Challenge*, WALL ST. J., Oct. 9, 2014, at A1.
2. *E.g.*, DEP'T OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2014 REVENUE PROPOSALS 49–51 (2013), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2014.pdf ("There is evidence indicating that income shifting through transfers of intangibles to low-taxed affiliates has resulted in a significant erosion of the U.S. tax base.").
3. *E.g.*, H. COMM. ON WAYS & MEANS, 112TH CONG., TECHNICAL EXPLANATION OF THE WAYS AND MEANS DISCUSSION DRAFT PROVISIONS TO ESTABLISH A PARTICIPATION EXEMPTION SYSTEM FOR THE TAXATION OF FOREIGN INCOME 32–35 (2011), *available at* http://waysandmeans.house.gov/uploadedfiles/final_te_--_ways_and_means_participation_exemption_discussion_draft.pdf.
4. *E.g.*, Michael J. Graetz & Rachael Doud, *Technological Innovation, International Competition, and the Challenges of International Income Taxation*, 113 COLUM. L. REV. 347 (2013); Omri Marian, *Jurisdiction to Tax Corporations*, 54 B.C. L. REV. 1613 (2013).
5. Edward D. Kleinbard, *Stateless Income's Challenge to Tax Policy*, *in* TAX NOTES 1021, 1443 (2012); *see also* Lee A. Sheppard, *Reflections on the Death of Transfer Pricing*, 120 TAX NOTES 1112 (2008) (quoting top official that enforcement of "transfer pricing is dead"). *See generally* Martin A. Sullivan, *Economic Analysis-Intangible Profits: Oh, the Places You'll Go!*, 139 TAX NOTES 1218 (2013) (noting the inability of tax scholars to solve how to source intellectual property (IP) profits to prevent tax avoidance).
6. *E.g.*, David M. Schizer, *Frictions as a Constraint on Tax Planning*, 101 COLUM. L. REV. 1312 (2001) (explaining how some tax-avoidance strategies are discouraged by 'frictions' like bad financial accounting treatment, unenforceability of contracts under securities laws, and suboptimal organizational form).

Two characteristics of IP make it ideal for avoiding tax.[7] First, unlike workers or physical assets like factories or stores, IP can easily be moved to tax havens via mere paperwork.[8] Second, the uniqueness of every piece of IP makes a precise fair market value nearly impossible to establish, allowing multinationals to justify low valuations that result in the least tax. Virtually all IP-based tax-avoidance schemes involve assigning an artificially low price to a piece of IP at some point in time.[9]

For example, suppose that California-based engineers for Google Inc. develop a promising invention. Google immediately transfers the patent rights for an artificially low price to its Irish subsidiary.[10] Google's U.S. tax on this transfer is proportional to the price—artificially low. But the patented invention later becomes part of the newest Google Internet service or gadget and generates immense value. The substantial profits flow to Google's Irish subsidiary, where they escape taxation entirely,[11] even though the invention was developed in California. Such IP-shifting strategies cost the Treasury as much as $90 billion per year, a staggering one-third of the total U.S. income taxes paid by all corporations.[12]

Such strategies are, however, not tax fraud. Tax fraud generally requires misleading the Internal Revenue Service (IRS) or hiding information from the IRS.[13] In contrast, multinationals hire appraisers to prepare rigorous

7. Graetz & Doud, *supra* note 4, at 402.
8. *Id.*; Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 VA. TAX REV. 79, 88 (2008).
9. Graetz & Doud, *supra* note 4, at 395.
10. The author has no knowledge of the precise IP-based tax-minimization strategies used by Google. Taxpayers' tax-minimization strategies are nonpublic. This Article uses Google for this hypothetical example because, as a leading commentator has noted, Google is "the poster child for undervalued IP transfers." Lee A. Sheppard, *News Analysis: BEPS Implementation Anticipated*, 2014 TAX NOTES TODAY 41-3 (Mar. 3, 2014). For 2003 and an unknown number of subsequent tax years, Google and the Internal Revenue Service (IRS) have an advance pricing agreement (APA) to settle the methodology for "certain" intercompany transfer prices. *See* GOOGLE, INC., GOOGLE ANNOUNCES FOURTH QUARTER 2006 FINANCIAL RESULTS (2007), *available at* http://investor.google.com/earnings/2006/Q4_google_earnings.html. Google has successfully fought public disclosure of this APA. *See* Kristen A. Parillo, *SEC Backs Off Request to Google to Make APA Public*, 130 TAX NOTES 1524 (Mar. 28, 2011). Given that most APAs last approximately six years, this APA likely no longer applies. *See* BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS ¶ 79.14.2[5] (1999 & Supp. 2013). Even if a multinational has an APA with the IRS, that does not prevent transfer pricing mischief. *See* Sheppard, *supra* (noting Google's underpriced transfers despite having an APA).
11. For the details of how this arrangement avoids U.S. tax, see *infra* note 38. On how multinationals have generally managed to avoid Irish tax, see *infra* note 55.
12. *See infra* notes 63–64 and accompanying text.
13. Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir. 1968); Beck v. Comm'r, 82 T.C.M. (CCH) 738, 43-6 (2001); BITTKER & LOKKEN, *supra* note 10, ¶ 114.6.

documentation justifying their low transfer prices and make this documentation fully and promptly available to the IRS upon request.[14] These appraisers marshal extensive evidence that the IP has the low value claimed.

This Article introduces the insight that artificially low valuations—and the appraisers' reports justifying them—are these tax-avoidance strategies' Achilles heel. For instance, suppose Google sues another party (such as a competitor) for infringing the patent that it transferred to its Irish subsidiary. The defendant should be able to defend against Google's suit using five arguments that are natural extensions of existing patent law.

First, the defendant should argue that the artificially low price is evidence that the patent is invalid as "obvious."[15] For a patent to be valid, the invention must not have been obvious to scientists or engineers in the relevant field. To help judges and jurors—who are virtually never engineers or scientists in the relevant field—in making the obviousness determination, patent law has developed nontechnical "secondary considerations" such as commercial success and licensing success that are evidence for or against obviousness. The artificially low price fits nicely into this rubric by demonstrating with a hard figure that, immediately after the invention, Google did not see the patent as being a substantial innovation. Additionally, the appraisers' documentation justifying the low price may include damaging admissions or opinions downplaying the patent's innovativeness.

Second, the defendant should argue that, even if the patent is valid, it has a narrow scope, making it harder for Google to prove infringement.[16] Courts give innovative patents a broad scope that allows finding infringement whenever the infringer uses a close equivalent to the claimed invention. By contrast, less-innovative patents are given a narrower scope. The low transfer price is evidence that Google did not perceive the patent as particularly innovative, and thus it should receive a narrower scope that makes it harder for Google to prove infringement. Moreover, the appraisers' documentation justifying the low price will often include damaging evidence downplaying the patent's inventiveness, further hindering Google's suit.

Third, even if the court finds the patent valid and infringed, the defendant should be able to point to the low transfer price as evidence that

14. 26 C.F.R. § 1.6662-6(d)(2)(iii)(A) (2013) (provision of documentation to the Internal Revenue Service within 30 days of a request).

15. *See infra* Part II.A.1; *cf.* Andrew Blair-Stanek, *Tax in the Cathedral: Property Rules, Liability Rules, and Tax*, 99 VA. L. REV. 1169, 1203–10 (2013) (noting how the IRS, unlike private litigants such as IP defendants, often fails to deter tax abuse because of political and media pressures).

16. *See infra* Part II.B.1.

any damages owed to Google should be correspondingly low.[17] After all, a patent's price reflects its potential to generate profits and royalties, and patent damages replace the patent holder's lost profits and royalties.

Fourth, Google would likely request a preliminary injunction against the defendant's infringement and, if Google prevails on the merits, then request a permanent injunction. But a low price for the patent directly undermines several of the showings Google would have to make to obtain this relief. For example, to get any injunction Google would need to demonstrate that, without the injunction, it would suffer irreparable harm that could not be adequately compensated by money damages.[18] Yet choosing a transfer price expressly quantifies the patent's value, making it much harder for Google to argue that the infringement harm cannot be measured and compensated. Indeed, a low transfer price indicates that the harm is easily reparable with modest damages.

Finally, even if the court finds Google's patent valid and infringed, the defendant should argue that Google's tax avoidance was "patent misuse."[19] When a court finds that a patent holder used the patent in a way that violates public policy, it will refuse to award damages or injunctive relief, at least until the misuse has been remedied. Misuse does not require that the patent holder harmed the defendant,[20] only that the patent holder used the IP in a way that violated public policy. Avoiding taxes is certainly against public policy. If the court finds Google's tax avoidance sufficiently egregious, it could refuse relief to Google until it has repaid the U.S. Treasury the taxes it improperly avoided.

These five extensions of patent law—invalidity, narrow scope, low damages, no injunctions, and misuse—provide any defendant with strong tools to defend against Google's suit for infringing the patent used in Google's tax-avoidance strategy. Both trademark law and copyright law have analogous doctrines that allow for similar arguments against multinationals that avoid taxes by transferring their trademarks and copyrights for artificially low prices. This Article's approach provides a robust deterrent to tax avoidance using all three major categories of IP: patents, copyrights, and trademarks.

The arguments proposed by this Article have particular traction because multinationals like Google must attest on their tax returns—under penalties

17. *See infra* Part II.C.1.
18. *See infra* Part II.D.2.
19. *See infra* Part II.E.
20. *See infra* note 276.

of perjury—that they believe their transfer prices were correct.[21] As a result, multinationals cannot disavow a low transfer price as being merely for tax purposes. Moreover, they hire appraisers to create detailed, reasoned reports justifying the low transfer prices. These reports not only make it yet harder to disavow the transfer prices but also are full of facts and data that can provide additional fodder for defendants sued by multinationals for IP infringement.

This Article's proposals not only have strong doctrinal foundations in IP law but also are consistent with the policies underpinning IP law. IP law is often justified as increasing economic well-being. This Article's proposals would have a number of economic benefits, including reducing the massive distortions in worldwide investment decisions, fiscal imbalances, and transaction costs resulting from IP-based tax avoidance.

Moreover, multinationals can use IP for tax avoidance, while individuals and small businesses like startups cannot.[22] This asymmetry distorts the employment of creative professionals (such as inventors and authors) away from smaller businesses and self-employment, and toward multinationals, which generally make less efficient use of creative professionals' labor.[23] This Article's proposals would reduce this economically damaging distortion.

Many judges and scholars justify IP on Lockean grounds of just deserts for creative professionals' labor, or on Kantian grounds of promoting conditions for creative professionals' individual autonomy. Perversely, the ability of multinationals (but not startups or individuals) to use IP for tax avoidance makes creative professionals more likely to work for multinationals, which generally give creative professionals less autonomy and less opportunity to reap the profits from their inventive and creative labor. This Article's proposals would reduce this distortion in creative professionals' employment, promoting their autonomy and allowing them to capture more of the fruit of their labor.

To be clear, this Article's proposed extensions of existing IP law would not substantially undermine IP rights. Rather, they are simply additional ammunition for defendants accused of infringement. For example, patents will be slightly less likely to be held valid when courts consider low transfer prices. Similarly, IP damages would not plunge but would only fall modestly as low transfer prices provide additional data for calculating damages.

21. *See infra* note 93 and accompanying text.
22. Martin A. Sullivan, *Economic Analysis: Will International Tax Reform Slow U.S. Technology Development?*, 141 TAX NOTES 459, 461 (Nov. 4, 2013).
23. *See id. at* 461 ("[I]t is widely believed that small and start-up firms conduct more productive research than large firms . . . .").

This Article proceeds in five Parts. Part I details how multinationals avoid taxes by using their IP, as well as tax policymakers' and scholars' inability to devise workable tax-law solutions to these abuses. Part II proposes extending patent, copyright, and trademark law to make it harder for multinationals to enforce IP that they have used to avoid taxes. It proposes fifteen extensions of existing IP law. As Part III demonstrates, these extensions further many of the policies underpinning IP law. Part IV explores how this Article's approach extends to IP that is never litigated, to countries other than the U.S., to involving the tax whistleblower statute, and to nontraditional intangible assets. For example, when a multinational avoids tax using a nontraditional intangible asset like "workforce in place," employment law can be extended to make it harder for the multinational to sue a competitor for "poaching" an employee. Finally, Part V explores the failure of litigants, scholars, and policymakers to advance the extensions of IP law that this Article proposes.

I. THE PROBLEM: IP AS A TAX-AVOIDANCE VEHICLE

This Part explains how multinationals use IP to avoid taxes on a staggering scale, relying in large part on norms of international tax enshrined in thousands of bilateral tax treaties. The Part then explores the magnitude of the problem and its harmful effects. It concludes by discussing how tax-law solutions proposed by policymakers and scholars either fail to address multinationals' informational advantages over the IRS or would deeply disrupt the current international tax system.

A. The Simplest Case: A Low-Price License of the IP

The Introduction sketched out the simplest use of IP as a tax-avoidance vehicle by a U.S. multinational, using Google as a hypothetical example. This Subpart fills in the details.[24] When Google's California-based engineers develop a promising invention, Google owns the rights to all patents that can be obtained on the invention, as corporate ownership of employee-created IP is common practice.[25] Google then quickly licenses all the patent rights to a

24. For an excellent diagram explaining these tax-avoidance mechanisms, see Sheppard, *supra* note 5, at 1112 ("Example of Outbound Transfer Pricing Structure").

25. *See, e.g.*, Microsoft Corporation Employee Agreement, signed by Andrew Blair-Stanek, July 17, 2000 (on file with Author), at ¶ 4 (requiring that the employee promise to assign all inventions to the employer); Teets v. Chromalloy Gas Turbine Corp., 83 F.3d 403, 407 (Fed. Cir. 1996) ("[C]ontract law allows individuals to freely structure their transactions and employee relationships. An employee may thus freely consent by contract to assign all rights

subsidiary in a tax haven like Ireland.[26] Licensing allows the future profits from the patents to accrue to the Irish subsidiary,[27] while the legal ownership remains with Google itself in the U.S. This arrangement thus enables Google to continue benefiting from the U.S.'s robust protections for IP owners.[28]

U.S. tax law requires that Google receive "arm's-length" royalties from its Irish subsidiary for the patent license.[29] The "arm's-length" price is defined as the price that would have been charged if Google had instead been dealing with an unrelated party under the same circumstances.[30] (Google's Irish subsidiary is the quintessential related party, being fully owned by Google.) The "arm's-length" principle for cross-border transactions is deeply enmeshed in not only U.S. tax law but also the numerous bilateral tax treaties signed by the U.S. with its trading partners, including Ireland.[31] Google must pay U.S. corporate tax of 35 percent on these "arm's-length" royalties.[32]

Herein lies the mischief. Google does not transfer its promising IP to unrelated parties, so there is no observable "arm's-length" price. Valuing

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in inventive ideas to the employer."). *See generally* DONALD S. CHISUM, CHISUM ON PATENTS §§ 22.01, 22.03 (rev. ed.00202013) [hereinafter CHISUM ON PATENTS]. The patent rights at this stage are typically just the patent applications, which are fully assignable. 35 U.S.C. § 261 (2013). Once the Patent and Trade Office (PTO) approves the applications, rights to patent applications become rights to the patents. *Id.*

26. Graetz & Doud, *supra* note 4, at 396–97.
27. The license can be made economically equivalent to selling the patent by licensing it for less than the patent's full legal term, but greater than the technology's economic life. *See* PHILLIP F. POSTLEWAITE ET AL., FEDERAL INCOME TAXATION OF INTELLECTUAL PROPERTIES & INTANGIBLE ASSETS ¶ 2.04 (2013).
28. Memorandum from the Chairman, Carl Levin and Ranking Member, John McCain of the S. Permanent Subcomm. on Investigations, Offshore Profit Shifting and the U.S. Tax Code-Part 2 (Apple, Inc.), at 8–9 (May 21, 2013), *available at* http://www.hsgac.senate.gov/download/?id=CDE3652B-DA4E-4EE1-B841-AEAD48177DC4 [hereinafter SENATE APPLE REPORT]; STAFF OF THE JOINT COMM. ON TAXATION, PRESENT LAW AND BACKGROUND RELATED TO POSSIBLE INCOME SHIFTING AND TRANSFER PRICING, NO. JCX-37-10, at 95 n.198 (July 20, 2010) [hereinafter JCT REPORT]; SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, OFFSHORE PROFIT SHIFTING AND THE U.S. TAX CODE, at 20 n.68 (Sept. 20, 2012) [hereinafter SENATE MICROSOFT REPORT], *available at* http://www.hsgac.senate.gov/download/?id=7B9717AF-592F-48BE-815B-FD8D38A71663. Patentees that give mere nonexclusive licenses to their foreign subsidiaries have found it somewhat harder to prove standing for patent damages under a lost profits theory, making the protection for their IP in U.S. courts somewhat less robust. *See, e.g.*, Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359, 1367-68 (Fed. Cir. 2008); Volterra Semiconductor Corporation v. Primarion, Inc., 08–cv–05129–JCS, 2013 WL 6905555 at *16 (N.D. Cal. Sept. 24, 2013).
29. 26 U.S.C. § 482; 26 C.F.R. § 1.482-1 (2013); *see also infra* note 81 (discussing the failure of the "commensurate with income" standard).
30. 26 C.F.R. § 1.482-1(b)(1) (2013).
31. Income Tax Treaty, U.S.-Ir., Dec. 17, 1997, 2141 U.N.T.S. 167, Art. 9(1)(b) & (2).
32. 26 U.S.C. § 11(b)(1)(D) (35 percent corporate rate); *id.* § 61(a)(6) (including royalties, which include payments for IP licensing, in gross income).

IP—particularly brand-new IP—is difficult and subjective. Unlike a mass-produced machine or a ton of aluminum, each piece of IP is unique and its economic potential is difficult to predict. Treasury regulations provide detailed econometric methods to estimate IP values,[33] but these are extremely imprecise, often leading to a wide range of acceptable prices. Tax law requires that Google hire appraisers (oftentimes economists) to ascertain an "arm's-length" price for the transfer to Ireland, and to support that price with extensive contemporaneous documentation.[34] But Google selects and pays these appraisers, who thus have incentives to err toward lower valuations.[35] As a leading tax practitioner recently observed, appraisers tend to agree with their paymasters on valuation questions.[36]

After the transfer to Google's Irish subsidiary, the patented technology is incorporated into a new Google device.[37] The Irish subsidiary oversees a Chinese contract manufacturer's building of the new devices.[38] The Irish subsidiary then sells the devices for a full markup that includes the value of the IP to Google distribution subsidiaries worldwide. Those subsidiaries subsequently sell the devices to consumers. As consequence, the substantial profits from the IP remain in Ireland, typically not subject to Irish tax, and also not subject to U.S. tax so long as the cash is not returned to the U.S.[39] A senior government official nicely summarized multinationals' strategy: "Good

33. 26 C.F.R. § 1.482-4 (2013).
34. 26 U.S.C. § 6662(e)(3)(B); 26 C.F.R. § 1.6662-6(d)(2)(iii) (2013) (detailing contemporaneous documentation requirements to avoid serious penalties); Robert Culbertson, *The Interplay Between Substantive and Penalty Rules in the U.S. Transfer Pricing Regulations*, 11 TAX NOTES INT'L 1509 (Dec. 5, 1995) ("The regulations 'encourage' taxpayers to [follow the documentation requirements] by threatening them with crippling penalties.").
35. Sheppard, *supra* note 5, at 1112; Brauner, *supra* note 8, at 108 ("[T]he clear incentive created by the system is to push the envelope and reach the price that is most aggressive, yet still within the very wide margin of reasonability.").
36. Sheppard, *supra* note 5, at 1112 (citing Willard B. Taylor of Sullivan & Cromwell LLP).
37. Most of this increase in value reflects the artificially low earlier transfer price. But some of the increase in value results from the fact that a well-designed patent portfolio (such as the one that a multinational assembles in Ireland) has more value than the sum of the value of its individual patents standing alone. *See* Gideon Parchomovsky & R. Polk Wagner, *Patent Portfolios*, 154 U. PA. L. REV. 1 (2005).
38. *See* Sheppard, *supra* note 5, at 1113 ("Example of Outbound Transfer Pricing Structure"). Having the Irish subsidiary involved in activities such as oversight, choice of the manufacturer, and quality control meets the "substantial contribution to manufacturing" test at 26 C.F.R. § 1.954-3(a)(4)(iv) (2013). As a result, the Irish subsidiary's profits are not "foreign base company sales income," 26 C.F.R. § 1.954-3(a)(4) (2013), not "foreign base company income," 26 U.S.C. § 954(a)(2), not "subpart F income," *id.* § 952(a)(2), and hence not included in Google's income when earned, *id.* § 951(a).
39. 26 U.S.C. § 61(a)(7). Foreign taxes paid (if any) are creditable against Google's U.S. taxes. *Id.* § 902.

ideas are identified early and transferred early. . . . We're being gamed because of the low value at the time of the transfer."[40]

When Google transferred the IP to its Irish subsidiary, a true "arm's-length" price would have been substantially higher, reflecting its potential for great profitability as part of the newest Google device. A true "arm's-length price" would have thus resulted in correspondingly higher U.S. tax revenue. If the IP had been priced accurately, there would have been no tax avoidance. This Article's proposals would create incentives in IP law for multinationals to use accurate transfer prices.

B. Variations in Structure: Sale, Services, and Cost-Sharing Arrangements

The licensing arrangement described above is one of the most popular methods used by multinationals to avoid taxes by transferring IP to subsidiaries in tax havens, like Ireland,[41] before the IP's high value becomes apparent.[42] But there are three other methods that multinationals use as well.

First, the IP can be sold outright (rather than licensed) for an artificially low sales price to a tax-haven subsidiary.[43] Sales and licenses can be structured to have nearly identical economic consequences.[44] Again, the multinational has every incentive to choose a low sales price to minimize its U.S. taxes.[45] The downside to a sale is that it results in much less favorable tax treatment than a license, thanks to U.S. tax law's quirks.[46]

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40. Sheppard, *supra* note 5, at 1112 (quoting Edward Kleinbard, then chief of staff of the Joint Committee on Taxation).

41. SENATE APPLE REPORT, *supra* note 28, at 8 (explaining that licensing and cost-sharing arrangements are the two most popular IP offshoring approaches); JCT REPORT, *supra* note 28, at 103 (same); *id.* at 51–102 (surveying six U.S. multinational's tax strategies and finding most use licensing or cost-sharing arrangements).

42. JCT REPORT, *supra* note 28, at 20–21; Graetz & Doud, *supra* note 4, at 396–98.

43. Graetz & Doud, *supra* note 4, at 396. It is possible to sell the IP for tax purposes to the Irish subsidiary while the legal title remains in the U.S. *See* Grodt & McKay Realty, Inc. v. Comm'r, 77 T.C. 1221, 1237 (1981) (explaining that legal title is just one of many factors determining tax ownership).

44. *See supra* note 27.

45. 26 U.S.C. § 61(a)(3) (making gains from sales gross income); *id.* § 1001(a) (defining gain as sale price minus basis). The patent rights likely have zero basis because R&D expenditures are immediately deductible. *Id.* §§ 174, 263(a)(1)(B). (In tax law, an asset's basis is a dollar figure that generally represents the taxpayer's investment in the asset, minus deductions.).

46. First, selling the right to use IP in the U.S. is a purchase of "United States property" under 26 U.S.C. § 956(a), (c)(1)(D), resulting in double taxation to the multinational, once from *id.* § 951(a)(1)(B), and again from *id.* § 61(a)(3). Merely licensing the U.S. IP rights to the Irish subsidiary does not cause this double-tax. *See* 26 C.F.R. § 1.956-2(d)(1)(i)(a) (2013); *accord* JCT REPORT, *supra* note 28, at 64 n.186.

A second strategy is to bundle the IP rights with a contract to provide both IP and related services for an artificially low price.[47] For example, Google could enter into a low-priced contract with its Irish subsidiary whereby Google provides both rights to the IP and engineering services closely related to the IP.[48] Bundling IP rights with services obscures the value of the IP. Again, much of the profits from the IP are attributed to the Irish subsidiary, avoiding U.S. tax.

Finally, a third strategy involves contributing the IP rights to a cost-sharing arrangement (CSA).[49] For example, Google and its Irish subsidiary might enter into a contractual cost-sharing arrangement to jointly develop IP.[50] Under such an arrangement, Google would contribute IP developed by its California engineers, in return for an artificially low "buy-in" payment from the Irish subsidiary.[51] Google's Irish subsidiary would then fund a share of Google's California-based research to further develop the IP. This funding would have no tax implications for Google.[52] But all rights to profits from the IP outside the U.S. would be held by the Irish subsidiary, where the profits can pile up tax-free.[53] CSAs and outright licensing, which was discussed in the previous Subpart, are the two most popular IP offshoring strategies used by U.S. multinationals.[54]

Despite their differences, all of these strategies for using IP as a tax-avoidance vehicle have a common thread: setting an artificially low price for

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Second, licensing the right to use IP outside the U.S. results in foreign-source income that can typically be offset by foreign tax credits on income earned in other countries, per 26 U.S.C. § 862(a)(4). By contrast, when a U.S. multinational sells the right to use IP outside the U.S., the income may be entirely domestic-source and thus ineligible for foreign tax credits. *See id.* § 865(a)(1), (d)(2) (making noncontingent sales of personal property, which includes IP, domestic-source).

47. JCT REPORT, *supra* note 28, at 20; Graetz & Doud, *supra* note 4, at 397.

48. *Cf.* JCT REPORT, *supra* note 28, at 57.

49. *Id.* at 21.

50. 26 C.F.R. § 1.482-7 (2013).

51. *See* Lee A. Sheppard, *Intangibles Migration and Excess Profits*, 130 TAX NOTES 1379, 1381 (2011) ("The gambit, as illustrated by the *Veritas* case, was to assign a low value to existing technology based on the make-sell rights, while ignoring the value of that technology as a platform for the development of new technology. . . . This facilitated the transfer of promising technologies and future income outside U.S. tax jurisdiction."); *cf.* Andrew Chin, *Installed Base Opportunism and the Scope of Intellectual Property Rights in Software Products*, 10 WAKE FOREST INTELL. PROP. L.J. 323 (2010) (discussing the potentially very high value of established technology platforms).

52. Although the R&D payments would be gross income to Google, 26 U.S.C. § 61, they would then be immediately deductible by Google, offsetting the gross income. *Id.* §§ 162(a)(1), 174.

53. SENATE APPLE REPORT, *supra* note 28, at 26–31 (discussing Apple's CSA); SENATE MICROSOFT REPORT, *supra* note 28, at 19–20 (discussing Microsoft's CSA).

54. *See supra* note 41.

the IP at an early point, with the profits later accumulating in tax havens like Ireland.[55] This Article's proposals aim to create incentives in IP law for accurate transfer prices (and correspondingly appropriate tax revenue) regardless of which strategy a multinational takes.

C. The Magnitude of the Problem

All multinationals—even low-tech ones—use IP to avoid taxes. As one leading commentator observes, "every multinational is stripping income out of market countries and into tax haven intangibles holding companies."[56] The growing importance of IP in commerce makes this widespread abuse possible. As the World Trade Organization (WTO) notes, "[m]any products that used to be traded as low-technology goods or commodities now contain a higher proportion of [IP] in their value—for example brand-named clothing or new varieties of plants."[57] Indeed, it is estimated that two-thirds of the value of large industrial companies now derive from intangible assets.[58] Not only patents but also trademarks and copyrights are involved in tax avoidance, being transferred early to subsidiaries in tax havens for low prices. For example, the copyright on the script for an unfilmed movie or unreleased software program, or the trademark for a burgeoning product line, might be transferred for an artificially low price.

55. Ireland is hardly the only destination for IP; other popular destinations include the Netherlands, Puerto Rico, Singapore, and Switzerland. *See* JCT REPORT, *supra* note 28 (surveying IP tax-avoidance structures of six unnamed U.S. multinationals, which involve these countries). Multinationals often avoid paying even the relatively low taxes in these countries. Ireland has a corporate tax rate of 12.5 percent, compared to the U.S. corporate tax rate of 35 percent. But through structures with exotic names such as "Double Irish Dutch Sandwich" that rely on tax treaties and subsidiaries in traditional tax havens such as Bermuda and the Cayman Islands, multinationals often avoid even paying tax in countries like Ireland. *See* Duhigg & Kocieniewski, *supra* note 1. Although Ireland has taken steps to curtail such structures, the changes will not phase in until 2020 (giving multinationals plenty of time to search for alternative structures), and Ireland plans to offer a special "low competitive and sustainable tax rate" for IP royalties (called a "knowledge development box" tax regime). *See* Margaret Burow, *Ireland to Stop New 'Double Irish' Arrangements in 2015*, Oct. 15, 2014, *available at* 2014 TNT 199-3; *see also* Sam Schechner, *Ireland to Close 'Double Irish' Tax Loophole*, WALL ST. J., Oct. 15, 2014, at B1. Regardless of the tax-avoidance structure used, the gateway is always the artificially low price initially put on the IP.

56. Lee A. Sheppard, *Is Transfer Pricing Worth Salvaging?*, 136 TAX NOTES 467, 470 (2012).

57. *Intellectual Property: Protection and Enforcement*, WORLD TRADE ORG. http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm7_e.htm (last visited June 18, 2014).

58. Peter S. Menell & Suzanne Scotchmer, *Intellectual Property Law*, *in* 2 HANDBOOK OF LAW AND ECONOMICS 1473, 1475 (A. Mitchell Polinsky & Steven Shavell eds., 2007); SWISS REINSURANCE CO., THE SIGNIFICANCE OF INTELLECTUAL PROPERTY ASSETS, RISKS AND INSURANCE (2000).

Starbucks' IP-based tax avoidance is a case in point. Starbucks is a brick-and-mortar retailer dependent on physical presence in high-tax countries. Yet Starbucks puts IP, like trademarks, proprietary roasting methods, and store trade dress (protected by trademark law),[59] into low-tax jurisdictions.[60] Such creative planning has enabled Starbucks to almost entirely avoid paying taxes in some countries, such as the United Kingdom.[61]

No one really knows how much this profit-shifting costs the U.S. government. Multinationals understandably keep these strategies confidential and as opaque as possible.[62] But the best estimates range as high as $60 to $90 billion per year.[63] By comparison, the entire U.S. corporate income tax generates only around $220 billion per year.[64]

This loss of U.S. tax revenue is clearly detrimental to the national interest.[65] First, the loss results in higher deficits, lower spending, and higher taxes on individual citizens and smaller businesses.[66] Second, IP-based tax avoidance causes multinationals to make inefficient investment decisions, thereby reducing worldwide economic output.[67] Third, IP tax avoidance requires that multinationals spend substantial amounts of money on legal opinions and valuation appraisals, which are transaction costs.[68] Finally, harder to quantify—but no less

59. Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 1244 (1992) (trade dress of Mexican restaurants).

60. *See* Edward D. Kleinbard, *Through a Latte Darkly: Starbucks's Stateless Income Planning*, 139 TAX NOTES 1515, 1522–27 (2013).

61. *See id.* at 1516; *see also* Peter Campbell, *Starbucks Facing Boycott Over Tax*, DAILY MAIL (Oct. 12, 2012), http://www.dailymail.co.uk/news/article-2218819/Starbucks-facing-boycott-tax.html?printingPage=true; U.K. House of Commons Public Accounts Committee, *Minutes of Hearing HC716, Q61* (Nov. 12, 2012), *available at* http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/716/121105.htm.

62. *See* Graetz & Doud, *supra* note 4, at 402.

63. *See* Kimberly A. Clausing, *The Revenue Effects of Multinational Firm Income Shifting*, 130 TAX NOTES 1580, 1585 (2011); *see also* Graetz & Doud, *supra* note 4, at 402; Mark P. Keightly, Cong. Research Serv., R42927, AN ANALYSIS OF WHERE AMERICAN COMPANIES REPORT PROFITS: INDICATIONS OF PROFIT SHIFTING 1 (2013). The primary mechanism for profit-shifting is IP tax-avoidance, although creative loans between subsidiaries also allow for profit-shifting. Harry Grubert, *Intangible Income, Intercompany Transactions, Income Shifting, and the Choice of Location*, 56 NAT'L TAX J. 221 (2003).

64. *See* IRS, Statistics of Income, *Corporate Returns, 2010*, http://www.irs.gov/pub/irs-soi/10corporatereturnsonesheet.pdf; Clausing, *supra* note 63, at 1585 (making this comparison).

65. *See* Graetz & Doud, *supra* note 4, at 423.

66. The following formula summarizes a government's deficit:

Deficit = Taxes from Multinationals + Taxes from Everyone Else – Spending.

If Taxes from Multinationals are lower, then the result must be one (or more) of the following: deficits go up, taxes from everyone else go up, or spending goes down.

67. *See* Edward D. Kleinbard, *Stateless Income's Challenge to Tax Policy*, 132 TAX NOTES 1021, 1038 (2011).

68. *See* Brauner, *supra* note 8, at 83.

important—is the potentially corrosive effect on overall tax compliance when the public witnesses multinationals' epic tax avoidance.[69]

The problems produced by IP-based tax avoidance are hardly limited to U.S. multinationals or losses to the U.S. Treasury. U.S. multinationals use IP transfers at artificially low prices to avoid other countries' taxes, as with Starbucks avoiding U.K. taxes. Foreign-based multinationals also use the same strategies to avoid both U.S. and foreign taxes.[70]

D. Tax-Law Proposals and Tax-Law Impotence

Tax law has failed to stop IP transfer-pricing abuse. The U.S. Congress and the IRS have tried several approaches, to little avail.[71] The chief of staff of Congress' Joint Committee on Taxation famously stated that the enforcement of "transfer pricing is dead."[72] Tax law faces two fundamental roadblocks in countering multinationals' IP-based tax avoidance strategies: information asymmetry, and international legal norms.

First, the taxpayer knows far more about the characteristics, potential, and value of its IP than does the IRS (or any appraiser). For example, Google has the intimate business and engineering understanding of how its new invention could fit profitably into an incredibly complex new device in a way that neither a team of IRS experts nor a team of private appraisers ever could. When the IRS challenges a low transfer price in court, the taxpayer has a depth of understanding of its own IP that gives it a large advantage in refuting the IRS challenge.[73]

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69. *See* Floyd Norris, *The Corrosive Effect of Apple's Tax Avoidance*, N.Y. TIMES, May 24, 2013, http://www.nytimes.com/2013/05/24/business/making-companies-pay-taxes-the-mccain-way.html?pagewanted=all&_r=0.
70. Sheppard, *supra* note 5, at 1113 (diagram of "Inbound Transfer Pricing Structure" whereby a foreign multinational evades U.S. taxation).
71. *See* Graetz & Doud, *supra* note 4, at 413–34 (efforts to date to prevent IP shifting have been unavailing); Lee A. Sheppard, *Xilinx and the Future of Transfer Pricing*, 123 TAX NOTES 1295, 1301 (2009).
72. *See* Sheppard, *supra* note 5, at 1112 (quoting Kleinbard saying, "The data speak for themselves" on the matter).
73. *See* JCT REPORT, *supra* note 28, at 116. A recent example of this advantage in action can be seen in a transfer-pricing case between Medtronic Inc. and the IRS, where the IRS received "voluminous documentary discovery" but argued that it needed to depose former Medtronic managers to make sense of them. *See* Ajay Gupta, *Discovery Disputes Heat Up in Medtronic Transfer Pricing Case*, 144 TAX NOTES 913 (Aug. 25, 2014). This advantage easily overcomes the standard that the IRS's transfer-pricing "determinations are upheld unless they are an abuse of discretion—unreasonable, arbitrary or capricious." Heaton v. United States, 573 F. Supp. 12, 14 (E.D. Wash. 1983).

Largely as a result of this information asymmetry, the IRS has lost both high-profile IP transfer-pricing cases litigated in the past decade.[74] A quotation from one of those opinions encapsulates the primary reason for the failed litigation: "Taxpayers are merely required to be compliant, not prescient."[75] Taxpayers can fully comply with the law by disclosing all facts to their appraisers who must determine the "arm's-length" transfer price. Any outsider (including judges) will not be able to discern its profit potential. But the multinational can determine its profit potential, which materializes only after the IP is safely in a tax-haven subsidiary.

Second, the prevailing international tax law norms make unilaterally changing U.S. tax law to fight IP-based tax avoidance quite difficult.[76] These norms were developed mostly by the League of Nations in the 1920s.[77] The norms are embodied in thousands of bilateral income tax treaties and in most countries' tax laws. They reflect the economic realities of the era where value was created through manufacturing interchangeable physical goods.[78] Now that intangibles account for the bulk of the value of international commerce—even for a coffee purveyor like Starbucks—these norms enable multinationals to use IP to avoid taxes. The "arm's-length" standard is the most problematic norm, allowing IP transactions at easily manipulated prices. Another similarly problematic norm is that corporate subsidiaries are respected as separate entities, even when they are used to avoid taxes.[79] The U.S. Supreme Court adopted this separate-entity norm into U.S. tax law over seventy years ago in *Moline Properties, Inc. v. Commissioner*.[80]

Scholars and policymakers have proposed a number of innovative tax-law solutions to prevent IP-based tax avoidance.[81] Although many show promise,

74. Xilinx, Inc. v. C.I.R., 598 F.3d 1191 (9th Cir. 2010); Veritas Software Corp. v. C.I.R., 133 T.C. 297 (2009).
75. *Veritas*, 133 T.C. at 316.
76. *See* Graetz & Doud, *supra* note 4, at 404 ("Unfortunately, the problems of international income taxation that these kinds of transactions bring to the surface are much more fundamental.").
77. Hugh J. Ault, *Some Reflections on the OECD and the Sources of International Tax Principles*, 70 TAX NOTES INT'L 1195, 1195 (2013).
78. Lee A. Sheppard, *OECD Tries to Fix Income Shifting*, 138 TAX NOTES 782, 784 (2013).
79. *See id.*; JCT REPORT, *supra* note 28, at 23.
80. 319 U.S. 436, 438–39 (1943); *see also* Nat'l Carbide Corp. v. C.I.R., 336 U.S. 422, 433 (1949) (applying separate-entity norm to relations between a corporation and its subsidiaries).
81. *See, e.g.*, Graetz & Doud, *supra* note 4, at 414 (summarizing the five categories of proposals). An earlier attempt by the U.S. Congress, expressed in the second sentence of 26 U.S.C. § 482, to require that "income with respect to [any intangible] transfer or license shall be commensurate with the income attributable to the intangible," has largely been a failure. *See* Graetz & Doud, *supra* note 4, at 415 ("success remains elusive"); *see also* Sheppard, *supra* note

they all either fail to deal with the information asymmetry between multinationals and the IRS, or upend international tax norms.[82] Moreover, many of these proposals, if adopted unilaterally by the U.S., would put the U.S. in breach of its tax treaties.[83] Adoption by only some countries but not others could cause the prevailing international equilibrium to become "unglued."[84] There are roughly 200 countries, and if adoption of new norms were not coordinated among them, the result could be the same income being taxed in full by two (or more) countries, which would seriously discourage cross-border economic activity by massively overtaxing it.[85] The necessary coordination seems unlikely to occur anytime soon.

Information asymmetry and international tax norms render tax law impotent to solve the problem of IP-based tax avoidance.[86] Tax law's impotence suggests that a better solution may instead be incrementally extending existing, well-established IP doctrines. The next Part details this novel solution.

II. IP LAW SOLUTIONS

IP litigation—whether it involves patents, copyrights, or trademarks—typically follows a common lifecycle. The IP owner sues the alleged infringer. The alleged infringer defends by arguing both that it does not infringe the IP, and that the IP is invalid and hence unenforceable. The IP owner often also asks for a preliminary injunction against further infringement while the case progresses. If the IP is ultimately found valid and infringed, then the court generally orders the infringer to pay damages to the IP owner and may even grant a permanent injunction against further infringement. But if the IP owner

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71, at 1301 ("There have been several previous attempts to address valuation of intangibles transfers, including the commensurate with income clause, and none of them have worked.").

82. *See* Graetz & Doud, *supra* note 4, at 414–23.

83. *See* Susan C. Morse, *The Transfer Pricing Regs Need a Good Edit*, 40 PEPP. L. REV. 1415, 1434 (2013).

84. Graetz & Doud, *supra* note 4, at 419.

85. David D. Stewart, *OECD and European Commission Leaders Discuss Fundamental Corporate Tax Reform*, WORLDWIDE TAX DAILY, June 12, 2013 (reporting testimony of Pascal Saint-Amans, director of the Organisation for Economic Co-operation and Development (OECD) Centre for Tax Policy and Administration). The OECD plays a crucial role in shaping international tax norms. *See* RICHARD E. ANDERSEN, INCOME TAX TREATIES ¶ 1.02[2] (2013).

86. *See* Ajay Gupta, *BEPS Action 8 (Intangibles): Arm's Length Is Still the Mantra*, TAX NOTES TODAY, Sept. 17, 2014 (criticizing the recent set of proposals by the OECD to address IP-based transfer-pricing abuse, saying that it "doesn't amount to much").

engaged in inequitable conduct, the court may withhold any remedy from the IP owner.[87]

This Article's proposed extensions of IP law would allow the alleged infringer to defend itself at each stage, using the low transfer price as evidence of the IP's invalidity, the lack of infringement, lower damages, the inappropriateness of injunctions, and inequitable behavior. This Part explains how using the low transfer price in these ways is a natural extension of existing IP doctrine. A beneficial consequence of these proposed extensions would, of course, be that multinationals would be discouraged from avoiding taxes by choosing artificially low transfer prices.

Transfer prices for IP and the appraisal documentation justifying the pricing are unambiguously discoverable.[88] The transfer prices are contract terms, with no claim to privilege or work-product protection.[89] Meanwhile, the appraisal documentation is expressly prepared to be turned over to the IRS pursuant to tax-law requirements[90] and thus is neither privileged[91] nor protected

87. These equitable doctrines include equitable estoppel and laches, as well as misuse. *See infra* notes 371–372; *see also infra* note 280 (explaining that misuse is equitable).

88. *See* FED. R. CIV. P. 26(b)(1) ("Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense."); *see, e.g.*, Hickman v. Taylor, 329 U.S. 495, 507 (1947) (interpreting discovery rules expansively). Incidentally, tax returns and related documentation are not discoverable directly from the IRS. 26 U.S.C. § 6103. But the Supreme Court has unambiguously held that tax returns and related documentation are discoverable from the taxpayer itself under the Federal Rules of Civil Procedure. St. Regis Paper Co. v. United States, 368 U.S. 208, 218–19 (1961); *see also* Grosek v. Panther Transp., Inc. 251 F.R.D. 162, 166–67 (M.D. Pa. 2008).

89. *See, e.g.*, La Chemise Lacoste v. Alligator Co., 60 F.R.D. 164, 171 (D. Del. 1973) (holding that trademark transfers are discoverable); Intersong-USA, Inc. v. CBS, Inc., No. 84 Civ. 998 (JFK), 1985 WL 441, at *3 (S.D.N.Y. Mar. 21, 1985) (holding that copyright transfers are discoverable); Arendi Holding Ltd. v. Microsoft Corp., Civ. No. 09-119-JJF-LPS, 2009 WL 3805585, at *2 (D. Del. Nov. 4, 2009) (holding that patent transfers are discoverable); Biax Corp. v. Nvidia Corp., 271 F.R.D. 200, 215 (D. Colo. 2010); Wyeth v. Orgenus Pharma Inc., No. 09-3235 (FLW), 2010 WL 4117157, at *4 (D.N.J. Oct. 19, 2010) (citing numerous cases where "other courts have routinely recognized that license agreements relating to the patent-in-suit . . . are discoverable").

90. 26 U.S.C. § 6662(e)(3)(B)(i)(III), (ii)(III) (the taxpayer must provide the appraisal documentation to the IRS within 30 days of a request for it); *see also* supra note 34 (discussing this requirement).

91. "The attorney-client privilege does not apply to communications that are intended to be disclosed to third parties." Westinghouse Elec. Corp. v. Republic of Philippines, 951 F.2d 1414, 1427 (3d Cir. 1991) (quoting United States v. Rockwell Int'l, 897 F.2d 1255, 1265 (3d Cir. 1990)); *accord* United States v. BDO Seidman, LLP, 492 F.3d 806, 827 (7th Cir. 2007). *See generally* 24 CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE: EVIDENCE § 5484 (1st ed., 2014 supp.) (discussing the confidentiality requirement for privilege). Appraisal documentation may be communication between a taxpayer and its tax advisors, but it is intended from the get-go to be available for disclosure to a third party, specifically the IRS, to comply with the explicit tax-law requirements cited *supra* note 90.

as work-product.[92] Attorneys representing IP defendants should obtain discovery of both the transfer prices and the appraisal documentation. Indeed, these items should be boilerplate discovery requests in every IP suit.

These items—transfer prices and the supporting appraiser's documentation—have real legal significance. Enforceable rights were actually transferred by binding contract for the transfer price. The multinational hired expert appraisers to justify the price. Most importantly, a duly-appointed officer of the multinational signed a tax return based on that price being correct, declaring:

> Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.[93]

Given this declaration and the contemporaneous expert appraisal, arguing that the low price was merely "for tax purposes" will have little credibility.

Not all the proposals in this Part need to be adopted by courts for the remaining proposals to have a real impact. Each proposed extension of IP law provides an independent disincentive that makes it moderately harder for a multinational that has used IP for tax avoidance to prevail in litigation.

A. Invalidity

Professor Jeffrey Matsuura observes that one of the "key components of effective valuation of legal rights of ownership for intangible assets . . . is the enforceability of the ownership rights."[94] The more likely IP is to survive a

92. The work-product doctrine does not protect "[m]aterials assembled in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes." Fed. R. Civ. P. 26 advisory committee notes, 48 F.R.D. 487, 501; *accord* United States v. Roxworthy, 457 F.3d 590, 593 (6th Cir. 2006); United States v. Adlman, 134 F.3d 1194, 1202 (2d Cir. 1998); Martin v. Bally's Park Place Hotel & Casino, 983 F.2d 1252, 1260–61 (3d Cir. 1993). *See generally* Robin L. Greenhouse, Michael Kelleher & Randy Herndon, *District Court Opinion Guts Work Product Protection for Tax Opinions*, 144 TAX NOTES 329 (July 21, 2014) (providing good overview of tax practitioner privilege and work product doctrine for tax documents). The appraisal documentation is prepared not only "pursuant to public requirements" (specifically the tax-law requirements cited *supra* note 90), but also for purposes having nothing to do with any IP litigation. Additionally, the work-product doctrine does not protect a document "if it would have been prepared in substantially the same manner irrespective of the anticipated litigation." *Roxworthy*, 457 F.3d at 594 (citing *Adlman*, 134 F.3d at 1205). At the time the appraisal is prepared for tax purposes, the IP litigation is rarely even anticipated.
93. IRS Form 1120, at 1 (Corporate tax return) (emphasis added); *see* 26 U.S.C. § 6065 (requiring returns to be signed under penalty of perjury).
94. Jeffrey H. Matsuura, *An Overview of Intellectual Property and Intangible Asset Valuation Models*, RES. MGMT. REV., Spring 2004, at 33, 38; *cf.* Edward F. Sherry & David J. Teece,

challenge to its validity, the more it is worth. Conversely, the less likely the IP is to be held valid, the less it is worth. A reasonable explanation for a low valuation for IP is that it is likely invalid. As this Part demonstrates, existing doctrines in patent law and trademark law specifically make low valuation evidence probative of invalidity.[95]

1. Patents: Obviousness via Secondary Considerations

The most important requirement for patent validity is "nonobviousness."[96] Specifically, before the patent application was filed, the invention must not have been "obvious" to scientists or engineers having ordinary skill in the relevant field.[97] This standard is imprecise and no patent can be 100 percent guaranteed to be valid. In virtually all patent litigation, the defendant counterclaims that the patent was obvious and hence invalid,[98] and courts find approximately half of litigated patents invalid,[99] with obviousness being the most common grounds.[100]

Obviousness involves highly technical facts that the Supreme Court has noted are not easily "susceptible of judicial treatment."[101] In response, the Court and lower courts have developed nine nontechnical "secondary considerations," some of which are evidence of obviousness (and thus invalidity), and some of which are evidence of nonobviousness (and thus validity).[102] The

Royalties, Evolving Patent Rights, and the Value of Innovation, 33 RES. POL'Y 179 (2004) (proven-valid-and-infringed patent is a more valuable economic commodity than an untested patent).

95. Copyrights need only be "original" to be valid, which is a very low bar. MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT ¶ 2.01[A] (rev. ed. 2013) [hereinafter NIMMER ON COPYRIGHT].
96. Michael Abramowicz & John F. Duffy, *The Inducement Standard of Patentability*, 120 YALE L.J. 1590, 1593 (2011) ("the 'nonobviousness' requirement . . . is typically introduced as 'the most important of the basic patent requirements'" (quoting ROBERT PATRICK MERGES & JOHN FITZGERALD DUFFY, PATENT LAW AND POLICY: CASES AND MATERIALS 643 (3d ed. 2007))).
97. 35 U.S.C. §103(a) (Supp. V 2012).
98. John R. Allison & Mark A. Lemley, *Empirical Evidence on the Validity of Litigated Patents*, 26 AIPLA Q.J. 185, 208 (1998).
99. *Id.* at 205.
100. *Id.* at 208 ("By far the largest number of invalidity determinations were made on the basis of obviousness.").
101. Graham v. John Deere Co. of Kansas City, 383 U.S. 1, 36 (1966); Marconi Wireless Co. v. United States, 320 U.S. 1, 60 (1943).
102. *See generally* CHISUM ON PATENTS, *supra* note 25, § 5.05. Many Federal Circuit judges believe that the label "secondary" is misleading, because these considerations are so important. Robert P. Merges, *Commercial Success and Patent Standards: Economic Perspectives on Innovation*, 76 CAL. L. REV. 803, 834 (1988).

Court approves using these secondary considerations because they "focus attention on economic and motivational rather than technical issues."[103]

Transfer-pricing valuations go to the heart of the nonobviousness inquiry and provide high-quality secondary consideration evidence. Obviousness is determined by whether the invention was obvious to persons having ordinary skill in the relevant field. The multinational has unfettered access to persons (specifically, the inventors) who have ordinary or above-ordinary skill in the relevant field, meaning that the multinational has the best information about the invention. A low transfer price is thus an admission—by the entity in the best position to evaluate the invention—that the invention was not a significant advance.

Moreover, transfer-pricing valuation happens at the ideal time. Nonobviousness is measured at the time right before the filing date of the patent.[104] Courts must evaluate obviousness as of this date, without later-occurring facts clouding the analysis.[105] Multinationals tend to transfer patent rights very soon after the invention occurs,[106] so transfer-pricing valuation is done close to the time that nonobviousness is evaluated. This timing makes transfer-pricing valuations ideal secondary consideration evidence.

a. Better Evidence Than Commercial Success

Transfer-pricing valuations are better evidence on nonobviousness than the leading existing secondary consideration, called "commercial success."[107] If a patent holder experiences commercial success with the invention, courts view that success as evidence that the patent was nonobvious, under the theory that "if an invention is both obvious and lucrative, why wasn't it thought of earlier?"[108]

But commercial success suffers from two flaws that transfer-pricing valuations do not. First, it often takes years to integrate an invention into a marketable product, test for safety, get regulatory approval, arrange manufacturing, and organize distribution. As a result, commercial success occurs well after the time at which obviousness is evaluated, which is the time

103. *Graham*, 383 U.S. at 35–36.
104. 35 U.S.C. § 103(a) (Supp. V 2012).
105. *Graham*, 383 U.S. at 36 (stating that courts must "guard against slipping into use of hindsight" (quoting Monroe Auto Equip. Co. v. Heckethorn Mfg. & Sup. Co., 332 F. 2d 406, 412 (6th Cir. 1964))).
106. Sheppard, *supra* note 5, at 1112 ("Good ideas are identified early and transferred early.").
107. CHISUM ON PATENTS, *supra* note 25, § 5.05[1]; *cf.* Andrew Blair-Stanek, Note, *Profits as Commercial Success*, 117 YALE L.J. 642 (2008).
108. WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 305 (2003).

the patent application is filed. By contrast, transfer-pricing valuation is typically done very soon after the invention, which makes the valuation more reliable.

Second, commercial success can result from effective advertising, good distribution networks, unpatented features, or superior quality control,[109] none of which reflect the invention's nonobviousness. By contrast, the transfer-pricing valuation is unperturbed by such external factors.

Of course, a desire to avoid taxes may exert a downward influence on transfer prices, but that is entirely within a multinational's control. Multinationals not only pay for rigorous documentation justifying transfer prices,[110] but also attest to their accuracy under penalties of perjury.[111] A multinational should be held to its transfer price,[112] particularly when every other characteristic of transfer pricing indicates that it provides excellent data regarding obviousness.

b. Low Transfer Prices Negate Commercial Success Evidence

A low transfer price should conclusively refute a patent holder's attempt to show nonobviousness through commercial success. Recall that commercial success is relevant under the reasoning that "if an invention is both obvious and lucrative, why wasn't it thought of earlier?"[113] But as Professor Edmund Kitch has observed, this reasoning rests on an implicit assumption that the innovation's "potential commercial success was perceived before its development."[114]

Consider the following example that illustrates Kitch's point. Suppose that all engineers in the widget field think that it is obvious how to create a widget that works under water, but that everyone in the field sees no commercial potential in an underwater widget. Suppose also that one engineer develops an underwater widget and gets a patent on it. (Individuals and firms obtain patents for many reasons unrelated to the invention's

109. *See* Demaco Corp. v. F. Von Langsdorff Licensing Ltd., 851 F.2d 1387, 1392 (Fed. Cir. 1988) (not due to unpatented features); *id.* at 1393 ("extraneous factors other than the patented invention, such as advertising, superior workmanship, etc."); Solder Removal Co. v. ITC, 582 F.2d 628, 637 (C.C.P.A. 1978).
110. *See supra* note 34.
111. *See supra* note 93 and accompanying text.
112. *Cf.* Part III.F (discussing IP law's extensive use of estoppel).
113. LANDES & POSNER, *supra* note 108, at 305.
114. Edmund W. Kitch, Graham v. John Deere Co.*: New Standards for Patents*, 1966 SUP. CT. REV. 293, 332 (1966).

potential commercial success.[115]) Suppose further that, five years later, industry changes in deep-water oil drilling create a huge, previously unexpected demand for underwater widgets, leading to great commercial success for that engineer. The engineer brings infringement suits and offers this commercial success as evidence that the patent is nonobvious. This evidence has no relevance whatsoever, since no one saw commercial potential in the innovation. The implicit assumption behind commercial success' relevance—that the potential commercial success was perceived before the innovation's development—is not present.

A low transfer price similarly refutes this implicit assumption and severs the logical connection between commercial success and nonobviousness. A low transfer price proves that, even after the innovation's development, the multinational itself saw little commercial potential in it. A patent's value directly reflects its commercial potential. In practice, if a patent plaintiff attempts to rely on commercial success evidence to show nonobviousness, the defendant can use a low transfer price to demonstrate that the commercial success is irrelevant.

c. Better Evidence Than Licensing Success

Transfer-pricing valuations are better evidence regarding obviousness than licensing success. Licensing success is another often-used secondary consideration. It is based on the theory that those who would license a patent know the field and would therefore not pay money for a license unless convinced of the patent's nonobviousness.[116] Courts see licensing success as a "real world consideration[] provid[ing] a colorful picture of the state of the

115. For example, even patents that are likely invalid are routinely used to extract modest licensing fees from thousands of businesses that probably do not infringe, but which pay the licensing fee to avoid costly patent litigation. EXECUTIVE OFFICE OF THE PRESIDENT, PATENT ASSERTION AND U.S. INNOVATION 1 (2013), *available at* http://www.whitehouse.gov/sites/default/files/docs/patent_report.pdf. A totally different motivation may come from the fact that patents enhance the résumés of the inventors, conveying professional bragging rights and increasing their career prospects. *See* Aaron X. Fellmeth, *Conception and Misconception in Joint Inventorship*, 2 NYU J. INTELL. PROP. & ENT. L. 73, 78 (2012). Firms may have similar motivations, because patents can be used to signal a firm's technological prowess to outsiders. Clarissa Long, *Patent Signals*, 69 U. CHI. L. REV. 625, 651-53 (2002). In a totally different vein, low-value patents may nonetheless create opportunities for legal obfuscation and legal posturing. Kelce S. Wilsona & Claudia Tapia Garcia, *Patent Application Prioritization and Resource Allocation Strategy*, 46 LES NOUVELLES 87 (June 2011).

116. Indian Head Indus., Inc. v. Ted Smith Equip. Co., 859 F. Supp. 1095, 1105 (E.D. Mich. 1994).

art, what was known by those in the art, and a solid evidentiary foundation on which to rest a nonobviousness determination."[117]

But licensing success, like commercial success, can be distorted by many external factors. First, licensees often take out licenses simply to avoid the substantial expense and uncertainty of patent litigation, even for very questionable patents.[118] Second, potential licensees may simply lack full information about how well (or poorly) the patented invention works. Third, mistrust and negotiation costs often keep patent owners from licensing to direct competitors.[119] Finally, licensees of patented technology are often more interested in accessing the unpatented know-how and trade secrets that also come with the licensing arrangement.[120]

By contrast, none of these external distortions apply when a multinational transfers a patent to a tax-haven subsidiary. The multinational has the best possible information about how well the invention actually works. Multinationals by definition own their subsidiaries and hence trust them, and refrain from suing or competing with them. As a result, transfer pricing is a more accurate secondary consideration than licensing success.

2. Trademarks: Lack of Secondary Meaning

Descriptive trademarks are those trademarks that describe some aspect of the product,[121] such as "5-Hour Energy" energy shots,[122] or "Holiday Inn" motels.[123] Descriptive trademarks are valid only if consumers associate the

117. Minn. Mining & Mfg. Co. v. Johnson & Johnson Orthopaedics, Inc., 976 F.2d 1559, 1575 (Fed. Cir. 1992).
118. Merges, *supra* note 102, at 867; *see also* Andrew Blair-Stanek, *Increased Market Power as a New Secondary Consideration in Patent Law*, 58 AM. U.L. REV. 707, 724 (2009) (collecting sources criticizing licensing as a secondary consideration).
119. *See* Richard E. Caves et al., *The Imperfect Market for Technology Licenses*, 45 OXFORD BULL. ECON. & STATS. 249, 260–62 (1983).
120. Merges, *supra* note 102, at 871.
121. Abercrombie & Fitch Co. v. Hunting World, Inc., 537 F.2d 4, 9 (2d Cir. 1976). Trademarks fall into three categories: (1) inherently distinctive marks, which are either arbitrary ("Apple Computer") or fanciful ("Kodak"), and which require no secondary meaning to be valid; (2) generic marks, which are always invalid ("Aspirin"); and (3) descriptive marks, which require secondary meaning to be valid. 2 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS & UNFAIR COMPETITION § 11:1 (4th ed. 2013) [hereinafter MCCARTHY ON TRADEMARKS]. The transfer price is relevant only to the validity of descriptive trademarks, in that it relates to the existence of secondary meaning.
122. Innovation Ventures, LLC v. N2G Distrib, Inc., 779 F. Supp. 2d 671 (E.D. Mich. 2011).
123. Zimmerman v. Holiday Inns of America, Inc., 438 Pa. 528 (1970).

mark with the mark's owner. This association in consumers' minds is called "secondary meaning."[124]

Courts have considered a wide variety of evidence in determining whether or not secondary meaning exists. Examples include consumer surveys, amounts spent on advertising, the length and exclusivity of the mark's use, the mark's place in the market, the number of customers, and sales data.[125] Such evidence may cut either for or against a descriptive mark's validity. For example, in a case involving the descriptive trademark "SnakeLight" for flexible lights, the court found the owner's low sales probative of lack of secondary meaning and hence of invalidity.[126]

A transfer price provides concrete, quantitative evidence of secondary meaning, or lack thereof. A trademark's valuation correlates strongly with evidence that courts already consider in determining whether secondary meaning exists, including the mark's place in the market, the number of customers, and sales.[127] A trademark's value derives from its ability to increase its owner's profits either by increasing sales, by allowing charging a higher price, or both. Thus, a low valuation demonstrates that the trademark either does not help increase sales (indicating little consumer awareness) or does not allow charging a higher price (indicating that consumers who do buy do not have strong associations between the trademark and its owner). Either indication undercuts the existence of secondary meaning, weighing against a descriptive trademark's validity.[128]

124. *Abercrombie*, 537 F.2d at 9.
125. Echo Travel, Inc. v. Travel Associates, Inc., 870 F.2d 1264, 1267 (7th Cir. 1989); Thompson Med. Co. v. Pfizer Inc., 753 F.2d 208, 217 (2d Cir. 1985); 2 MCCARTHY ON TRADEMARKS, *supra* note 121, § 15:30.
126. Black & Decker Corp. v. Dunsford, 944 F. Supp. 220 (S.D.N.Y. 1996).
127. *See* Robert F. Reilly & Robert P. Schweihs, *Valuation of Trademarks and Trade Names*, J. PENSION PLAN. & COMPLIANCE, Winter 2000, at 35, 37–38 tbl.1 (listing factors that influence trademark valuation, including length of use, profitability, market share, and name recognition); *cf. Echo Travel*, 870 F.2d at 1267 (listing similar factors for secondary meaning).
128. A low transfer price for a new descriptive trademark is less damning than a low transfer price for the patent rights on a new invention (the subject of the previous Subpart). Patent nonobviousness is determined as of before the time of filing, 35 U.S.C. § 103 (2012), so a low transfer price just after invention is particularly weighty evidence of obviousness and hence invalidity. By contrast, trademark secondary meaning is generally determined at the time the defendant started infringement. *See* PaperCutter, Inc. v. Fay's Drug Co., 900 F.2d 558, 564 (2d Cir. 1990); 2 MCCARTHY ON TRADEMARKS, *supra* note 121, § 15:4. The start of infringement may come many years after a low-price transfer. Between the transfer and infringement, secondary meaning could come into existence, supporting validity despite the low transfer price. Nonetheless, a trademark's low transfer price is additional evidence (in addition to evidence like sales data and numbers of customers) that can guide a court in determining whether secondary meaning exists. A low transfer price will have stronger probative value the fewer years that have elapsed between the transfer and the start of infringement. *Echo Travel*, 870

B. Limiting Scope

The previous Subpart explained that a low transfer price is often evidence of invalidity. But if the IP is found to be valid, the court must also determine whether the defendant's activities fall within the scope of what IP law prohibits. This Subpart argues that a low transfer price for IP naturally indicates that it has a narrow scope.

Before litigation, the scope of protection for IP is uncertain. Unlike real property, which typically has a clear scope defined by the land's physical boundaries, IP affords its owner a much more amorphous scope of protection against intrusion.[129] In patent suits, a defendant can infringe the patent either literally or under the "doctrine of equivalents" that prevents defendants from avoiding literal infringement through minor changes.[130] Trademark infringement suits require determining the "strength" of the mark, while trademark dilution suits require determining whether the mark is "famous."[131] And in copyright law, the court must determine whether the defendant has engaged in "fair use."[132]

IP scope and value go hand-in-hand. A piece of IP can have value for two basic reasons: Its owner can exclude others from using the IP, allowing the owner to charge higher prices, or its owner can license the IP in exchange for royalty payments. IP with broad scope allows its owner either a broader range of exclusivity (increasing the owner's profits), or a larger set of licensees who must pay royalties (also increasing the owner's profits).

Professor Jeffrey Matsuura has observed that the "scope of the rights" associated with IP is a "key component[] of effective valuation"[133] of the IP—"the broader that scope, the more valuable the asset."[134] Professors Robert Merges and Richard Nelson reached the same conclusion about patents: "The economic significance of a patent depends on its scope: the broader the scope, the larger the number of competing products and processes that will infringe the patent."[135]

F.2d at 1267 (explaining that the length of the use of a mark is important for determining secondary meaning).

129. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 3.3, at 50 (8th ed. 2011) ("An idea does not have a stable physical locus like a piece of land. With the passage of time it becomes increasingly difficult to identify the products in which a particular idea is embodied . . . .").

130. *See* Part II.B.1.

131. *See* Parts II.B.3, II.B.4.

132. *See* Part II.B.2.

133. Matsuura, *supra* note 94, at 38.

134. *Id.*

135. Robert P. Merges & Richard R. Nelson, *On the Complex Economics of Patent Scope*, 90 COLUM. L. REV. 839, 839 (1990); *see also id.* at 875 (noting that "the *scope* of [property]

Because of this correlation between scope and value, a low transfer price for IP is evidence of the IP's narrow scope. This Subpart elaborates on this insight for each type of IP, building on existing IP doctrine.

1. Patents: The Doctrine of Equivalents

If a patent is valid, there are two ways it can be infringed. First, "literal infringement" occurs if the defendant's product falls within the patent's claims.[136] Second, even without literal infringement, a patent may be infringed under the "doctrine of equivalents" if the defendant "makes unimportant and insubstantial changes and substitutions in the patent."[137] The potential for making the changes or substitutions can arise long after the patent issued.[138]

For example, suppose a mousetrap manufacturer patents a new mousetrap using a particular plastic. Several years later, a new plastic comes on the market. A competing mousetrap maker manufactures a mousetrap identical to the patented mousetrap, except for substituting the newly developed plastic. Although the competitor does not literally infringe the patent, the competitor may still be liable for infringement under the doctrine of equivalents.

Not all patents get the same scope of protection under the doctrine of equivalents. The Supreme Court recognizes that "the range of equivalents depends upon and varies with the degree of invention."[139] More innovative patents receive a greater zone of equivalency for infringement.[140] Conversely, patents on minimal technological advances receive little or no zone of equivalency.[141]

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rights is crucial" (emphasis in original)); *cf.* Sherry & Teece, *supra* note 94 (explaining that a patent that been proven infringed is more valuable).

136. *See* Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502, 510 (1917).

137. Graver Tank & Mfg. Co. v. Linde Air Prods. Co., 339 U.S. 605, 607 (1950). *See* CHISUM ON PATENTS, *supra* note 25, § 18.04.

138. *See* Warner-Jenkinson Co. v. Hilton Davis Chem. Co., 520 U.S. 17, 37 (1997) ("[T]he proper time for evaluating . . . knowledge of interchangeability between elements . . . is at the time of infringement . . . .").

139. Cont'l Paper Bag Co. v. E. Paper Bag Co., 210 U.S. 405, 415 (1908); *see also* Texas Instruments, Inc. v. ITC, 805 F.2d 1558, 1563 (Fed. Cir. 1986) ("It has long been recognized that the range of permissible equivalents depends upon the extent and nature of the invention, and may be more generously interpreted for a basic invention than for a less dramatic technological advance.").

140. *See* CHISUM ON PATENTS, *supra* note 25, § 18.04[2]. To a large extent, this greater zone results from more groundbreaking patents not being limited by prior art or prosecution history estoppel. *See* Augustine Med., Inc. v. Gaymar Indus., Inc., 181 F.3d 1291, 1301–02 (Fed. Cir. 1999).

141. *See* Perkin-Elmer Corp. v. Westinghouse Elec. Corp., 822 F.2d 1528, 1532 (Fed. Cir. 1987); CHISUM ON PATENTS, *supra* note 25, § 18.04[2].

Generally, the more innovative a patent is, the more profit potential it has, and vice versa.[142] A multinational giving a low valuation to a patent therefore admits that it was not particularly innovative. Consequently, a low patent valuation should hinder the patent holder in proving infringement under the doctrine of equivalents.[143]

2. Copyrights: Fair Use

Copyright's fair use doctrine is a defense against copyright infringement and plays a crucial role in limiting the scope of copying that gives rise to liability.[144] For example, a book reviewer who quotes portions of the copyrighted book under review is almost certainly not liable for infringement, because the quoting is a fair use. But beyond such simple examples, courts have long wrestled with whether particular copying is fair use, with one court observing that "the issue of fair use . . . is the most troublesome in the whole law of copyright."[145]

The statutory provision governing fair use provides a nonexclusive list of activities that may be fair use (criticism, comment, news reporting, teaching, scholarship, and research) and provides four nonexclusive factors for courts to consider.[146] One of these four statutory factors is "the effect of the use upon the *potential* market for or value of the copyrighted work."[147] The Supreme Court has held that this "potential market" factor is "undoubtedly the single most important element of fair use."[148]

But this "potential market" factor creates a severe circularity problem that bedevils courts: "[I]n every fair use case [the] plaintiff suffers a loss of a *potential* market if that potential is defined as the theoretical market for

142. *See, e.g.*, Hildreth v. Mastoras, 257 U.S. 27, 34 (1921) (finding a patent to be a pioneer entitled to broad equivalency protection in large part because it cut the cost of candy manufacture by 90 percent).

143. In rare instances, the doctrine of equivalents also works in reverse. *See* CHISUM ON PATENTS, *supra* note 25, § 18.04[4]. A low transfer price for a patent should preclude any argument that it is a sufficiently true breakthrough to qualify for this reverse doctrine of equivalents.

144. *See* 17 U.S.C. § 107.

145. *See* Dellar v. Samuel Goldwyn, Inc., 104 F.2d 661, 662 (2d Cir. 1939) (per curiam).

146. *Id.*

147. 17 U.S.C. § 107(4) (emphasis added).

148. Harper & Row Publishers, Inc. v. Nation Enters., 471 U.S. 539, 566 (1985). *Accord* 4 NIMMER ON COPYRIGHT, *supra* note 95, ¶ 13.05[A][4] ("If one looks to the fair use cases, if not always to their stated rationale, [the effect on the plaintiff's potential market] emerges as the most important, and indeed, central fair use factor." (citations omitted)).

licensing the very use at bar."[149] For example, suppose that the author of a book on 1960s trivia quotes copyrighted lyrics from a 1960s rock-and-roll song as part of a trivia question. The song's copyright owner then sues the trivia book's author for infringement.[150] The author would doubtless assert fair use. Was there a "potential market" for licensing the song lyrics for use in trivia books? Such a potential market would exist if (and only if) the copying were not fair use. If courts found such copying was not fair use, then licensing lyrics to trivia books would be a potential market for song copyright owners. But if courts instead found the copying to be a fair use of the lyrics, then no such market would exist. This perfect circularity can create "severe problems of proof" for courts.[151]

Transfer-price evidence cuts elegantly through this Gordian knot. The expert appraisal report justifying the transfer price will often expressly state the markets in which the multinational expects the copyright to generate value.[152] Evidence that a copyright owner did not expect to move into a particular market weighs heavily toward finding that a defendant's foray into that market was fair use.[153]

Even if the appraisal report does not discuss potential markets, a low transfer price itself helps cut the potential-market Gordian knot in many cases. The value of a copyright reflects the present value of the profits expected from all potential markets for the copyright. Typically a copyrighted work will have clear potential markets.[154] Suppose a defendant is sued for using the copyrighted material in a market other than the clear potential markets. This defendant should hire an expert to provide a reasonable estimate of the value the copyright would have had solely for use in the clear potential markets. If this reasonable estimate is equal to or higher than the actual transfer price, that demonstrates that the copyright owner did not expect to move into markets other than the clear potential ones. A low transfer price thus can demonstrate that the copyright owner did not contemplate entering the market that the defendant

149. NIMMER ON COPYRIGHT, *supra* note 95, ¶ 13.05[A][4].
150. *See id.*
151. *Id.*
152. *See* 26 C.F.R. § 1.482-4(c)(2)(iii)(B)(2)(ii).
153. *See* Twin Peaks Prods., Inc. v. Publications Int'l, Ltd., 996 F.2d 1366, 1377 (2d Cir. 1993); Lewis Galoob Toys, Inc. v. Nintendo of Am., Inc., 964 F.2d 965, 971–72 (9th Cir. 1992).
154. *Cf.* Shyamkrishna Balganesh, *Foreseeability and Copyright Incentives*, 122 HARV. L. REV. 1569 (2009) (arguing copyright scope should only extend to markets foreseeable at the time of creation, which properly calibrates copyright creators' incentives); Justin Hughes, *Fair Use Across Time*, 50 UCLA L. REV. 775, 782–83 (2003) (arguing that the fair use analysis should look at the present value of the copyright at the time its owner made the decision whether to invest in its creation).

entered, which weighs heavily toward finding fair use.[155] Indeed, the statute expressly contemplates that the copyright's value can be relevant to determining fair use, requiring courts to consider "the effect of the use upon the potential market for or *value of* the copyrighted work."[156]

In short, a low transfer price and the appraisal documentation justifying it will often significantly help copyright defendants to demonstrate fair use and thus to prevail.

3. Trademarks: The Strength of a Mark

In any trademark infringement case, the mark's "strength" is crucial to determining whether the defendant is infringing. Strength is determined by looking at both its distinctiveness and its commercial strength, meaning its recognition in the marketplace.[157] The stronger a mark is, the wider its scope of protection. Hence, more names and symbols used by competitors can constitute actionable infringement.[158] For example, the trademark "Beefeater" for gin is quite strong, being "famous and celebrated throughout the United States."[159] As a result, even the use of "Sign of the Beefeater" as the name of a beef-serving restaurant in suburban Detroit was held infringing.[160] The policy rationale is simple: "The stronger the mark, the more likely it is that encroachment on it will produce confusion" for consumers.[161]

A low transfer price for a mark indicates the mark's low commercial strength, which means that the mark is weak and its scope should be narrower. As the Fourth Circuit recently observed, a "mark's lack of commercial strength renders the mark weak for purposes of our strength of the mark analysis."[162]

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155. *See* Twin Peaks Prods., Inc., 996 F.2d at 1377; Lewis Galoob Toys, Inc., 964 F.2d at 971–72.
156. 17 U.S.C. § 107(4) (emphasis added). *Accord* Princeton Univ. Press, Machmillan, Inc. v. Mich. Document Services, Inc., 99 F.3d 1381 (6th Cir. 1996) (en banc) (finding no fair use on reasoning that "[i]f copyshops across the nation were to start doing what the defendants have been doing here . . . the potential *value* of the copyrighted works of scholarship published by the plaintiffs would be diminished accordingly" (emphasis added)).
157. *See* 2 MCCARTHY ON TRADEMARKS, *supra* note 121, § 11:83.
158. *See* Acad. of Motion Picture Arts and Scis. v. Creative House Promotions, Inc., 944 F.2d 1446, 1455 (9th Cir. 1991) (quotation marks omitted); 2 MCCARTHY ON TRADEMARKS, *supra* note 121, § 11:73 ("Greater protection for stronger marks.").
159. James Burrough, Ltd. v. Sign of Beefeater, Inc., 540 F.2d 266 (7th Cir. 1976).
160. *See id.*
161. Champions Golf Club v. The Champions Golf Club, 78 F.3d 1111 (6th Cir. 1996).
162. George & Co. LLC v. Imagination Entm't Ltd., 575 F.3d 383, 396 (4th Cir. 2009). *Accord* Sullivan v. CBS Corp., 385 F.3d 772, 777 (7th Cir. 2004) ("The legal strength of a mark is usually the same as its economic and marketing strength." (quoting 2 MCCARTHY ON TRADEMARKS, *supra* note 121, § 11:73))

In short, a trademark plaintiff's low transfer price makes it harder to show infringement.

In *La Chemise Lacoste v. Alligator Co.*, a district court recognized trademark valuation as evidence of the mark's strength.[163] Alligator Co. made Alligator brand raincoats and had been purchased—along with its Alligator trademarks—by a conglomerate.[164] Later, the French company that makes Lacoste polo shirts (bearing a crocodile logo) brought a trademark suit against Alligator Co. and attempted to discover the purchase price, including the portion relevant to the Alligator trademark.[165] The court held that the purchase price was potentially relevant "to establish the value of Alligator's reputation as a quality manufacturer and to provide evidence of the strength of Alligator's trademarks."[166] This same reasoning should apply equally to the price put on a trademark transferred to a multinational's subsidiary.

4. Trademarks: Not "Famous" Enough to Be Diluted

Transfer pricing is also relevant to trademark scope as evidence of how much of the consuming public recognizes the trademark, and hence, whether the trademark is sufficiently "famous" to be "diluted." Dilution is an entirely separate cause of action from infringement.[167] The owner of a "famous" mark may sue for dilution by anyone who "blurs"[168] or "tarnishes"[169] the mark in consumers' minds. The cause of action for dilution is available even if the famous trademark owner and the defendant do not compete,[170] even if there is no likelihood of consumer confusion,[171] and even if the famous trademark owner suffers no actual economic injury.[172]

163. 60 F.R.D. 164 (D. Del. 1973).
164. *See* La Chemise Lacoste v. General Mills, Co., 53 F.R.D. 596 (D. Del. 1971) (factual background).
165. *See La Chemise Lacoste*, 60 F.R.D. at 170.
166. *See id.* at 171.
167. Anti-dilution statutes started at the state level. *See* 4 MCCARTHY ON TRADEMARKS, *supra* note 121, § 24:77. Only in 1996 did Congress pass a federal level antidilution statute. *See* Federal Trademark Dilution Act, Pub. L. No. 104-98, 109 Stat. 985 (Jan. 16, 1996) (codified at 15 U.S.C. § 1125(c) (2012)) (amended by Trademark Dilution Revision Act of 2006, Pub. L. No. 109-312, 120 Stat. 1730 (Oct. 6, 2006)).
168. *See* 15 U.S.C. § 1125(c)(2)(B) (2012).
169. 15 U.S.C. § 1125(c)(2)(C).
170. *See* Malletier v. Dooney & Bourke, Inc., 561 F. Supp. 2d 368, 379 (S.D.N.Y. 2008); 15 U.S.C. § 1125(c)(1) (explaining that the cause of action is available "regardless of . . . competition").
171. *See id.* 15 U.S.C. § 1125(c)(1) (explaining that the cause of action is available "regardless of . . . actual or likely confusion").
172. *See id.* (explaining that the cause of action is available "regardless of . . . actual economic injury").

For example, "Chevrolet" is a famous trademark for cars. If another company attempted to market "Chevrolet mouthwash," consumers would not confuse the mouthwash as being made by or associated with the carmaker.[173] There is no trademark infringement, but the mouthwash is diluting the famous "Chevrolet" trademark by "blurring" its "ability . . . uniquely to identify a single source and thus maintain its selling power."[174] As another example, "Viagra" is a famous trademark for an erectile dysfunction drug.[175] An equipment business emblazoned "Viagra" on decommissioned missiles and was found to have diluted the drug trademark by "tarnishing" the mark's reputation in the public mind.[176]

Dilution can be an extraordinarily powerful legal tool for trademark owners,[177] but only if the trademark is "famous." Famousness is a yes-or-no proposition: Either a mark is famous and gives its owner a dilution cause of action, or it is not famous and gets zero protection against dilution.[178] Determining whether a trademark is famous is fact-intensive.[179] For example, "Motown" (music),[180] "Big Gulp" (large drinks),[181] and "The Other White Meat" (pork)[182] have all been held famous. Meanwhile, "App Store" (Apple's online software store),[183] "Coach" (handbags),[184] and the University of Texas "Longhorn" logo[185] have been held not famous.

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173. *See* Mead Data Cent., Inc. v. Toyota Motor Sales, U.S.A., Inc., 875 F.2d 1026, 1031 (2d Cir. 1989) (giving dilution hypotheticals, including "Buick aspirin"); Nat'l Pork Bd. & Nat'l Pork Prods. Council v. Supreme Lobster & Seafood Co., 96 U.S.P.Q.2d 1479 (T.T.A.B. 2010) (explaining that "The Other White Meat" trademark for pork was famous and would likely be diluted by blurring by using "The Other Red Meat" for salmon).
174. Louis Vuitton Malletier S.A. v. Haute Diggity Dog, LLC, 507 F.3d 252, 265 (4th Cir. 2007).
175. *See* Pfizer Inc. v. Sachs, 652 F. Supp. 2d 512 (S.D.N.Y. 2009).
176. *Id.*
177. *See* Mattel, Inc. v. MCA Records, Inc., 296 F.3d 894, 904-05 (9th Cir. 2002) ("A dilution injunction, by contrast to a trademark injunction, will generally sweep across broad vistas of the economy."); 4 MCCARTHY ON TRADEMARKS, *supra* note 121, § 24:106 (referring to the "extraordinary scope of the federal antidilution law").
178. *See* Palm Bay Imports, Inc. v. Veuve Clicquot Ponsardin Maison Fondee en 1772, 396 F.3d 1369, 1375 (Fed. Cir. 2005).
179. *See* 15 U.S.C. § 1125(c)(2)(A) (2012) ("The court may consider all relevant factors").
180. *See* UMG Recordings, Inc. v. Mattel, Inc., 100 U.S.P.Q.2d 1868, 1887 (T.T.A.B. 2011).
181. *See* 7-Eleven Inc. v. Lawrence I. Wechsler, 83 U.S.P.Q.2d 1715 (T.T.A.B. 2007).
182. *See* Nat'l Pork Bd. & Nat'l Pork Producers Council v. Supreme Lobster & Seafood Co., 96 U.S.P.Q.2d 1479 (T.T.A.B. 2010).
183. *See* Apple, Inc. v. Amazon.com Inc., 100 U.S.P.Q.2d 1835 (N.D. Cal. 2011) (finding that App Store was not shown famous for purposes of a preliminary injunction).
184. *See* Coach Servs., Inc. v. Triumph Learning LLC, 668 F.3d 1356, 1376 (Fed. Cir. 2012).
185. *See* Bd. of Regents, Univ. of Tex. Sys. *ex rel.* Univ. of Tex. at Austin v. KST Elec., Ltd., 550 F. Supp. 2d 657, 678 (W.D. Tex. 2008).

The statutory standard for famousness is whether the mark is "widely recognized by the general consuming public of the United States as a designation of source of the goods or services of the mark's owner."[186] The statute specifies that "[t]he extent of actual recognition of the mark"[187] is a relevant factor. For example, 7-Eleven's "Big Gulp" trademark was held famous based in part on its recognition by 73 percent of all consumers.[188] Indeed, a leading commentator believes that this factor (the extent of actual recognition) "goes directly to the heart of the matter."[189] A low transfer price for a mark is evidence that few members of the consuming public actually recognize it, and thus, that the mark is not "famous." Each consumer who recognizes a mark provides some quantum of expected future profits. The value of the mark is, at a minimum, that per-consumer value multiplied by the number of consumers who recognize it. Moreover, the expert appraiser's report justifying the low transfer price for a mark will often contain damaging data and assumptions about low consumer recognition.

Additionally, a low transfer price suggests that a mark is not "famous" because of another statutory factor for determining whether a mark is famous: "[t]he duration, extent, and geographic reach of advertising and publicity of the mark."[190] A rational mark owner will not spend $1 on advertising to build up its mark unless the expected increase in sales exceeds $1. A low transfer price for a trademark means one of two situations exists. One possibility is that the total amount spent on advertising for the mark is correspondingly low, which makes this factor weigh against famousness. The other possibility is that the owner has spent more than that amount on advertising, but that the advertising has failed to get traction, also weighing against famousness.[191]

In sum, low transfer prices for trademarks provide strong evidence that—at least at the time of the transfer—the mark was not famous. Of course, between the mark owner's low-price transfer and the start of the allegedly diluting use,[192] subsequent advertising and publicity may make the mark famous. But the low transfer price should be evidence weighing against famousness. Multinationals, which are disproportionately likely to have

186. 15 U.S.C. § 1125(c)(2)(A) (2012).
187. 15 U.S.C. § 1125(c)(2)(A)(iii) (2012).
188. *See* 7-Eleven Inc. v. Lawrence I. Wechsler, 83 U.S.P.Q.2d 1715 (T.T.A.B. 2007).
189. *See* 4 MCCARTHY ON TRADEMARKS, *supra* note 121, § 24:106.
190. 15 U.S.C. § 1125(c)(2)(A)(i).
191. *See* 15 U.S.C. § 1125(c)(2)(A) (explaining that "a mark is famous if it is widely recognized").
192. The relevant time for determining famousness is the time the defendant's allegedly diluting use commenced. *See* 4 MCCARTHY ON TRADEMARKS, *supra* note 121, § 24:103.

famous marks,[193] will thus risk losing dilution remedies if they transfer trademarks for artificially low prices.

C. Lower Damages

The previous two Subparts demonstrated that a low transfer price often weighs against finding IP valid and infringed. But if IP is found both valid and infringed, then the fact finder must determine the monetary damages to award to the IP owner. Transfer prices are highly relevant to damages.

IP has value because it allows its owner to increase profits—either directly through operating its business more profitably using the IP, or through receiving royalties from licensing the IP (or both). The value of a piece of IP equals the risk-adjusted amount by which it is expected to increase its owner's profits.[194] Damages for IP infringement are typically based on the profits or royalties that the IP owner lost as a result of the infringement.[195] A low transfer price for IP thus indicates that the IP owner expected low profits and royalties from the IP, supporting correspondingly low damages for infringement.

A recent non-IP case supports using transfer prices in determining damages. In *Eli Lilly & Co. v. Air Express International USA, Inc.*,[196] the multinational pharmaceutical company Eli Lilly sued a transport company for damaging a shipment of insulin in transit.[197] The court decided that Eli Lilly's tax transfer price for the insulin provided the "best measure" of damages because the transfer price had to be arm's-length to comply with tax law.[198]

IP owners might protest that their low transfer prices did not reflect low expected profits, but instead reflected a downwards adjustment for the risks

193. The scale required to expand operation beyond the U.S. to multiple countries correlates strongly with having sufficient market penetration in the U.S. to have a famous mark. Indeed, anecdotally, it appears that virtually all famous marks—ranging from "Ford" and "Nike" to "Starbucks" and "Viagra"—are held by multinationals. *See* 4 MCCARTHY ON TRADEMARKS, *supra* note 121, §§ 24:106–107 (listing examples of marks held famous).

194. GORDON V. SMITH, TRADEMARK VALUATION 16, 22 (2007); Robert Pitkethly, *The Valuation of Patents* 8 (1997), *available at* http://users.ox.ac.uk/~mast0140/EJWP0599.pdf (noting that one form of income-based valuation is discounting at the risk-free interest rate, multiplied by cash flows that are risk adjusted); Matsuura, *supra* note 94, at 38.

195. There are instances where IP damages are based not on the plaintiff's lost profits, but instead on other measures like the defendant's increased profits. But these measures will rarely apply for multinationals. *See infra* notes 223–223 and accompanying text.

196. 602 F. Supp. 2d 1260 (S.D. Fla. 2009), *rev'd on other grounds*, 615 F.3d 1305 (11th Cir. 2010).

197. *Id.* at 1264–67.

198. 602 F. Supp. 2d at 1279 ("The Court finds that the transfer price is the best measure of damages here. Marty Clemens, a manager in tax for Lilly, testified regarding the nature of pricing within Lilly and amongst its affiliates. Lilly and its affiliates transact with each other at arm's length.") (citation omitted).

that the IP might turn out to be invalid or narrow in scope. But IP damage determinations only occur after the plaintiff has successfully persuaded the court that the IP is both valid and infringed. This success tends to show that the risk of invalidity or narrow scope was low, and, mathematically, that the profits expected from the IP were correspondingly low.[199]

The transfer price of the IP should not be the sole measure of damages, or even the primary measure. But the low transfer price is additional, relevant data for the fact finder to consider. The Supreme Court has emphasized that damages in IP cases require "not mathematical exactness but only a reasonable approximation."[200] Lower courts have likewise repeatedly echoed that IP damages are only "reasonable approximations."[201] Transfer prices, based on expert appraisal documentation and affirmed as correct under penalties of perjury, are data that fact finders should use to refine IP damages. This Subpart explains why transfer prices should inform damages for infringement of each type of IP.

1. Patent Damages

There are two primary measures of patent infringement damages: lost profits and reasonable royalties.[202] Transfer pricing valuations are relevant to both. Of the two measures, patentees tend to prefer to recover lost profits.[203]

199. A good first-order approximation for the value V of a piece of IP is:

$$V = u \times p$$

u is the probability that the IP will be held both valid and having meaningful scope. p is the total present value of all profits (from business operations and from licensing royalties) if the IP is held both valid and having meaningful scope. *See* Pitkethly, *supra* note 194, at 8; Matsuura, *supra* note 94, at 38; SMITH, *supra* note 194, at 22 (algebraically identical formula where $1/u$ is called r). Note that p is the upper limit on damages, measured by lost profits and royalties, which occurs only if the defendant causes the IP holder to lose all of its profit and royalties. Although the multinational may have legitimately misestimated u in coming up with a transfer price, a successful verdict on validity and infringement tends to indicate that u is high, approaching 1. Algebraically, $p = V/u$. If the valuation at transfer (V) was low, and if u is fairly high (approaching 1), then p will necessarily be fairly low, corresponding to low damages.

200. Sheldon v. Metro-Goldwyn Pictures Corp., 309 U.S. 390, 408 (1940) (copyright).

201. Skydive Ariz., Inc. v. Quattrocchi, 673 F.3d 1105, 1113 (9th Cir. 2012) (trademark); Davis v. Gap, Inc., 246 F.3d 152, 166–67 (2d Cir. 2001) (copyright); I4I Ltd. P'ship v. Microsoft Corp., 598 F.3d 831, (Fed. Cir. 2010) (patent).

202. 35 U.S.C. § 284 (2006 & Supp. V 2012); CHISUM ON PATENTS, *supra* note 25, § 20.03 ("The patent statutes provide for the recovery of compensatory damages as the primary monetary remedy for patent infringement."). A court may also measure damages by an established royalty, although this method is largely of historical interest. *Id.* § 20.03[2].

203. Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359, 1366 (Fed. Cir. 2008) ("patentees tend to try to fit their damages cases into the 'lost profits' framework, or else fall back on the statutory grant of a reasonable royalty").

A lower transfer price suggests lower lost profits because the transfer price reflects the profits the patent can earn for its owner.[204] Thus, a low transfer price suggests lower lost-profits damages.

The other primary measure of damages is an award of a "reasonable royalty."[205] Courts use this measure of damages in two kinds of situations. First, the patent owner may lack sufficient market evidence to demonstrate actual lost profits.[206] Second, the patent owner may not have sold the patented invention itself but instead made money by licensing the patent to others who sell the patented invention.[207]

Because many IP-based tax avoidance structures involve granting licenses to subsidiaries in tax havens like Ireland,[208] a reasonable royalty will often be the proper damages measure. A reasonable royalty is defined as the rate that would have been reached in a hypothetical negotiation between the patent holder and defendant, as of the date infringement began, assuming that the patent was valid.[209]

Multinationals' licensing transfer prices to their subsidiaries are highly relevant data in ascertaining a reasonable royalty.[210] The standards for being a "reasonable royalty" under patent law and tax law's requirement for a valid transfer price are strikingly similar: Both require a hypothetical "arm's-length" negotiation[211] between willing, uncontrolled parties,[212] and both involve looking

204. One of the four traditional *Panduit* factors is "the amount of the profit it would have made." Tate Access Floors, Inc. v. Maxcess Techs., Inc., 222 F.3d 958, 971 (Fed. Cir. 2000) (citing Panduit Corp v. Stahlin Bros. Fibre Works, Inc., 575 F.2d 1152 (6th Cir. 1978)).

205. 35 U.S.C. § 284; CHISUM ON PATENTS, *supra* note 25, § 20.03[1], [3].

206. 35 U.S.C. § 284; CHISUM ON PATENTS, *supra* note 25, § 20.03.

207. Poly-America, L.P. v. GSE Lining Tech., Inc., 383 F.3d 1303, 1311 (Fed. Cir. 2004) (reasonable royalties are the only damages for a patent owner that does not sell the patented product and is merely a single economic unit with the nonexclusive licensee).

208. *See supra* Part I.A.

209. CHISUM ON PATENTS, *supra* note 25, § 20.07.

210. KRISTOPHER A. BOUSHIE ET AL., CALCULATING AND PROVING DAMAGES § 6.06[1][b] (2011) (Tax-motivated transfer pricing studies are "perceived to be rigorous analyses of value. If such an analysis exists for the patents at issue in an infringement matter, that analysis is potentially probative information that an expert and the court would consider in establishing a reasonable royalty."); *id.* § 6.07[1] (listing "IRC Section 482 studies" as a good source of damages data).

211. Minks v. Polaris Indus., Inc., 546 F.3d 1364, 1373 (Fed. Cir. 2008) (patent law: "the hypothetical negotiation is deemed to be an arm's length transaction."); 26 C.F.R. § 1.482-1(b)(1) (2013) (tax law: "the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer").

212. Lucent Techs., Inc. v. Gateway, Inc., 580 F.3d 1301, 1324–25 (Fed. Cir. 2009) (patent law: discussing the "willing licensor-willing licensee" approach); Unisplay, S.A. v. Am. Elec. Sign Co., Inc., 69 F.3d 512, 516–17 (Fed. Cir. 1995) (same); CHISUM ON PATENTS, *supra* note 25, § 20.07[1] (discussing willing-buyer-willing-seller rule); 26 C.F.R. § 1.482-1(b)(1)

to the most closely comparable transactions.[213]

Moreover, the timeframe for the hypothetical patent law "reasonable royalty" negotiation will often (but not always) overlap with the time of transferring the patent offshore for tax purposes. The "reasonable royalty" hypothetical negotiation is deemed to have occurred at the time that the defendant started infringing the patent.[214] In many industries, competitors often develop or mimic similar technologies at similar times, so infringement tends to start at a fairly early date in the technology's existence. Most tax-avoiding IP transfers are also done at an early date in the technology's existence to help justify the low transfer price.[215] This closeness in time will make the patent's transfer price particularly valuable evidence in determining damages.[216]

Patent damages case law from analogous situations supports using transfer prices as damages evidence. Companies often purchase patents from unrelated parties such as other companies and inventors. Courts have found such patent transfers—which are done truly at arm's-length—to be potentially relevant for determining patent damages.[217] These cases thus support using tax transfer prices, which multinationals attest to as being arm's-length prices.

(2013) (tax law: standard is "dealing at arm's length with an uncontrolled taxpayer"); *cf.* Texaco, Inc. v. Comm'r, 98 F.3d 825, 830 (5th Cir. 1996) (tax law: consensual nature of dealings consistent with 26 U.S.C. § 482 regulations).

213. LaserDynamics, Inc. v. Quanta Computer USA, Inc., 694 F.3d 51, 79 (Fed. Cir. 2012) (patent law); 26 C.F.R. § 1.482-1(b)(1) & (d)(2) (tax law).

214. Wang Labs., Inc. v. Toshiba Corp., 993 F.2d 858, 869 (Fed. Cir. 1993); CHISUM ON PATENTS, *supra* note 25, § 20.07; AM. JUR. 2D *Patents* § 956. *But see* Honeywell Int'l, Inc. v. Hamilton Sundstrand Corp., 378 F. Supp. 2d 459 (D. Del. 2005) (allowing that reasonable royalty determination could look to some facts after the start of the alleged infringement).

215. Sheppard, *supra* note 5, at 1112 ("Good ideas are identified early and transferred early.").

216. *Cf.* CHISUM ON PATENTS, *supra* note 25, § 20.07[2][h] (courts tend to lower reasonable royalty damages when, at the time of start of infringement, the patent had not yet been fully commercially developed).

217. Integra Lifesciences I, Ltd. v. Merck, 331 F.3d 860, 871 (Fed. Cir. 2003) ("Integra purchased Telios (together with all of its products, patents and know-how) for $20,000,000 in 1996. A $15,000,000 award figure to compensate for infringement of only some of Telios' patents before Integra's acquisition seems unbalanced in view of the overall acquisition price."); Fresenius Med. Care Holding Inc. v. Baxter Int'l, Inc., 224 F.R.D. 644, 652–53 (N.D. Cal. 2004) (amount paid to acquire a company and its desired patents is relevant to reasonable royalty calculations); Robocast, Inc. v. Microsoft Corp., CV 10-1055-RGA, 2014 WL 202399 at, *2 (D. Del. Jan. 16, 2014) (patent purchase price "serves as a relevant data point" for determining reasonable royalty); Lantiq Deutschland GMBH v. Ralink Tech. Corp., No. 11-CV-00234-EJD (PSG), 2012 WL 1439087, at *1–*2 (N.D. Cal. Apr. 25, 2012) (defendant compelled to produce "Documents and communications showing . . . valuations of [defendant's] technologies" pursuant to merger). *See generally* Gregory Leonard & Stephen Rusek, *Patent Purchase Price is Useful in Damages Analysis*, IP LAW360 (Sept. 8, 2014).

Indeed, transfer prices used to transfer IP to a subsidiary will often be more reliable than purchase prices between unrelated parties, because numerous extraneous factors impact sales prices between unrelated parties. For example, the buyer may not have as much information about the patent as the seller, resulting in a lower purchase price.[218] Alternatively, disparities in bargaining power may result in higher or lower prices, as the case may be.[219] No such distortions exist when a multinational determines the transfer price with its own subsidiary.

Transfer prices are relevant to patent damages, but courts look to multiple factors in determining a reasonable royalty.[220] Comparable transactions are only the first among the many factors. For example, even if a low price to transfer a patent to an Irish subsidiary might indicate a correspondingly low reasonable royalty,[221] it might be necessary to adjust upwards if the patent holder and infringer are competitors, who generally demand higher royalties from each other.[222]

218. *See* Bruce W. Burton & Scott Weingust, *Misuse of Patent Purchase Price in Damages Analysis: Part 1*, IP LAW360 (Aug. 11, 2014) ("Uncertainty and [l]ack of [i]nformation [l]eads to [c]onservative [e]stimates [t]hat [c]ause the [d]ifference [b]etween [p]atent [p]urchase [p]rice and [l]itigation [d]amages [v]alue to [i]ncrease.").

219. *Id.* (noting that purchasers may be "highly skilled negotiators", resulting in a lower price); Bruce W. Burton & Scott Weingust, *Misuse of Patent Purchase Price in Damages Analysis: Part 2*, IP LAW360 (Aug. 12, 2014) (noting that competition between purchasers can drive up prices above expectations, as happened with the Nortel Networks portfolio); Leonard & Rusek, *supra* note 217 (discussing the likely portion of patent values captured by buyers).

220. Georgia-Pacific Corp. v. U.S. Plywood Corp., 318 F. Supp. 1116, 1120 (S.D.N.Y. 1970) (the leading case compiling factors relevant to reasonable royalties).

221. Johns-Manville Corp. v. Guardian Indus. Corp., 718 F. Supp. 1310 (E.D. Mich. 1989) (considering non-tax-motivated patent royalty rates to foreign subsidiaries as a factor in determining reasonable royalty). In *Johns-Manville*, there was no indication that the royalty to foreign subsidiaries was claimed to be "arm's-length" as required for U.S. tax purposes, since the IP remained in the U.S. *Id.* With IP transferred abroad for tax purposes, the price should be "arm's-length" and hence should weigh even more towards a reasonable royalty than in *Johns-Manville*.

222. *See* Minks v. Polaris Indus., Inc., 546 F.3d 1364, 1373 (Fed. Cir. 2008) (district court relied heavily on non-tax-motivated royalty rate between related parties to determine reasonable royalty, but appeals court held rate might have to be adjusted upwards to determine reasonable royalty between competitors); Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359, 1373–74 (Fed. Cir. 2008) (reasonable royalty for licensing to competitor will be higher than standard arm's-length rate); Medtronic Sofamor Danek USA, Inc. v. Globus Med., Inc., 637 F. Supp. 2d 290, 309–10 (E.D. Pa. 2009) (non-tax-motivated related-party license does not reflect higher royalty that would be charged between competitors).

2. Copyright Damages

The reasons for using transfer prices as data for patent damages apply equally to copyright damages. Case law establishes that a copyright owner's actual damages "are usually determined by the loss in the fair market value of the copyright."[223] The transfer price for a copyright is required by tax law to be its fair market value (its arm's-length price) at the time of transfer.[224] As a result, a multinational's transfer price for a copyright should generally limit the actual damages it can receive.

Damages in patent law and copyright law differ slightly. Unlike patent law, copyright law permits plaintiffs to elect statutory damages of $30,000 per use.[225] But multinationals will make this election when litigating transferred copyrights only in unusual cases.[226] More importantly, copyright owners can recover their own actual damages, plus any of the infringer's profits attributable to the infringement.[227] But double recovery is not allowed.[228] For example, if each sale of an infringing book brings the infringer $5 in profits and causes the copyright owner to lose $5 in profits, then the owner's damages are limited to $5 per book. To award $10 per infringing sale would result in unjust duplicative recovery.

Multinationals will rarely be entitled to an award of infringer's profits beyond their actual profits ($5 in the example above). As Judge Richard Posner observed, there are generally only two situations where a copyright owner will be entitled to recoup an infringer's profits.[229] But neither situation is likely to apply to a copyright owned by a multinational. First, Judge Posner noted that the infringer

223. McRoberts Software, Inc. v. Media 100, Inc., 329 F.3d 557, 566 (7th Cir. 2003); *see also* BOUSHIE ET AL., *supra* note 210, at § 8.06[1].

224. *See supra* note 30 and accompanying text.

225. 17 U.S.C. § 504(c)(1). These can be $150,000 for willful infringement. *Id.* § 504(c)(2).

226. The "per use" requirement applies regardless of how many times the infringer copies each copyrighted work. Playboy Enters., Inc. v. Webbworld, Inc., 968 F. Supp. 1171 (N.D. Tex. 1997). Multinationals asserting infringement of copyrights worth many millions (or billions) of dollars seem unlikely to choose such trifling damages, except in unusual cases involving infringing many works. *See* NIMMER ON COPYRIGHT, *supra* note 95, § 14.04[E][1] (examples of such unusual cases). If a multinational did elect statutory damages, transfer prices would, indeed, not limit damages.

227. 17 U.S.C. § 504(a)(1), § 504(b); Sheldon v. Metro-Goldwyn Pictures Corp., 309 U.S. 390 (1940) (interpreting "attributable to the infringement" as limiting recovery of infringer's profits).

228. 17 U.S.C. § 504(b) ("The copyright owner is entitled to recover the actual damages . . . and any profits of the infringer that . . . are not taken into account in computing the actual damages.").

229. Taylor v. Meirick, 712 F.2d 1112, 1120 (7th Cir. 1983) (Posner, J.) ("If the infringer makes greater profits than the copyright owner lost, because the infringer is a *more efficient producer* than the owner or *sells in a different market*, the owner is allowed to capture the additional profit even though it does not represent a loss to him." (emphases added)).

might be more efficient than the copyright owner, extracting more profits from each infringing sale.[230] To vary the example above, if each infringing book sale resulted in $6 in profit for the infringer, yet caused the copyright owner to lose $5 in profit, then an award of $6 per sale would be appropriate. But multinationals will rarely be less-efficient producers than infringers, simply because worldwide operations allow maximum economies of scale.

Second, Judge Posner noted that the infringer might be selling into a market that the copyright owner has not entered.[231] For example, if the infringer got $5 from selling each infringing book in Alaska, and the copyright owner was selling books only in the continental U.S., then awarding the owner all profits from the infringer's sales in Alaska would be nonduplicative and hence permissible. But multinationals thrive on entering all markets with profit potential, making it unlikely that an infringer will be tapping a market the multinational missed.

In sum, except in unusual cases, multinationals suing for copyright infringement will receive only their actual damages. Copyright actual damages, in turn, are generally limited to the copyright's fair market value,[232] a value that transfer prices are required to reflect.

3. Trademark Damages

Trademark damages law is much more chaotic than either patent or copyright damages law. As a leading commentator observes, "The case law on monetary recovery in trademark infringement cases is a confusing mélange of common law and equity principles, sometimes guided (and misguided) by analogies to patent and copyright law, and finding little statutory guidance."[233] Indeed, depending on the situation, a successful trademark infringement suit often results in no damages at all—only an injunction.[234]

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230. *Id.*
231. *Id.*
232. *Supra* note 223.
233. 5 MCCARTHY ON TRADEMARKS, *supra* note 121, § 30:58; *accord* Mark A. Thurmon, *Confusion Codified: Why Trademark Remedies Make No Sense*, 17 J. INTELL. PROP. L. 245 (2009); SMITH, *supra* note 194, at 185–86 ("The questions that must be answered in trademark infringement elicit varied responses that usually do not create a clear path to damage quantification.").
234. 5 MCCARTHY ON TRADEMARKS, *supra* note 121, § 30:58 ("[W]hile injunctive relief is largely a matter of strict liability, monetary relief should require 'something more.'"); SMITH, *supra* note 194, at 189 ("Trademark infringement disputes are most often resolved by the courts using injunctive relief.").

Courts typically award trademark owners damages only upon proof of either actual consumer confusion (rather than a mere "likelihood" of consumer confusion), or intentionally deceptive conduct.[235] When actual confusion or intentional deception is proved, the owner's damages are typically measured by lost profits,[236] the calculation of which courts forthrightly admit is highly imprecise.[237] For the reasons discussed above that apply to all IP,[238] a transfer price for a trademark is additional data about the profits it could be expected to bring its owner. Thus, the transfer price can be used to refine the damages determination. Indeed, courts have considered the amount paid for a trademark in a non-tax-motivated transaction as potential evidence of trademark damages.[239]

As with copyright law, trademark law also potentially allows the IP owner to recover the infringer's profits from infringement,[240] provided they are not duplicative of the IP owner's recovery of its own lost profits.[241] But this disgorgement of a trademark infringer's profits is rare in practice. A leading commentator has noted, "To put it bluntly, courts are not willing to grant an accounting of profits unless the judge 'gets mad' at the defendant."[242] Even when judges do "get mad," an IP-owning multinational's economies of scale and global reach mean that awarding the defendant's profits would almost always be duplicative.[243] In sum, the transfer prices for trademarks are very relevant data for determining damages.

235. 5 MCCARTHY ON TRADEMARKS, *supra* note 121, § 30:74.
236. *Id.* § 30:79.
237. *E.g.*, Broan Mfg. Co. v. Associated Distrib., Inc., 923 F.2d 1232, 1234 (6th Cir. 1991); Otis Clapp & Son v. Filmore Vitamin Co., 754 F.2d 738 (7th Cir. 1985); *see also* 5 MCCARTHY ON TRADEMARKS, *supra* note 121, § 30:76.
238. *See supra* notes 194–199 and accompanying text.
239. La Chemise Lacoste v. Alligator Co., Inc., 60 F.R.D. 164, 171 (D. Del. 1973) (consideration paid for trademark may have "bearing upon the issue of [mark owner's] damages" and is thus discoverable).
240. 15 U.S.C. § 1117(a).
241. Victoria Cruises, Inc. v. Changjiang Cruise Overseas Travel Co., 630 F. Supp. 2d 255, 264 (E.D.N.Y. 2008) ("[A]warding plaintiff both defendant's profits and its own lost profits based on the same sales would constitute an impermissible double recovery." (citations omitted)); 5 MCCARTHY ON TRADEMARKS, *supra* note 121, § 30:73. Even when judges do "get mad" and award the defendant's profits, it is most often as a "rough measure of the plaintiff's damages," which in turn are correlated with the transfer price. *Id.* § 30:59 (citations omitted) (internal quotation marks omitted).
242. *Id.* § 30:62; *accord* SMITH, *supra* note 194, at 195.
243. *See supra* notes 229–231 and accompanying text (discussing Taylor v. Meirick, 712 F.2d 1112, 1120 (7th Cir. 1983)).

D. Harder to Receive Injunctions (Both Preliminary and Permanent)

An artificially low transfer price for IP should weigh against granting the IP owner either a preliminary or a permanent injunction.[244] At the outset of most IP litigation, the IP owner requests that the court grant a preliminary injunction to enjoin infringement while the case is progressing. Later, if the IP owner prevails at trial, the owner invariably requests a permanent injunction against the defendant's infringement.

To get a preliminary injunction, an IP owner must show: (1) a likelihood of prevailing on the merits; (2) that allowing continued infringement will likely cause the owner "irreparable harm" that cannot be compensated by money damages; (3) that the balance of hardships tips in the owner's favor; and (4) that an injunction is in the public interest.[245] All four showings are required, but a low transfer price weighs against finding the first three, as discussed in Subparts II.D.1, II.D.2, and II.D.3 below.

To get a permanent injunction after prevailing at trial, the IP owner must make three of the four same showings: irreparable harm, balance of hardships, and public interest.[246] The IP owner must make each of these three showings. A low transfer price weighs against finding either irreparable

244. This approach will work better for patent and copyright than for trademark, given two unique aspects of trademark law. First, trademark law serves primarily to avoid consumer confusion, so the public interest factor will often weigh towards injunctions. *See* 5 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR INFRINGEMENT § 30:52 (4th ed. 2014). Second, trademark infringement by shoddy goods can do hard-to-quantify damage to the mark owner's goodwill, making the "insufficiency of monetary damages" factor often weigh towards injunctions. *Id.* § 30:47.

245. Winter v. Natural Res. Def. Council, Inc., 555 U.S. 7, 20 (2008) ("A plaintiff seeking a preliminary injunction must establish that he is likely to succeed on the merits, that he is likely to suffer irreparable harm in the absence of preliminary relief, that the balance of equities tips in his favor, and that an injunction is in the public interest." (citations omitted)); Celsis In Vitro, Inc. v. CellzDirect, Inc., 664 F.3d 922, 926 (Fed. Cir. 2012) (patent); Fox Broad. Co., Inc. v. Dish Network LLC, 723 F.3d 1067, 1072-73 (9th Cir. 2013) (copyright); Peoples Fed. Sav. Bank v. People's United Bank, 672 F.3d 1, 9 (1st Cir. 2012) (trademark).

246. eBay, Inc. v. MercExchange, LLC, 547 U.S. 388, 391 (2006). The *eBay* Court listed four factors rather than just three, but lower courts and scholars have observed that factors (1) ("irreparable injury") and (2) ("remedies available at law, such as monetary damages, are inadequate to compensate for that injury") are really just one factor. *See, e.g.*, CHISUM ON PATENTS, *supra* note 25, § 20.04[2][c][iii] (quotation marks omitted) ("The Court erred by separating the two factors. In logic, in historic origin, and in practice, irreparable injury and inadequacy of damages are two sides of the same coin. In logic, the factors overlap completely."); *accord* MercExchange, LLC v. eBay, Inc., 500 F. Supp. 2d 556, 569 n.11 (E.D. Va. 2007) (on remand) ("The irreparable harm inquiry and remedy at law inquiry are essentially two sides of the same coin. . . .").

harm or a favorable balance of hardships, as discussed in Subparts II.D.2 and II.D.3 below.

1. Lower Likelihood of Prevailing on the Merits

To get a preliminary injunction, an IP owner must demonstrate a reasonable likelihood of success on the merits. The owner must not only show that the IP is likely valid but also that the defendant likely engages in actionable infringement or dilution. A low transfer price for IP is evidence that the scope of infringing activity is narrow, making it less likely that the defendant's behavior is actionable.[247] Similarly, a low transfer price is evidence of invalidity, particularly in the patent context, where a low transfer price is evidence that the multinational thought the invention was not a meaningful technological advance.[248]

Hearings on preliminary injunctions are limited affairs where the full merits cannot possibly be tried and only limited discovery has taken place. Recall that the IP holder is required to have the appraiser's transfer-pricing documentation already prepared and ready to provide to the IRS on short notice.[249] Case law supports granting IP defendants expedited discovery of easily produced documents to defend against preliminary injunctions.[250] This case law comfortably applies to transfer-pricing documentation.

In patent cases, courts deciding whether to issue preliminary injunctions particularly welcome evidence of nontechnical secondary considerations, such

247. *See* Part II.B (arguing that a low transfer price is evidence suggesting that the IP has narrow scope). Courts often look at such issues of IP scope in determining whether to issue a preliminary injunction. For example, evaluations of the likelihood of the defendant being protected by fair use play a large role in deciding whether to issue preliminary injunctions against copyright infringement. *See* NIMMER ON COPYRIGHT, *supra* note 95, § 14.06[A][5][b].

248. *See* Part II.A.

249. 26 C.F.R. § 1.6662-6(d)(2)(iii) (2011) (requiring that the "documentation must be in existence when the return is filed" and be provided to the IRS within 30 days of a request); *see also supra* note 34.

250. *E.g.*, Apple, Inc. v. Samsung Elecs Co., Ltd., 768 F. Supp. 2d 1040, 1043 (N.D. Cal. 2011) (The court and even Apple agreed that defendant Samsung could get expedited discovery of Apple's "documents concerning good will; loss of good will; market share; reputation to Apple . . . research surveys or studies relating to the likelihood of confusion" to oppose Apple's motion for preliminary injunction; listing factors relevant to expedited discovery); *see* Fed. R. Civ. P. 26(d), (f); *id.* (1993 amendments commentary) (stating that expedited discovery per court order "will be appropriate in some cases, such as those involving requests for a preliminary injunction").

as licensing success and commercial success.[251] Transfer prices are analogous to these nontechnical secondary considerations, but less distorted by external factors and the passage of time.[252] Low transfer prices (and the often-disparaging expert appraisal documentation justifying these prices) are easily accessible evidence that the IP owner is unlikely to prevail on the merits.

Courts deciding whether to issue preliminary injunctions in copyright cases often wrestle with whether the alleged infringement is fair use,[253] which is hard enough to determine even with a full trial on the merits. The appraiser's documentation justifying a copyright's transfer price will often specify the potential markets the copyright owner considered, which is highly relevant to fair use.[254] To justify a low transfer price, the appraisers will naturally consider fewer potential markets. If the defendant entered a market not listed as a potential market by the appraisers, then the appraiser's documentation weighs toward fair use and against a preliminary injunction.[255]

In trademark infringement cases, deciding whether to issue a preliminary injunction often centers on whether there is a likelihood of customer confusion between the trademark and the alleged infringer's use.[256] A low transfer price for a trademark is an admission by its owner that the mark is probably not that strong, weighing against a likelihood of customer confusion.[257] Similarly, in trademark dilution cases, which require a showing that the mark is famous, a low transfer price neatly indicates a lack of fame[258] and hence should weigh against a preliminary injunction.

251. CHISUM ON PATENTS, *supra* note 25, § 20.04[2][iii]; *e.g.*, Zenith Labs., Inc. v. Eli Lilly & Co., 460 F. Supp. 812, 814, 817 (D.N.J. 1978) (issuing preliminary injunction to patent holder who had substantial commercial success and licensing success).

252. *See* Part II.A.1.

253. 5-14 NIMMER ON COPYRIGHT, *supra* note 95, § 14.06[A][5][b] ("The tough cases arise when fair use is mixed into the [preliminary injunction] analysis.").

254. *See supra* note 153.

255. *See* Part II.B.2. For patents and trademarks, both the low transfer price and the appraisal documentation can be helpful in fighting a preliminary injunction. By contrast, for copyrights, only the appraisal documentation is likely to be helpful. While a low transfer price for a copyright can help show fair use, doing so likely requires the defendant to hire an expert to value the copyright in different markets. *See supra* note 155 and accompanying text.

256. *See, e.g.*, New Kayak Pool Corp. v. R & P Pools, Inc., 246 F.3d 183, 185 (2d Cir. 2001).

257. *See* Part II.B.3.

258. *See* Part II.B.4.

2. Lack of Irreparable Harm

For both preliminary and permanent injunctions, the IP owner must demonstrate that, without the injunction, it would suffer irreparable harm.[259] If the IP owner can be adequately compensated by money damages, even very large damages, then there is no irreparable injury.[260] But when a multinational has transferred IP to avoid taxes, it has demonstrated that the IP's value—which roughly correlates with the maximum damages for infringing it—can be quantified, and was actually quantified at a low number.[261]

A recent Federal Circuit case had closely analogous circumstances. In *Innogenetics, N.V. v. Abbott Laboratories*,[262] the patent was found valid and infringed.[263] The jury granted the patent owner damages consisting of both an up-front "market entry fee" and a running royalty.[264] The district court also granted a permanent injunction to the patent owner.[265] But the Federal Circuit took the somewhat unusual step of vacating this permanent injunction as an abuse of discretion, reasoning that the "market entry fee"

259. *See* Flexible Lifeline Sys., Inc. v. Precision Lift, Inc., 654 F.3d 989, 999–1000 (9th Cir. 2011) (internal quotation marks omitted) (citation omitted) (copyright: "[h]arm must be proved, not presumed"); *accord* eBay, Inc. v. MercExchange, LLC, 547 U.S. 388, 392–93 (2006) (citations omitted) (patent: "this Court has consistently rejected . . . a rule that an injunction automatically follows a determination that a copyright has been infringed"). But it is possible that trademark law may still retain the presumption of irreparable harm after *eBay*. *See* Peoples Fed. Sav. Bank v. People's United Bank, 672 F.3d 1, 9 n.11 (1st Cir. 2012); 5 MCCARTHY, *supra* note 244, § 30:47 (reviewing unclear case law).

260. *See* Celsis In Vitro, Inc. v. CellzDirect, Inc., 664 F.3d 922, 930 (Fed. Cir. 2012) ("As its name implies, the irreparable harm inquiry seeks to measure harms that no damages payment, however great, could address."); *see also* CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE & PROCEDURE § 2948.1 (3d ed., 2014) ("A preliminary injunction usually will be denied if it appears that the applicant has an adequate alternate remedy in the form of money damages or other relief." (footnotes omitted)).

261. In some unusual markets, the IP owner's earlier quantification of the IP in suit does not mean that there is an adequate monetary remedy. For example, in *Broadcom Corp. v. Qualcomm, Inc.*, 543 F.3d 683, 702 (Fed. Cir. 2008), the patent owner had previously licensed the patent to a noncompetitor. This previous license should have established an adequate monetary remedy for the defendant's infringement, making an injunction inappropriate. But the defendant was the patent owner's competitor, and the district court had found that "[t]he market for baseband chips is unlike the typical market for consumer goods where competitors compete for each consumer sale . . . rather competition is characterized by competing for 'design wins' . . . ." *Id.* at 702. Because of this atypical market, the district court found the prior quantification did not establish an adequate monetary remedy, and it issued an injunction. *Id.* at 702–04. On appeal, the Federal Circuit upheld this injunction as not being an abuse of discretion, also relying on the atypical market at issue. *Id.*

262. 512 F.3d 1363 (Fed. Cir. 2008).

263. *Id.* at 1369.

264. *Id.* at 1379–81.

265. *Id.*

already quantified the harm from ongoing infringement.[266] Given that the harm had already been expressly quantified and awarded in damages, the patent owner could not show that monetary damages were inadequate, and thus, the injunction was inappropriate. Similarly, if a multinational has transferred IP, the transfer price quantifies its future profit potential, weakening later arguments that infringement cannot be fully compensated by monetary damages.

3. Unfavorable Balance of Hardships

The balance of hardships required for both preliminary and permanent injunctions compares two hypothetical harms: the harm to the IP owner if the infringement is not enjoined, versus the harm to the defendant if the infringement is enjoined.[267] For example, if exclusive use of a patented technology is particularly important to the patent owner's business, then that fact demonstrates harm to the IP owner from not enjoining the infringement and supports an injunction.[268] Conversely, if the patented technology is less important to the patent owner, that weighs against an injunction.[269]

The transfer price for the IP at issue is relevant to the harm to the IP owner if the infringement is not enjoined. In general, the maximum harm to the IP owner is the loss of all profits the IP is expected to generate,[270] which the transfer price should approximate. A low transfer price is thus a useful piece of data for a court to estimate the IP owner's hardships and will tend to weigh against issuing preliminary or permanent injunctions.

266. *Id.* at 1380.
267. Acumed LLC v. Stryker Corp., 551 F.3d 1323, 1329–30 (Fed. Cir. 2008).
268. *See* Martek Biosciences Corp. v. Nutrinova, Inc., 520 F. Supp. 2d 537, 59 (D. Del. 2007) (the patent owner's "primary source of revenue"); Amgen, Inc. v. F. Hoffmann-La Roche Ltd., 581 F. Supp. 2d 160, 212 (D. Mass. 2008), *aff'd mem*, 296 Fed. App'x 69 (Fed. Cir. 2008) (patents were "the foundation of Amgen's business").
269. *See*, *e.g.*, Tensar Corp. v. Tenax Corp., 24 U.S.P.Q.2d 1605, 1614 (D. Md. 1992) (preliminary injunction denied when patent holder held "a ninety-eight percent market share and . . . has continued to hold it even though a prior adjudicated infringement took place").
270. This statement is particularly true for patent and copyright, where the IP's value comes from the ability to reap monopoly profits, and infringement (at worst) takes away all of the IP holder's monopoly profits. But this statement is not always true for trademarks, where infringement by a low-quality competitor potentially could also harm sales even beyond those if the mark never existed. MCCARTHY ON TRADEMARKS, *supra* note 121, § 30:47; *cf.* Int'l Kennel Club of Chicago, Inc. v. Mighty Star, Inc., 846 F.2d 1079, 1091 (7th Cir. 1988).

E. Misuse

Misuse provides an entirely separate, standalone defense to enforcement of any remedies (either damages or injunctions) in IP suits. Courts withhold any remedy if the IP owner "misused" the IP in a way that violates public policy, even if the IP has been held valid and infringed, and even if the defendant has not been harmed by the misuse.[271] Patent misuse,[272] copyright misuse,[273] and trademark misuse,[274] all provide defenses to enforcement of the respective type of IP until the misuse has been fixed.

The Supreme Court explained misuse by stating that courts "may appropriately withhold their aid where the plaintiff is using the right asserted contrary to the public interest."[275] The defendant need not be harmed by the misuse in order to assert the misuse defense.[276] The touchstone for determining misuse is whether the IP owner used the IP in violation of public policy.[277]

Few public policies are more important than the full payment of taxes, which the Supreme Court has repeatedly described as "the life-blood of government."[278] As Justice Holmes eloquently stated: "Taxes are what we pay

271. *See infra* note 277.
272. *See* Morton Salt Co. v. GS Suppiger Co., 314 U.S. 488 (1942); CHISUM ON PATENTS, *supra* note 25, § 19.04; *cf.* Mark A. Lemley, Comment, *The Economic Irrationality of the Patent Misuse Doctrine*, 78 CALIF. L. REV. 1599 (1990).
273. NIMMER ON COPYRIGHT, *supra* note 95, § 13.09[A]; *see, e.g.*, Practice Mgmt. Info. Corp. v. Am. Med. Ass'n, 121 F.3d 516, 520 (9th Cir. 1997) (finding copyright misuse); Lasercomb Am., Inc. v. Reynolds, 911 F. 2d 970, 979 (4th Cir. 1990) (holding that copyright misuse was a valid defense).
274. MCCARTHY ON TRADEMARKS, *supra* note 121, § 31:44–58; Worden v. California Fig Syrup Co., 187 U.S. 516, 539–40 (1903) (consumer deception was trademark misuse); U.S. Jaycees v. Cedar Rapids Jaycees, 794 F.2d 379, 383 (8th Cir. 1986) (trademark misused to punish chapter for admitting women); *cf.* Dunn Computer Corp. v. Loudcloud, Inc., 133 F.Supp.2d 823, 830 n.23 (E.D. Va. 2001) (trademark misuse is an affirmative defense, not an independent cause of action).
275. *Morton Salt*, 314 U.S. at 492.
276. CHISUM ON PATENTS, *supra* note 25, § 19.04[5] ("[I]t has been clear at least since *Morton Salt* that the individual defendant raising a misuse defense need not show that he was personally harmed by the abusive practice."); Lemley, *supra* note 272, at 1599 ("[T]he sanction is awarded as a windfall to the patent infringer even if that party was not injured by the misuse."); MCCARTHY ON TRADEMARKS, *supra* note 121, § 31:47; Nat'l Football League v. Governor of the State of Del., 435 F. Supp. 1372, 1391 n.35 (D. Del. 1977) (holding that trademark misuse potentially includes any harm to the public).
277. Aaron Xavier Fellmeth, *Copyright Misuse and the Limits of the Intellectual Property Monopoly*, 6 J. INTELL. PROP. L. 1, 24–25 (1998); William E. Ridgway, *Revitalizing the Doctrine of Trademark Misuse*, 21 BERKELEY TECH. L.J. 1547, 1564 (2006).
278. GM Leasing Corp. v. United States, 429 U.S. 338, 350 (1977) (quoting Bull v. United States, 295 U. S. 247, 259 (1935)).

for civilized society."[279] Courts should therefore find misuse when IP has been used for egregious tax avoidance.

A court should find sufficiently egregious tax avoidance whenever an IP owner argued at trial for a valuation for damages purposes that was substantially greater than the transfer-pricing valuation used to avoid taxes. There is no precise formula for how egregious the disparity must be. Misuse is an imprecise equitable defense exercised at the court's discretion.[280] But other equitable defenses that continue to play a lively role in IP law, like laches and equitable estoppel, similarly rely on imprecise concepts such as "unreasonable delay" and "prejudice."[281] The imprecision of misuse thus does not prevent courts from using it.

Misuse does not permanently prevent the IP owner from obtaining relief. Generally, once the misuse stops and the IP owner fixes the ill effects, courts will give the IP owner its remedies.[282] Accordingly, courts should give a tax-avoiding multinational its remedies once it has voluntarily paid the Treasury back taxes appropriate for an accurate valuation of the IP.[283]

Patents, copyrights, and trademarks all generally grant their holders exclusive rights, so the most common public-policy violations triggering misuse involve anticompetitive behavior—although antitrust violations are not required for finding misuse.[284] In a seminal case, the Supreme Court found misuse when a patent holder on a salt tablet machine required that lessees of the patented machines also buy unpatented salt from the patent

279. Compañia General de Tabacos de Filipinas v. Collector of Internal Revenue, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

280. *Morton Salt*, 314 U.S. at 494 (characterizing patent misuse, trademark misuse, and copyright misuse as deriving from principles of equity); Transitron Elec. Corp. v. Hughes Aircraft Co., 487 F. Supp. 885, 893 (D. Mass. 1980), *aff'd*, 649 F.2d 871 (1st Cir. 1981) ("Patent misuse was developed as an equitable doctrine to provide an equitable defense . . . .").

281. CHISUM ON PATENTS, *supra* note 25, § 19.05 (discussing patent laches and equitable estoppel).

282. Senza-Gel Corp. v. Seiffhart, 803 F.2d 661, 668 n.10 (Fed. Cir. 1986) ("A successful patent misuse defense results in rendering the patent unenforceable until the misuse is purged.").

283. Withholding both damages and any injunctive relief is entirely appropriate for patent misuse or copyright misuse, where the IP is supposed to reward the owner. But trademark law also aims to spare consumers from confusion. As a result, for trademark misuse, withholding damages but not injunctive relief might be appropriate. *Cf.* Ridgway, *supra* note 277, at 1584–85 (noting how trademark misuse's remedies may need to be shifted to prevent consumer confusion).

284. Practice Mgmt. Info. Corp. v. Am. Med. Ass'n, 121 F.3d 516, 521 (9th Cir. 1997) ("[A] defendant in a copyright infringement suit need not prove an antitrust violation to prevail on a copyright misuse defense."); *accord* Morton Salt, 314 U.S. at 494 (1942) ("It is unnecessary to decide whether respondent has violated the Clayton Act, for we conclude that in any event the maintenance of the present suit to restrain petitioner's manufacture or sale of the alleged infringing machines is contrary to public policy . . . .").

holder.[285] The Court found that such a requirement was an impermissible attempt to extend the market power already granted by the patent.[286] Misuse can be found for violation of any public policy, not just the public policy against anticompetitive behavior. As Judge Richard Posner observed, "The doctrine [of misuse] arose before there was any significant body of federal antitrust law, and reached maturity long before that law . . . attained its present broad scope."[287] For example, courts have found trademark misuse when a trademark was deceptive, and when a trademark was used to force social clubs to exclude women.[288] Extending misuse to include IP-based tax avoidance is an entirely sensible extension of existing misuse case law.[289]

Finding misuse when IP is used to avoid taxes serves the exact same public-policy goals as the antitrust laws. Antitrust law has three major goals: minimizing deadweight losses caused by anticompetitive behavior,[290] preventing producers from pocketing consumer surplus for themselves,[291] and avoiding undue concentration of economic power.[292]

285. *Morton Salt*, 314 U.S. at 494.
286. *Id.* at 489.
287. USM Corp. v. SPS Techs., Inc., 694 F.2d 505, 511 (1982).
288. U.S. Jaycees v. Cedar Rapids Jaycees, 794 F.2d 379 (8th Cir. 1986); Worden v. California Fig Syrup Co., 187 U.S. 516, 540 (1903) (trademark for "Syrup of Figs" denied relief for using few figs); Manhattan Medicine Co. v. Wood, 108 U.S. 218 (1883); *see* Ridgway, *supra* note 277, at 1554 (discussing trademark misuse's origins in dishonest IP owners).
289. *Cf.* Robert P. Merges, *Reflections on Current Legislation Affecting Patent Misuse*, 70 J. PAT. & TRADEMARK OFF. SOC'Y 793, 797 (1988) (arguing for patent misuse when the court perceives unclean hands); Ridgway, *supra* note 277, at 1564 (arguing for an extension of trademark misuse to deal with inappropriate trademark overenforcement to suppress discussion on the internet); *see also* Lemley, *supra* note 272, at 1612 (there is "no theoretical bar to the creation of non-antitrust classes of patent misuse"); William J. Nicoson, *Misuse of the Misuse Doctrine in Infringement Suits*, 9 UCLA L. REV. 76, 109–10 (1962) (recommending that the patent misuse doctrine be limited to cases in which the antitrust laws do *not* apply).
290. Louis Kaplow & Carl Shapiro, *Antitrust*, *in* 2 HANDBOOK OF LAW & ECONOMICS 1099 (A. Mitchell Polinsky & Steven Shavell eds., 2007); William M. Landes, *Optimal Sanctions for Antitrust Violations*, 50 U. CHI. L. REV. 652, 653 (1983). *Supra*-competitive prices increase producer surplus by less than they decrease consumer surplus. As a result, the total surplus (consumers' plus producers') is lower. *See id.* at 654 fig.1. The decrease in total surplus is referred to as deadweight loss. Note that it is unsettled whether antitrust law should aim to maximize consumer surplus, or should aim to maximize the sum of consumer and producer surplus. Kaplow & Shapiro, *supra*, at 1166–67 (outlining current state of this debate).
291. Kaplow & Shapiro, *supra* note 290, at 1099. Charging *supra*-competitive prices increases producer welfare but decreases consumer welfare.
292. Standard Oil Co. v. United States, 221 U.S. 1, 50 (1911) (legislative history demonstrates "that the main cause which led to the [Sherman Act was] . . . the vast accumulation of wealth [which] would be exerted to oppress individuals and injure the public generally").

Just as anticompetitive behavior creates deadweight losses, IP-based tax avoidance leads to substantial deadweight losses in terms of misallocated investment and expense.[293] Just as businesses engaged in anticompetitive behavior shift value from consumers to themselves, tax avoiders shift tax burdens from themselves to taxpayers in general. And just as the antitrust laws fight concentrations of economic power, IP-based tax avoidance is only available to multinationals, giving them a competitive advantage over smaller businesses, thus increasing the concentration of economic power. In sum, applying the IP misuse doctrines to tax avoidance would serve the same public policies that courts have long served by finding IP misuse for anticompetitive behavior.

Misuse based on anticompetitive behavior has been more sparingly applied in recent years.[294] But this development should not hinder finding tax avoidance to be misuse. For the past half-century, IP misuse law has focused on anticompetitive concerns, but that can be seen as the product of a Supreme Court obsessed with curtailing anticompetitive behavior. Indeed, in a 1972 case, the Court called the antitrust laws "the Magna Carta of free enterprise,"[295] and even analogized them to the Bill of Rights.[296] Yet since the late 1970s, the Court has consistently pared back the scope and bite of the antitrust laws.[297] In this context, it is not surprising that findings of IP misuse based on anticompetitive behavior have correspondingly declined.

But IP misuse predates antitrust law and has been applied to various violations of public policy unrelated to anticompetitive behavior. Misuse is thus a flexible equitable doctrine that courts should adapt to the increasingly serious problem of multinationals' IP-based tax avoidance.

III. CONSISTENT WITH IP POLICY

The previous Part illustrated how existing IP law can be naturally extended to make it harder for IP owners to use their IP to avoid taxes and later sue for infringement of that IP. These proposed extensions have solid doctrinal foundations, with extensive case law for defendants to cite.

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293. *See* Kleinbard, *supra* note 67, at 1038; Brauner *supra* note 8, at 82–83.

294. *See, e.g.*, Princo Corp. v. ITC, 616 F.3d 1318 (Fed. Cir. 2010) (en banc).

295. United States v. Topco Associates, Inc., 405 U. S. 596, 610 (1972).

296. *Id.*

297. *See, e.g.*, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (*overruling* Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911)); Continental T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

Turning now to policy, this Part considers whether these proposed extensions of IP law are consistent with the policies underlying IP law. Neither scholars nor courts have settled on any single justification for IP law. Rather, there are multiple different accepted justifications, including economic efficiency, just deserts, and individual autonomy of creators.[298] After considering some threshold matters, this Part examines these accepted justifications and concludes that this Article's proposals either further these justifications or, at worst, are neutral. Next, this Part considers a policy counterargument to this Article's proposals: that current IP law provides suboptimal incentives for IP creation, and allowing IP-based tax avoidance is desirable because it increases the after-tax incentives for multinationals to create IP. This Part then explains why this Article's proposals would have minimal impact on IP litigation involving IP not used to avoid taxes. Finally, this Part examines a policy deeply embedded in the fabric of IP law: that IP owners should be held to prior statements. This Article's proposals clearly further this policy.

A. Not Undermining IP Rights

As a threshold matter, it is important to note that none of this Article's proposals would substantially undermine IP rights. Judges and juries consider many different types of evidence when deciding on validity, scope, damages, and injunctions. For example, many different considerations go into the patent obviousness determination,[299] and a low transfer price for a patent might increase its likelihood of being invalidated from, say, 20 percent to 25 percent. While this increase in risk is a genuine deterrent against IP-based tax avoidance, it does not substantially undermine IP rights.

B. Reducing Distortion of Creative Professionals' Employment

IP-based tax avoidance is available only to multinationals—not to startups, not to other small businesses, and not to anyone who is self-employed. The IP-based tax avoidance strategies discussed above in Subparts I.A and I.B require substantial business operations in multiple countries, subsidiaries in tax havens, and sophisticated tax advisors.[300] Tolerating IP-based tax avoidance thus distorts the market for the creative professionals, such as

298. An excellent, comprehensive survey of the justifications for IP law is ROBERT P. MERGES, JUSTIFYING INTELLECTUAL PROPERTY (2011).
299. *See* CHISUM ON PATENTS, *supra* note 25, §§ 5.01–5.06.
300. Sullivan, *supra* note 22, at 461.

inventors and authors, who actually create IP. More creative professionals are employed by multinationals—as opposed to being self-employed or employed by small businesses like startups[301]—than would be the case in the absence of IP-based tax avoidance.

C. Economic Grounds

An IP system involves costs and benefits. The primary benefit is that it incentivizes inventions, creative works, and reliable brands. But it does so by giving IP owners the right to exclude others and thus to raise prices, causing deadweight losses.[302] And because subsequent creations use preexisting creations as inputs, existing IP rights stymie some amount of new innovation and creativity.[303] Other major costs of the IP system include litigation expenses and funding the Patent and Trademark Office.

Economists and legal scholars have been unable to reliably determine the relative costs and benefits of IP law or of changes to it. As leading law and economics scholars have observed, "economic analysis of intellectual property remains inconclusive, if not indeterminate."[304] This Subpart attempts, as best as possible, to weigh the economic costs and benefits of adopting the arguments proposed in Part II.

Adopting this Article's proposals should reduce the after-tax incentive for multinationals to create IP, by making it harder for multinationals to use IP to reduce their tax bills. Some scholars believe that current IP law provides too-low incentives for IP creation,[305] although the point is hotly debated.[306] If the incentives for IP creation are already inefficiently low, then this Article's

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301. A nontrivial portion of creative professionals work for smaller firms (including startups) or are self-employed. MERGES, *supra* note 298, at 203–25.

302. *See* Richard Gilbert & Carl Shapiro, *Optimal Patent Length and Breadth*, 21 RAND J. ECON. 106, 106 (1990).

303. Mark A. Lemley, *The Economics of Improvement in Intellectual Property Law*, 75 TEX. L. REV. 989, 996–99 (1997).

304. LANDES & POSNER, *supra* note 108, at 10; *accord* George L. Priest, *What Economists Can Tell Lawyers About Intellectual Property*, 8 RES. L. & ECON. 19, 24 (1986) (answer: "little"); MERGES, *supra* note 289, at 2–3, 6 (noting lack of hard evidence that IP law increases economic well-being); *id.* at 151–55 (explaining why economic efficiency is only a midlevel principle in IP law).

305. *See, e.g.*, Richard A. Epstein, *The Disintegration of Intellectual Property? A Classical Liberal Response to A Premature Obituary*, 62 STAN. L. REV. 455 (2010); Christopher Yoo, *Copyright and Public Good Economics: A Misunderstood Relation*, 155 U. PA. L. REV. 635, 706–14 (2007).

306. *See, e.g.*, Yochai Benkler, *Sharing Nicely: On Shareable Goods and the Emergence of Sharing as a Modality of Economic Production*, 114 YALE L.J. 273, 348–55 (2004); James Boyle, *The Second Enclosure Movement and the Construction of the Public Domain*, 66 LAW & CONTEMP. PROBS. 33 (2003).

proposals would worsen matters, imposing economic costs as multinationals reduce their IP creation.

But allowing IP-based tax avoidance almost certainly imposes economic costs in terms of lowering the efficiency of overall IP creation by distorting the employment of creative professionals like inventors and authors, making them more likely to work for multinationals (as opposed to small businesses like startups or being self-employed) than would otherwise be the case.[307] Yet multinationals burden creative professionals with more bureaucracy and less opportunity to reap the benefits of the IP they help create.[308] With dulled incentives to create IP, creative professionals employed by multinationals naturally produce less of it.[309] Regardless of whether one views current IP law as creating too-high or too-low incentives for IP creation, this Article's proposals will create an economic benefit in reducing this distortion in the employment of creative professionals.

Aside from the creation of IP, there are other clear economic benefits from adopting this Article's proposals. IP-based tax avoidance imposes enormous economic harm: distorted worldwide investment decisions by multinationals that lower economic output;[310] massive tax revenue losses, with results like higher government deficits, lower spending, and higher taxes on individuals;[311] and the high transaction costs involved in implementing the tax-avoidance strategies.[312]

A counterintuitive additional economic benefit could also come from adopting this Article's proposals. The additional bit of uncertainty that an IP owner would incur by using the IP to avoid taxes can actually improve economic welfare. Recall that IP generates rewards by giving the owner exclusive rights, almost always resulting in higher prices and deadweight loss to society. Professors Ian Ayres and Paul Klemperer demonstrate that a small increase in the uncertainty of a patent's validity and enforceability typically prevents a patent holder from charging the full price it would charge if the

307. *See supra* Part III.B.
308. *See* ZOLTAN J. ACS & DAVID B. AUDRETSCH, INNOVATION AND SMALL FIRMS 40 (1990) (explaining the innovative successes of smaller enterprises, with one reason being less bureaucracy). Although businesses of all sizes can offer stock options to creative professionals, their efforts are more likely to actually impact the value of the stock options when the business is smaller.
309. *See* Sullivan, *supra* note 22, at 461 ("[I]t is widely believed that small and start-up firms conduct more productive research than large firms . . . ."); *cf.* Scott Kirsner, *11 Ways Big Companies Undermine Innovation*, HARV. BUS. REV. BLOG (Oct. 21, 2013), http://blogs.hbr.org/2013/10/11-ways-big-companies-undermine-innovation.
310. *See supra* note 67.
311. *See supra* notes 62–66.
312. *See supra* note 68.

patent's validity and enforceability were absolutely certain.[313] This slightly lower price typically decreases the reward for the invention by a small amount but reduces the deadweight loss to society by a much greater amount.[314] In other words, a bit of uncertainty has low costs and high benefits, leading to a net increase in economic welfare. This Article's proposals all involve low transfer prices increasing the uncertainty that IP owners will prevail in asserting IP used to avoid taxes. In other words, adopting this Article's proposals can bring precisely the economic benefits described by Ayres and Klemperer.

In sum, although it is difficult (if not impossible) to precisely assess the economic impact of any change to IP law, adopting this Article's proposals would likely increase economic well-being. The cost is speculative, as multinationals' incentives to create IP may be inefficiently reduced. Meanwhile, the benefits include reducing the many distortions caused by IP-based tax avoidance: the distortion in the market for creative professionals, the fiscal distortions, and the distortions in worldwide investment decisions.

D. Philosophical Grounds: Lockean Just Deserts and Kantian Autonomy

Professor Robert Merges makes a very convincing case that IP law's foundational justifications are philosophical considerations, and he finds extensive support for his thesis in case law.[315] One primary consideration is John Locke's concept of "just deserts" for labor.[316] When a person labors to gather acorns from nature, he or she has earned those acorns and should be able to consider them property.[317] Similarly, when an inventor labors to harness physical laws to create a better mousetrap, the mousetrap should be her property. Merges points to numerous instances where IP case law reflects such Lockean considerations.[318]

313. *See generally* Ian Ayres & Paul Klemperer, *Limiting Patentees' Market Power Without Reducing Innovation Incentives: The Perverse Benefits of Uncertainty and Non-Injunctive Remedies*, 97 MICH. L. REV. 985 (1999).

314. Ayres & Klemperer's analysis depends, in part, on patent holders being entitled only to lost profits. *Id.* at 1030. As discussed *supra* notes 229, 230, 243 and accompanying text, multinationals owning copyrights and trademarks will rarely be entitled to anything other than lost profits.

315. MERGES, *supra* note 298, at 31–138.

316. *Id.* at 31–67.

317. *Id.*

318. *Id.*

Another philosophical consideration that Merges identifies as justifying IP comes from the work of Immanuel Kant.[319] Kant emphasized the importance of individuals' autonomy and systems of rules that can be enforced in a way that is consistent with the freedom of all.[320] Law has the imperative to respect each individual as an end in him- or herself, including his or her freedom to pursue his or her own ends and conception of the good life.[321] IP law does exactly that, by allowing artists, inventors, and other creative professionals to create and use ideas that are often highly expressive, while protecting them from the threat that others will convert their creations and themselves to be means to those others' ends.[322] Merges points to instances where IP case law[323] and characteristics of IP[324] reflect Kantian considerations.

Both Lockean and Kantian considerations support giving IP protection to the individual inventor laboring in a garage or to the aspiring novelist typing away on a manuscript. These considerations also provide fairly strong support to creative professionals working in small groups like startups, which often rely heavily on IP, and which typically give creative professionals substantial autonomy[325] and a large portion of the fruits of their labors.

But Lockean and Kantian considerations provide less support for giving IP protection to multinational corporations. Large corporations employing creative professionals do allow them to reap some benefits from their labor and do allow them some degree of autonomy—just less than if they were self-employed or working in a small group like a startup.[326] As a result, IP law can often best vindicate Locke and Kant's concerns, as Merges elaborates them, by being solicitous of creative professionals working either by themselves or in startups.[327]

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319. *Id.* at 68–101.
320. *Id.* at 87.
321. IMMANUEL KANT, FUNDAMENTAL PRINCIPLES OF THE METAPHYSICS OF MORALS 45-46 (T. Abbott trans., 1949).
322. MERGES, *supra* note 289, at 81; Kim Treiger-Bar-Am, *Kant On Copyright: Rights Of Transformative Authorship*, 25 CARDOZO ARTS & ENT. L.J. 1059 (2008).
323. *E.g.*, MERGES, *supra* note 289, at 96–101.
324. *Id.* at 95 (noting how the competing Kantian considerations of the autonomy of the creator and autonomy of others justify temporal limitations on IP right durations).
325. *Id.* at 212–13.
326. *Id.* at 21–23, 212–13.
327. *Id.* at 22 ("In some cases, . . . if IP law is to stay true to its foundational principles [those of Locke and Kant], legal rules must be tilted in favor of individual creators, at the expense of corporate owners."); *id.* at 23 (noting that IP law should make it easy for creative professionals to leave the employ of corporations to form startups or become self-employed).

This Article's proposed extensions of IP law would have precisely this effect, by removing the tax-driven distortion of the market for creative professionals that results in more of them working for multinationals than for startups or themselves.[328] In sum, IP law will better vindicate creative professionals' just deserts for labor and individual autonomy if courts adopt this Article's proposed extensions of IP law than if they don't.

E. Counterargument: Second-Best Way to Increase IP-Creation Incentives

Many scholars and practitioners believe that current IP law, by itself, provides insufficient incentives for creating IP.[329] If this is true,[330] and given that IP law is unlikely to change to increase incentives,[331] then tolerating the tax savings that IP-based tax avoidance allows can be justified as a second-best solution to the need for more IP-creation incentives. Anyone taking this view would argue against this Article's proposals to hinder IP-based tax avoidance as undermining this second-best solution.

The first flaw in this counterargument is that allowing IP-based tax avoidance creates a number of economically damaging distortions. These include the distortion of the employment of creative professionals away from startups and self-employment, and toward multinationals, which are less efficient at IP production. Indeed, allowing IP tax-avoidance may not merely reduce the efficiency of IP production but may even reduce total IP creation.

The second flaw is that there are many other options that government can—and already does—employ to incentivize invention and creativity.[332] Tolerating IP-based tax avoidance is not a second-best solution to insufficient incentives for invention and creativity, because there are multiple solutions that are better. Perhaps allowing IP-based tax avoidance might qualify as a fifth-best solution.

For example, government grants are made for scientific and engineering research through agencies such as the National Science Foundation and

328. *See supra* Part III.B.
329. *See, e.g.*, *supra* note 305.
330. This issue is heavily disputed. *Compare supra* note 305, *with supra* note 306. This Article and its author have no position on this matter.
331. If anything, the general move in the law is towards lessening IP protections. *See, e.g.*, eBay Inc. v. MercExchange, LLC, 547 U.S. 388 (2006) (making it harder for patent owners to receive injunctive relief); Leahy–Smith America Invents Act, Pub. L.112–29, 125 Stat. 284 (Sept. 16, 2011) (expanding opportunities to invalidate patents).
332. For an excellent taxonomy and analysis of innovation incentives, see generally Daniel J. Hemel & Lisa Larrimore Ouellette, *Beyond the Patents-Prizes Debate*, 92 TEX. L. REV. 303 (2013).

National Institutes of Health.[333] Grants for creative works can be made through agencies like the National Endowment for the Humanities.[334]

Prizes for solving particular engineering problems directly incentivize finding solutions, and multiple government agencies increasingly take this approach.[335] For example, the Department of Energy has offered a $10 million prize for developing a replacement for the sixty-watt incandescent lamp.[336] Prizes can also incentivize artistic creations, such as the U.S. Forest Service's prize for photos of urban and community forests.[337]

Further, tax code provisions passed by Congress can and do subsidize invention, creativity, and brand-building. These could be expanded to further encourage innovation and creativity; indeed, Congress is actively discussing such expansions as of this writing.[338] Of the existing provisions, the most notable is the heavy twofold subsidy for research and development (R&D) through both a tax credit directly reimbursing a portion of R&D expenses, and an immediate deduction for the remaining R&D expenses.[339] These tax subsidies have broad bipartisan support and funnel $13 billion a year toward private-sector R&D.[340] Creative activities by authors, photographers, and artists are deductible under a special provision.[341] Advertising and other expenses relating to creating and building trademarks are immediately deductible.[342] Looking beyond the U.S., many European

333. *Id.* at 320–21; *About Awards*, NAT'L SCIENCE FOUNDATION, http://www.nsf.gov/awards/about.jsp ("The [National Science Foundation] NSF funds research and education in science and engineering, through grants, contracts, and cooperative agreements.") (last visited Nov. 14, 2014); *Grants Process Overview*, NAT'L INSTITUTES OF HEALTH http://grants.nih.gov/grants/grants_process.htm (last visited Nov. 14, 2014).

334. *Grant Opportunities, Application Guidelines, and Resources for Managing Your Grant*, NAT'L ENDOWMENT FOR THE HUMANITIES, http://www.neh.gov/grants (last visited Nov. 14, 2014).

335. Hemel & Ouellette, *supra* note 332, at 317–19.

336. *L Prize Competition Overview*, U.S. DEP'T OF ENERGY, http://www.lightingprize.org/overview.stm (last visited Nov. 14, 2014).

337. *My Neighborhood Forest Photo Contest*, CHALLENGEPOST, http://urbanforest.challengepost.com (last visited Nov. 14, 2014).

338. Andrew Velarde, *Finance Committee Research Credit Amendment Is a Game Changer*, TAX NOTES TODAY, May 6, 2014; Press Release, H. Comm. on Ways & Means, Camp Releases International Tax Reform Discussion Draft (Oct. 26, 2011) (proposing inter alia an "innovation box").

339. 26 U.S.C. § 41 (2012) (tax credit directly reimbursing a portion of research and development (R&D) expenses); *id.* § 174 (immediate deduction for the remaining R&D expenses); *see also id.* § 280C(c) (limiting §174 deduction to expenditures not already fully-funded by the § 41 credit).

340. JOINT COMM. ON TAXATION, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012–2017, at 30 tbl.1 (2013).

341. 26 U.S.C. § 263A(h) (2012).

342. RJR Nabisco, Inc. v. Comm'r, 76 T.C.M 71, 1, 18 (1998).

countries offer "patent boxes" that provide special tax incentives for profits earned on patented inventions.[343]

The many policy levers listed above lack the deep problems of tolerating IP-based tax avoidance, which instead provides benefits only to multinationals,[344] creates large economic distortions,[345] and reduces the autonomy of creative professionals.[346] Hence, anyone who believes that IP currently provides its creators with insufficient rewards should instead press for more government grants, for more prizes, and for expansion of legitimate tax benefits, all of which can benefit small businesses and individuals.

F. Counterargument: Application to Transactions Between Unrelated Parties

This Article proposes that low transfer prices used by multinationals to transfer IP to tax-haven subsidiaries should be evidence against the multinational when it later asserts that IP. But would not this same logic apply to low transfer prices of IP between unrelated parties? For example, suppose that an individual inventor sold a patent for a low price to a manufacturer. Should that low sales price become evidence against the manufacturer if it subsequently asserts the patent?

Not necessarily. IP transactions between unrelated parties may result in distorted prices for two reasons. First, information asymmetry often exists between unrelated parties. In the example above, the individual inventor may not understand the full economic potential of the invention, while the manufacturer does, leading the inventor to accept a very low price for the patent.[347] Alternatively, while the inventor understands the technology and knows that it works as advertised, the manufacturer may not fully understand the technology or be confident that it works. As a result, the manufacturer would be willing to pay less for the patent.

The second distortion in price may come from different negotiating strengths. In the above example, the manufacturer may have highly experienced

343. Graetz & Doud, *supra* note 4, at 362.
344. *See* Part III.B.
345. *See* Part III.C.
346. *See* Part III.D.
347. *See* Burton & Weingust, *supra* note 218 (discussing the impact of "Uncertainty and Lack of Information" on patent purchase price).

negotiators, while the inventor may have no negotiating experience.[348] Or, the manufacturer may be the only plausible user of the invented technology. Alternatively, the inventor may need immediate cash and be unable to hold out for a higher price.

Neither of these distortions exists when a multinational transacts with its own subsidiary. No information asymmetry exists between the multinational and its subsidiary, which have the same management. The two have identical economic interests and do not actually bargain over the transfer price, eliminating distortions due to different negotiating strengths. Rather, the multinational must choose a transfer price that is arm's-length (backed up with rigorous appraisal documentation[349]) without either of these distortions, making it much more reliable evidence.

G. Consistency With IP Law's Extensive Use of Estoppel

This Article has proposed numerous natural extensions of IP law that defendants should advance (and that courts should accept) against multinationals that use IP for tax avoidance. These proposed extensions of IP law have a strong element of estoppel,[350] holding IP owners' own statements about value against them. This feature of this Article's proposals resonates with the strong policy preference for using estoppel and related equitable notions to shape substantive rights and remedies in IP law, as demonstrated by this Subpart.

Patent law, for example, has "prosecution history estoppel."[351] In the application process for a patent (called "prosecution"), the applicant may make arguments or amendments to get the Patent and Trademark Office to issue a patent containing the desired claims.[352] In subsequent litigation, those

348. *Id.* (noting the common divergence in negotiating skill between patent purchasers and sellers, and the impact on purchase price); *see also* Leonard & Rusek, *supra* note 217 (discussing the likely degree of divergence of negotiating power).

349. *See* supra note 34.

350. Quasi-estoppel also supports this Article's proposals. Quasi-estoppel "forbids a party from accepting the benefits of a transaction or statute and then subsequently taking an inconsistent position to avoid the corresponding obligations or effects." *In re* Davidson, 947 F.2d 1294, 1297 (5th Cir. 1991).

351. CHISUM ON PATENTS, *supra* note 25, §18.05; *e.g.* Festo Corp. v. Shoketsu Kinzoku Kogyo Kabushiki Co., Ltd., 535 U.S. 722 (2002). Trademark law also has prosecution history estoppel, although it is merely one factor to consider in trademark infringement. MCCARTHY ON TRADEMARKS, *supra* note 121, § 32:111.

352. CHISUM ON PATENTS, *supra* note 25, §18.05[2][a]–[c].

arguments or amendments estop the patent holder, thus substantively narrowing patent's scope and making it harder to show infringement.[353]

Patent law also includes the doctrine of "legal estoppel." Legal estoppel prevents the seller of one patent from claiming that the buyer infringes a second patent that the seller later acquires and is required to make the first patent work.[354]

Patent and trademark law both have "assignor estoppel," which prevents someone who sells IP from later challenging the IP's validity.[355] For example, the musicians in the rock band, "The Drifters," assigned the mark on their band's name to their manager.[356] One band member later left to start his own band, also called "The Drifters," and the manager naturally sued. The breakaway band member challenged the validity of the original mark, but assignor estoppel estopped this challenge.[357]

Trademark law has "licensee estoppel" that prevents a licensee from challenging the validity of a trademark that it has licensed from the owner.[358] The theory is that the licensee has confirmed the validity of the mark by agreeing to pay to license it.[359]

Copyright law's doctrine of "copyright estoppel"[360] reflects the crucial distinction that facts cannot be copyrighted, but fiction can.[361] Any author who represents that a creation is factual is estopped from subsequently claiming that it is fictional and therefore copyrightable. For example, the preface to the biography *Wyatt Earp, Frontier Marshall* stated (with self-puffery) that it was "in no part a mythic tale."[362] But much of this biography was actually pure fiction. A television show copied these fictionalized portions, and the biography's author sued for copyright infringement.[363] This

353. Conoco, Inc. v. Energy & Envtl. Int'l, L.C., 460 F.3d 1349, 1363–64 (Fed. Cir. 2006).
354. TransCore, LP v. Elec. Transaction Consultants Corp., 563 F.3d 1271, 1278–79 (Fed. Cir. 2009); CHISUM ON PATENTS, *supra* note 25, § 16.03[2][a][vi].
355. Diamond Scientific Co. v. Ambico, Inc., 848 F.2d 1220, 1224 (Fed. Cir. 1988); *see also* Westinghouse Elec. & Mfg. Co. v. Formica Insulation Co., 266 U.S. 342, 348–49 (1924). *See generally* CHISUM ON PATENTS, *supra* note 25, § 19.02[3][b][ii]; 3 MCCARTHY ON TRADEMARKS, *supra* note 121, §§ 18:16, 32:108.
356. Marshak v. Green, 505 F. Supp. 1054, 1056 (S.D.N.Y. 1981).
357. *Id.* at 1061.
358. MCCARTHY ON TRADEMARKS, *supra* note 121, § 18:63; Chrysler Motors Corp. v. Alloy Auto. Co., 661 F. Supp. 191 (N.D. Ill. 1987).
359. *Chrysler Motors Corp*, 661 F. Supp. at 192–93.
360. NIMMER ON COPYRIGHT, *supra* note 95, §§ 13.07[B]–§2.11[C].
361. *E.g.*, Sheldon v. Metro-Goldwyn Pictures Corp., 81 F.2d 49 (2d Cir. 1936).
362. Lake v. Columbia Broad. System, Inc., 140 F. Supp. 707, 708 (S.D. Cal. 1956).
363. *Id.*

suit failed under copyright estoppel, since the author had represented the biography as entirely factual, and facts cannot be copyrighted.[364]

Copyright law holds litigants to their tax law positions in many copyright ownership disputes. The Supreme Court, in *Community for Creative Non-Violence v. Reid*,[365] had to determine who owned the copyright to a statue: the sculptor or the organization that commissioned the sculpture.[366] Ownership depended on whether the sculpture was a "work made for hire," which in turn depended on whether the sculptor was the organization's "employee."[367] For tax purposes, the organization had treated the sculptor as an independent contractor, not an employee, which the Court found weighed toward the sculptor owning the copyright.[368] Subsequent copyright-ownership cases in lower courts have stated that the creator's tax treatment is "significant in virtually every situation,"[369] and can be a "virtual admission"[370] of the creator's copyright ownership.

Patent, copyright, and trademark law all allow for both equitable estoppel and the equitable doctrine of laches. Equitable estoppel bars IP owners from remedies—even against adjudged infringers—when the owner has misrepresented to the infringer that the owner will not enforce the IP, and the infringer has reasonably relied on that misrepresentation.[371] The related doctrine of laches bars IP owners from remedies—even against adjudged infringers—when the owner has been unreasonably slow in asserting the IP infringement, to the infringer's detriment.[372]

Trademark, patent, and copyright law all allow invalidation or unenforceability of IP for unethical conduct before the Patent and Trademark

364. 140 F. Supp. at 709; *accord* Nash v. CBS, Inc., 899 F.2d 1537 (7th Cir. 1990); Hoehling v. Universal City Studios, Inc., 618 F.2d 972 (2d Cir. 1980).
365. 490 U.S. 730 (1989).
366. *Id.* at 732.
367. 17 U.S.C. § 101(1) (2012).
368. *Community for Creative Non-Violence*, 490 U.S. at 752–53.
369. Aymes v. Bonelli, 980 F.2d 857, 861 (2d Cir. 1992); *accord* Farlow v. Wachovia Bank, 259 F.3d 309, 315 (4th Cir. 2001); Kirk v. Harter, 188 F.3d 1005, 1009 (8th Cir.1999).
370. *Aymes*, 980 F.2d at 862.
371. A.C. Aukerman Co. v. R. L. Chaides Constr. Co., 960 F.2d 1020, 1041–42 (Fed. Cir. 1992) (en banc) (equitable estoppel for patents); Hampton v. Paramount Pictures Corp., 279 F.2d 100, 104 (9th Cir. 1960) (equitable estoppel for copyrights); Nat'l Bus. Lists, Inc. v. Dun & Bradstreet, Inc., 552 F. Supp. 89, 97–99 (N.D. Ill. 1982) (equitable estoppel for copyrights); MCCARTHY ON TRADEMARKS, *supra* note 121, § 32:106 (equitable estoppel for trademarks; preventing customer confusion may sometimes override equitable estoppel).
372. *A.C. Aukerman Co.*, 960 F.2d at 1028–29 (citing Lane & Bodley Co. v. Locke, 150 U.S. 193 (1893)) (patent laches); Slifka v. Citation Fabrics Corp., 329 F. Supp. 1392 (S.D.N.Y. 1971) (copyright laches). *See generally* MCCARTHY ON TRADEMARKS, *supra* note 121, § 31:2 (trademark laches).

Office[373] or the Copyright Office.[374] These results—outright invalidation or unenforceability—are much harsher than this Article's proposal of admitting a low transfer price into evidence for judges and juries to consider.

* * *

To summarize, this Part has shown that this Article's proposed extensions of IP law are consistent with and further the policies and justifications underpinning IP law.

IV. FURTHER APPLICATIONS

Up to this point, this Article has focused on arguments relevant to patents, copyrights, and trademarks that are litigated under U.S. law, without any IRS involvement. This Part looks at how the same approach can have much broader impact: on IP that is licensed but never litigated, on nontraditional intangible property, in the international context, and with the IRS becoming involved.

A. Unlitigated IP: "Tainted" for Licensing

What about the vast majority of IP that is never litigated in court? IP generates substantial revenue for its owners from royalties paid by licensees who want to avoid being sued for infringement. Royalty rates are negotiated between the IP owner and licensees largely on the basis of factors such as the IP's likelihood of validity, its scope, the damages it could generate, and the likelihood of an injunction shutting down the licensee's business.[375] If courts adopt some or all of this Article's proposed extensions of IP law, multinationals would lose leverage in negotiating royalties. Multinationals who use IP for tax avoidance will find that IP "tainted," commanding lower royalties from licensees as well as becoming less effective in litigation.

B. Nontraditional Intangible Property

The three types of IP discussed so far (patent, copyright, and trademark) are the most common types of intangible property. But multinationals also

373. 60 Am. Jur. 2d Patents § 894; CHISUM ON PATENTS, *supra* note 25, at § 19.03A; 6 MCCARTHY ON TRADEMARKS, *supra* note 121, §§ 31:59–31:84.

374. Masquerade Novelty, Inc. v. Unique Indus., Inc., 912 F.2d 663, 667 (3d Cir. 1990).

375. eBay Inc. v. MercExchange, LLC, 547 U.S. 388, 396 (2006) (Kennedy, J., concurring) (asserting that "an injunction, and the potentially serious sanctions arising from its violation, can be employed as a bargaining tool" in licensing negotiations).

engage in tax avoidance through low transfer prices for other, more amorphous intangibles such as "workforce in place," customer lists, trade secrets, and corporate business opportunities.[376] The gambit is the same as with traditional IP: The intangibles are transferred at an early stage for a low price to a foreign subsidiary, with future profits escaping U.S. taxation.

Just as a patent's low transfer price should be held against its owner in subsequent litigation, there are many ways that the low transfer prices for amorphous intangibles can be held against their owners in subsequent litigation. For example, suppose that a multinational transfers a customer list for an artificially low price. A salesperson later leaves for a competitor and makes use of customer connections made while working for the multinational. The multinational will likely sue the competitor for both damages and an injunction against further use of the customer connections.[377] The competitor should be able to point to the low transfer price to argue for correspondingly lower damages.[378] The low price also should weigh against an injunction, not only demonstrating the adequacy of monetary remedies[379] but also casting the balance of hardships in an unfavorable light.[380] Additionally, the court could withhold damages and an injunction in light of the multinational's previous inequitable behavior (tax avoidance) with the customer list.[381]

Similarly, a multinational might transfer the amorphous intangible asset of "workforce in place" for an artificially low price. Later, if an employee who is part of that workforce decides to leave for a competitor, the multinational might well sue both the competitor and former employee for an injunction against the new employment relationship, as well as for damages.[382] The legal grounds might include breach of covenant not to compete and tortious interference with contractual employment relations.[383] The low price put on that employee's being "in place" should weigh against an injunction, for lower damages, and perhaps even for withholding all remedies.

376. DEP'T OF TREASURY, *supra* note 2, at 51; JCT REPORT, *supra* note 28, at 75.
377. *See, e.g.*, Morlife, Inc. v. Perry, 66 Cal. Rptr. 2d 731 (1997).
378. *Cf.* Part II.C.
379. *Cf.* Part II.D.2.
380. *Cf.* Part II.D.3.
381. *Cf.* Part II.E (discussing IP misuse, which is also equitable).
382. *See, e.g.*, Google, Inc. v. Microsoft Corp., 415 F. Supp. 2d 1018 (N.D. Cal. 2005) (part of litigation battle over star engineer Kai-Fu Lee leaving Microsoft for Google).
383. *Id.* at 1019.

C. International Usage

Most developed, non-tax-haven countries have seen their tax bases eroded by multinationals using IP-based strategies nearly identical to those described above,[384] resulting in extraordinary public anger and protests, particularly in austerity-weary Europe.[385] International organizations have promised action plans,[386] but no action has yet been forthcoming. This Article's proposed extension of IP law to fight tax avoidance can largely be used in other countries' IP law as well.[387]

D. IP Defendants as Whistleblowers to the IRS

The arguments proposed in Part II would discourage multinationals from using their IP to avoid taxes, without any involvement by the IRS or Congress, by harnessing the self-interest of defendants sued by multinationals. But defendants' self-interest can provide an additional form of deterrence when coupled with the tax whistleblower statute.[388] If a whistleblower brings "specific and credible information"[389] to the IRS, and the IRS uses that information to detect and collect underpayments of tax,[390] then the whistleblower is entitled to receive between 15 and 30 percent of the total collected proceeds.[391]

384. *See* Sheppard, *supra* note 56, at 467–68; Sheppard, *supra* note 78; *see also* Schechner, *supra* note 1 (discussing France challenging Google's tax setup).
385. *See* sources cited *supra* note 61.
386. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING 20 (2013), *available at* http://www.oecd.org/ctp/BEPSActionPlan.pdf.
387. IP law is increasingly harmonized between countries. *See* WORLD INTELLECTUAL PROPERTY ORG., PATENT LAW HARMONIZATION, *available at* http://www.wipo.int/patent-law/en/patent_law_harmonization.htm (last visited Mar. 20, 2014).
388. 26 U.S.C. § 7623.
389. 26 C.F.R. § 301.7623-1(c)(1).
390. 26 U.S.C. § 7623(a); 26 C.F.R. § 301.7623-1(a).
391. 26 U.S.C. § 7623(b)(1). Note that the award would be lower, capped at 10 percent of the IRS's collected proceeds, if the disclosure was based "principally on disclosures of specific allegations . . . resulting from a *judicial* or administrative *hearing*, from a governmental report, hearing, audit, or investigation, or from the news media." *Id.* § 7623(b)(2) (emphases added). One could argue that if a hearing before a magistrate on a discovery matter ultimately led an IP defendant to learn about a plaintiff-multinational's tax avoidance, then the 10 percent cap would apply. But that would be a strained reading of the statute, since it was the discovery request (not the judicial hearing on the discovery request) that ultimately resulted in the disclosure. Moreover, this provision shows a clear congressional purpose of capping recovery at 10 percent for whistleblowers who merely take publicly available information to the IRS. *See* 26 C.F.R. §301.7623-4(c)(2)(iii) (example of whistleblower who disclosed to the IRS that a taxpayer was criminally charged with embezzling funds). The canon of *noscitur a sociis*,

A defendant[392] sued by a tax-avoiding multinational is perfectly placed to come across the requisite "specific and credible information" demonstrating that the multinational underpaid its tax. On one hand, the defendant can discover the low transfer prices for the multinational's IP. On the other hand, in the IP litigation, the multinational presents arguments and expert reports justifying much higher damages, which show that the IP has higher value. These two sources of information combine into the requisite specific evidence of the multinationals' underpayment of taxes.[393] The IRS can use this evidence to audit the multinational and challenge its low transfer pricing, collecting additional tax proceeds, of which between 15 and 30 percent would go to the defendant.[394] The tax whistleblower statute thus provides yet another way for IP defendants sued by multinationals to benefit from the multinationals' tax avoidance.[395]

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meaning that "a word is known by the company it keeps," further supports interpreting "resulting from a judicial . . . hearing" to encompass only information made public at a judicial hearing, akin to "government reports" or "news media reports." *See* Gustafson v. Alloyd Co., 513 U.S. 561, 575 (1995) (applying *noscitur a sociis*). In sum, the 10 percent cap is unlikely to ever apply to IP defendants, who should instead be entitled to recovery in the 15 to 30 percent range.

392. The statute and regulations refer to whistleblowers as "individuals." 26 U.S.C. § 7623(b); 26 C.F.R. § 301.7623-1(b)(1). If the defendant is an entity like a corporation, then any individual agent of the entity can act as the whistleblower, provided she has sufficient knowledge of the plaintiff-multinational's tax underpayments to be able to submit the information with a declaration "under penalty of perjury that I have examined this application, my accompanying statement, and supporting documentation and aver that such application is true, correct, and complete, to the best of my knowledge." 26 C.F.R. § 301.7623-1(c)(3); *see also* 26 U.S.C. § 7623(b)(6) (requiring information be "submitted under penalty of perjury"). An attorney representing a defendant entity is an ideally placed individual agent of the defendant for these purposes. Of course, the defendant's agent would generally be required to turn over the whistleblower award from the IRS to the defendant. RESTATEMENT (THIRD) OF AGENCY § 8.02 (2006).

393. *Cf.* Andrew Velarde & David Sawyer, *Vanguard Associate Counsel Alleges Tax Evasion Against Company*, 144 TAX NOTES 540 (2014) (discussing whistleblower suit and accompanying whistleblower report to the IRS under § 7623, both premised on the accused corporation's inaccurate pricing).

394. 26 U.S.C. § 7623(b)(1).

395. The three-year statute of limitations for the IRS to assess additional taxes on the multinational may limit the amount of collected proceeds. *See* 26 U.S.C. § 6501(a). But this statute of limitations does not prevent the IRS (and hence the whistleblowing defendant) from recovering from a multinational who transferred IP to avoid taxes more than three years before the whistleblower providing information. For transfers of IP, the IRS has the ability to force a readjustment upwards of the consideration "in a subsequent taxable year without regard to whether the taxable year of the original transfer remains open for statute of limitation purposes." 26 C.F.R. §1.482-4(f)(2)(i). Evidence coming from the multinational's own damage expert about the high profitability or royalty potential of the IP would seem to be very helpful for the IRS to force such an adjustment. *Id.* ("The district director may consider all relevant facts and circumstances throughout the period the intangible is used"). As a

V. IP LAW AND TAX LAW'S FAILURE TO INTERACT

In Part II, this Article proposed fifteen natural extensions of IP law that IP defendants can and should advance when sued by multinational corporations who have used the IP to avoid taxes.[396] Fourteen of these have never been proposed by scholars or argued for in court, in any form.

Just one of the fifteen—that patent transfer prices are relevant to patent damages—has been proposed by commentators[397] or made in court. Litigants have made variants of this argument in only two cases.

One case involved Mars, Inc., the U.S. multinational famous for making M&Ms,[398] which owned both U.S. and British patents on the coin-accepting technology used in vending machines. Mars had licensed all these patents to its U.K. subsidiary, which apparently made no use whatsoever of the license on the U.S. patents,[399] but did use the British patents to sell coin acceptors in the U.K.[400] In exchange for getting the license, the U.K. subsidiary paid a royalty to Mars.

This arrangement appears not to have had any tax-avoidance motivation. The U.S. and U.K. had nearly the same corporate tax rate over all

result, the collections from the whistleblowing would be the three years of higher taxes from such an upward adjustment.

396. These are two on invalidity in Part II.A, four on scope in Part II.B, three on damages in Part II.C, three on injunction requirements in Part II.D, plus patent, trademark, and copyright misuse in Part II.E.

397. BOUSHIE ET AL., *supra* note 210 (stating that tax-motivated transfer pricing studies are "perceived to be rigorous analyses of value" that are "potentially probative information that an expert and the court would consider in establishing a reasonable royalty").

398. Brief for Appellant (Mars), Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359 (Fed. Cir. 2008), 2007 WL 2425911, at 3 ("The Mars family of companies probably is best known for its confectionary products, including M&M's(R) chocolate candies.").

399. Both sides agreed on this matter. *See* Appellee's Opening Brief, Mars, Inc. v. Coin Acceptors, Inc., 527 F.3d 1359 (Fed. Cir. 2008), 2007 WL 3218899 ("In the United States, MEI [which was not the U.K. subsidiary] was the *sole* Mars subsidiary that made and sold coin acceptors") (emphasis added); Appellant's Reply Brief, 2007 WL 4404124 ("Mars showed by declaration that MEI-UK did not do business in the United States"). A license to a U.S. patent (as Mars' U.K. subsidiary received) grants authority to make, use, offer to sell, or sell the patented invention "within the United States" or to "import[] into the the United States" the patented invention. *See* 35 U.S.C. § 271(a). Therefore, Mars' U.K. subsidiary (MEI-UK) cannot have made any use of the license it received to the U.S. patents. Further evidence that MEI-UK did not use the U.S. patents came from the testimony of Mars Corporate Tax Director, who testified that MEI-UK "could" have imported coin acceptors covered by the U.S. patents into the U.S., strongly implying that MEI-UK had not done so. *Mars*, 527 F.3d at 1368.

400. Appellee's Opening Brief, 2007 WL 3218899 ("In the United Kingdom, Mars owned a company called MEI-UK that sold coin acceptors there").

relevant years.[401] While paying the royalties reduced the U.K. subsidiary's U.K. taxes, Mars' U.S. taxes increased from receiving the royalties.[402] In sum, this arrangement bore no resemblance to the IP-based tax-avoidance strategies discussed earlier in Part I, with IP transferred to tax havens.

But the U.K. tax authorities felt that the royalty rate was too high, being above the arm's-length rate, allowing Mars' U.K. subsidiary to pay too little in U.K. taxes.[403] In 1996, under threat of litigation with the U.K. tax authorities, Mars and its U.K. subsidiary lowered the royalty rate to 4 percent.[404] Mars likely had little incentive to resist the U.K. tax authorities' demands, since the lower royalty payments would lower Mars' own U.S. taxes.[405] Unlike voluntary IP transfers within multinationals, which today must have prices supported by rigorous appraisal documentation,[406] this settlement with the U.K. tax authorities appears to have involved no such appraisal documentation.

Mars sued a competitor in federal district court in New Jersey for infringing its U.S. coin-acceptor patents, in *Mars, Inc. v. Coin Acceptors, Inc.*[407] The competitor rather disingenuously argued that damages should be limited to the 4 percent royalty rate reached to settle the dispute with the U.K. tax authorities.[408] Quite correctly, the district court judge gave little weight to this 4 percent royalty rate,[409] observing that "the record does not tell me anything about" the transactions with Mars' U.K. subsidiary.[410] Indeed,

401. *Compare* U.K. National Archives, *Rates of Corporation Tax*, http://webarchive.nationalarchives.gov.uk/20130103022348/http://www.hmrc.gov.uk/statistics/ct-receipts/table-a6.pdf (showing main corporate tax rates between 35 percent and 33 percent between 1986 and 1996, the years at issue), *with* 26 U.S.C. § 11(b)(1)(D) (1994) (showing main corporate tax rate as 35 percent).
402. 26 U.S.C. § 61(a)(6).
403. 527 F.3d at 1363, 1373.
404. *Id.* This settlement also involved MEI, a U.S. subsidiary of Mars. *Id.* Just like Mars, MEI was subject to immediate U.S. taxation, so the involvement of MEI had no apparent impact on the tax incentives. *Id.*
405. The tax treaty between the U.S. and U.K. provides a mechanism for the IRS and the U.K. tax authorities to work out matters—such as royalty rates—so that one country's deductions match up with the other country's income from the same transaction. Income Tax Treaty, U.S.-U.K., Dec. 31, 1975, Art. 25 (tax treaty covering relevant years). *See generally* JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION ¶ C4.21[1], [2] (rev. ed. 2014) (discussing these mutual agreement procedures).
406. *See supra* note 34.
407. Trial Transcript at 15, 90CV00049 (D.N.J. Apr. 20, 2007) (90-CV-00049-JCL), 2007 WL 5396179 [hereinafter Trial Transcript] (opinion delivered from bench), *aff'd*, 527 F.3d 1359, 1373 (Fed. Cir. 2008), *mandate recalled and amended by* 557 F.3d 1377 (Fed. Cir. 2009) (specifying postjudgment interest award).
408. *Mars*, 527 F.3d at 1373; Trial Transcript, *supra* note 407, at 15:12–15.
409. Trial Transcript, *supra* note 407, at 15:24–25 (the Judge said of the 4 percent settlement with the U.K. taxing authorities, "I regard it as of little relevance").
410. *See* Trial Transcript, *supra* note 407, at 15:21–22.

Mars' U.K. subsidiary did not even use the U.S. patents that were at issue in the infringement litigation,[411] making the 4 percent royalty rate irrelevant.[412]

In sum, *Mars v. Coin Acceptors* is easily distinguishable from situations where this Article's proposed extensions of IP law would apply. The 4 percent royalty rate was apparently not supported by any appraisal documentation, let alone the rigorous documentation now required for transfer prices. Indeed, Mars likely cared little what the royalty rate was. Most damningly, the 4 percent rate was paid for using patents other than the ones being litigated.

More recently, in a patent suit brought in the Northern District of Georgia, *Interface, Inc. v. Shaw Industries, Inc.*, the defendants planned to introduce the plaintiff's transfer prices as damages evidence.[413] But the case settled before the court ruled on the matter.[414]

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411. *See supra* notes 399–400.

412. There are additional reasons why the 4 percent royalty agreed upon with the U.K. taxing authorities was not reliable evidence. First, it was reached under threat of litigation from a governmental authority. Trial Transcript, *supra* note 407, at 15:23–24 (describing the absence of information that would dispel an inference that it was not an arm's length transaction); *Mars*, 527 F.3d at 1373 (explaining that the royalty rate resulted from negotiation with United Kingdom taxing authorities). Courts have long viewed licenses negotiated under the threat of litigation as less reliable. *See* RICHARD B. TROXEL & WILLIAM O. KERR, CALCULATING INTELLECTUAL PROPERTY DAMAGES § 5:28 (rev. 2014). The threat of litigation with a government with nearly unlimited resources is even less reliable. Second, Mars had little incentive to fight the U.K. taxing authority when it would likely get some or all of the money back from the IRS in the form of lower U.S. taxes on the lower royalty. *See* discussion *supra* notes 401, 402, 405 and accompanying text. Third and finally, an arm's-length royalty reached between two unrelated parties (which the settlement with the U.K. purported to be) might differ from the royalty reached between two unrelated parties who were competitors. *See Mars*, 527 F.3d at 1373. As discussed *supra* note 222 and accompanying text, in litigation between competitors, transfer prices are very relevant data for determining damages but may need to be adjusted upwards if the infringer is a competitor.

413. Brief in Support of Interface's Motion to Exclude Evidence, Opinions, and Argument Concerning Royalty Rates in Interface's Intracompany Agreements and Transfer Pricing Documentation, Collins & Aikman Floor Coverings, Inc. v. Interface, Inc., Nos. 05-CV-0133-HLM, 05-CV-0189-HLM, 05-CV-0190-HLM, 05-CV-0191-HLM, 2007 WL 6080636 (N.D. Ga. Apr. 13, 2009).

414. Stipulated Motion for Dismissal, Collins & Aikman Floor Coverings, Inc. v. Interface, Inc., Nos. 05-CV-0133-HLM, 05-CV-0189-HLM, 05-CV-0190-HLM, 05-CV-0191-HLM, 2007 WL 6080636 (N.D. Ga. June 1, 2009), 2009 WL 2707074. Additionally, in recent pharmaceutical litigation, the defendant argued that the plaintiffs' tax transfer prices for physical pills (not for the patent itself) limited damages. Glenmark's Motion in Limine No. 4: To Preclude Plaintiffs from Arguing that Any Party Other Than Abbott Laboratories Inc. Is Entitled to Lost Profits, Sanofi-Aventis Deutschland GmbH v. Glenmark Pharm., Inc., 821 F. Supp. 2d 681 (D.N.J. Jan. 31, 2011) (No. 07-CV-05855 DMC-JAD, Dkt. No. 335), 2011 WL 1193603. But the court never even reached this argument, disposing of it on a threshold issue. Sanofi-Aventis Deutschland GmbH v. Glenmark Pharm., Inc., No. 07-CV-05855- DMC-JAD, 2011 WL 383861, at *9-*10 (D.N.J. Feb. 3, 2011).

Why have IP defendants failed to take advantage of tax-motivated IP transfer pricing? One plausible explanation is that many IP defendants are themselves multinationals who engage in IP tax avoidance and thus do not want to make arguments that might undermine their own IP. But this explanation is lacking for three reasons.

First, the cost-benefit analysis for any multinational that is the defendant in an IP suit will typically favor making these arguments. The potential benefits are immediate, as the multinational has arguments to defend against the suit. But the potential costs materialize only if the arguments are successful and, even then, only to the extent that the multinational has IP vulnerable to the same successful argument. In other words, if a multinational deploys transfer-pricing arguments, there is no guarantee that the same arguments can be used against them, even if the court accepts the arguments.

Second, multinationals vary widely in their propensity to be IP plaintiffs versus IP defendants. For example, Microsoft has been the plaintiff in apparently only a tiny handful of patent suits over its four-decade history[415] but has been the defendant in countless patent suits.[416] Multinationals like Microsoft have long had strong incentives to make these arguments.

415. Gregg Keizer, *Microsoft Sues Salesforce.com Over 'Crown Jewel' Patents*, COMPUTERWORLD (May 18, 2010), *available at* http://www.computerworld.com/article/2517725/crm/microsoft-sues-salesforce-com-over—crown-jewel—patents.html ("In Microsoft's 35-year history, it's accused others of infringing its patents only three times before today [when it filed a fourth patent infringement suit]."); *see also* Andrew Longstreth, *Waaaiiit, Microsoft Is a Patent Plaintiff? Rare Occasion for Software Giant*, AM. LAWYER (May 21, 2010). Since May 2010, Microsoft has asserted its patents several additional times. *See, e.g.*, Press Release, Microsoft, Microsoft Files Patent Infringement Action Against Motorola (Oct. 1, 2010), *available at* http://www.microsoft.com/en-us/news/press/2010/oct10/10-01statement.aspx; Press Release, Microsoft, Microsoft Takes Legal Action Against Barnes & Noble, Foxconn and Inventec for Patent Infringement by Android Devices (Mar. 21, 2011), *available at* http://www.microsoft.com/en-us/news/press/2011/mar11/03-21corpnewspr.aspx. These facts suggest that Microsoft may have very recently decided to become more aggressive at asserting its patents; even if this is so, Microsoft's many prior years as disproportionately being a patent defendant gave it every incentive and plentiful opportunities to make the arguments proposed in this Article. It did not.

416. *See, e.g.*, MICROSOFT CORP., ANNUAL REPORT FOR FISCAL YEAR ENDED JUNE 30, 2014, FORM 10-K, at 84–86, *available at* http://www.sec.gov/Archives/edgar/data/789019/000119312514289961/d722626d10k.htm (listing various specific patent suits against Microsoft and adding that "[i]n addition to these cases, there are approximately 90 other patent infringement cases pending against Microsoft"); MICROSOFT CORP., ANNUAL REPORT FOR FISCAL YEAR ENDED JUNE 30, 2013, FORM 10-K, at 78–81, *available at* http://www.sec.gov/Archives/edgar/data/789019/000119312513310206/d527745d10k.htm (listing various specific patent suits against Microsoft and adding that "[i]n addition to these cases, there are approximately 65 other patent infringement cases pending against Microsoft").

Third, deep-pocketed governments and deep-pocketed nonprofits like universities are often IP defendants.[417] But governments and nonprofits do not engage in IP-based tax avoidance and should have no hesitation in making arguments based on low transfer prices.[418]

There are more prosaic explanations for why fourteen of this Article's extensions of IP law have never before been proposed by scholars or argued in court. These include legal specialization, corporations' organizational structures, different outside firms, and the persistence of pre–1993 views of transfer prices as tax fictions.

First, both tax law and IP law are intellectually challenging fields that require their practitioners and scholars to acquire a great deal of specialized knowledge.[419] This specialization leaves IP scholars and IP litigators little time to ponder multinationals' bizarre-seeming tax-avoidance strategies. My discussions with a number of extremely bright IP litigators indicate that most are not aware of multinationals' IP-based tax-avoidance schemes.[420] This divide has been exacerbated by the dearth of scholarship at the intersection of tax law and IP law.

Second, the organizational structures of IP defendants that are corporations may also help to explain their failure to develop these arguments. Tax planning, such as transfers of IP to reduce taxes, is often handled in a tax department reporting to the corporation's Chief Financial Officer. By contrast, IP litigation tends to be handled through attorneys reporting to the corporation's General Counsel.

Third, the outside professional organizations handling IP tax avoidance and IP litigation rarely overlap. Accounting firms and economic consulting

417. *E.g.*, United States v. Adams, 383 U.S. 39 (1966) (patent suit against federal government); Madey v. Duke Univ., 307 F.3d 1351 (Fed. Cir. 2002) (patent suit against tax-exempt university); *In re* NYC & Co., Trademark Application No. 77,179,942 (trademark dispute between city and Apple, Inc.).

418. 26 U.S.C. § 501(a) & (c)(3) (exempting nonprofit educational and scientific organizations from tax); *id.* § 115 (exempting state and local governments from tax).

419. Hemel & Ouellette, *supra* note 332, at 306 (noting the failure of IP scholars to look at relevant tax law). I have attempted to bridge the gulf between the two practice areas, at least on the subject matter of this article. Andrew Blair-Stanek, *IP Law Solutions to Transfer Pricing Abuse*, 143 TAX NOTES 1537 (2014) (publication read regularly by tax practitioners); Andrew Blair-Stanek, *The Untapped Gold Mine of Transfer-Price Evidence*, IP LAW360 (July 25, 2014) (publication read regularly by IP practitioners), *available at* http://ssrn.com/abstract=2473815.

420. *Cf.* Gregg D. Polsky & Dan Markel, *Taxing Punitive Damages*, 96 VA. L. REV. 1295, 1305–06, 1306 n.24 (2010) (investigating similar lack of arguments by tort plaintiffs lawyers for tax-aware arguments on punitive damages).

firms handle much of the transfer of IP for artificially low prices.[421] Meanwhile, IP litigation is handled by law firms.

Fourth, even IP litigators who are aware that IP is used as a tax-avoidance vehicle may view IP transfer prices as mere fictions adopted for tax purposes.[422] Before 1993, IRS examiners found that the majority of multinationals were "unable to provide an explanation of how their intercompany pricing was established."[423] When audited, multinationals simply created a post hoc justification for the IP transfer price.[424] Thus, before 1993, transfer prices often had an element of fiction. But in 1993, Congress adopted the requirement of contemporaneous, rigorous expert appraisal documentation for transfer prices.[425] This documentation has indeed become quite intellectually rigorous,[426] even if it generally results in the lowest justifiable price.[427] This documentation, plus multinationals' attesting to the prices under penalties of perjury,[428] means courts can no longer ignore transfer prices as fictions.[429]

CONCLUSION

This Article argues that tax avoidance can be addressed through IP law—an approach that scholars have not previously considered. IP defendants and courts can deploy the low transfer prices that multinationals assign to IP to

421. *See* Brauner, *supra* note 8, at 81 n.3; *see, e.g.*, *Transfer Pricing and Tax Effective Supply Chain Management*, ERNST & YOUNG, http://www.ey.com/US/en/Services/Tax/Transfer-pricing-and-tax-effective-supply-chain-management (last visited Nov. 14, 2014); *Transfer Pricing*, APPRAISAL ECONOMICS, INC., http://www.appraisaleconomics.com/range-of-services/transfer-pricing (last visited Nov. 14, 2014); *Transfer Pricing*, PRECISION ECONOMICS, LLC, http://www.precisionecon.com/category/services/transfer-pricing (last visited Nov. 14, 2014).
422. A contract-interpretation dispute involving years before 1993 illustrates the arbitrary nature of pre-1993 transfer prices. De Puy, Inc. v. Biomedical Eng'g Trust, 216 F. Supp. 2d 358, 365 (D.N.J. 2001) (labeling transfer prices between 1979 and 1987 as "arbitrary prices set solely for internal tax and bookkeeping purposes").
423. Proposed Rules: Imposition of Accuracy-Related Penalty, 58 Fed. Reg. 5304, 5304 (proposed Jan. 21, 1993).
424. H.R. REP. No. 103-111, at 719–20 (May 25, 1993), *reprinted in* 1993 U.S.C.C.A.N. 378, 950–51.
425. Revenue Reconciliation Act of 1993, Pub. L. No. 103-66, § 13236(b), 107 Stat. 312, 505 (adding the contemporaneous documentation requirement at 26 U.S.C. § 6662(e)(3)(B)(i)); *see also* Culbertson, *supra* note 34, at 17.
426. SMITH, *supra* note 194, at 29–30 (explaining these requirements have increased the rigor of transfer-pricing documentation); BOUSHIE ET AL., *supra* note 210, at § 6.06[1][b] (stating that tax transfer-pricing reports are "perceived to be rigorous analyses of value").
427. Sheppard, *supra* note 5, at 1112 ("[A]ppraisers tend to agree with their paymasters on [valuation] questions.").
428. *See supra* note 93.
429. *Cf. supra* notes 196–198 and accompanying text (discussing recent non-IP case finding tax transfer prices to be the best measure of damages).

avoid taxes as evidence of invalidity, noninfringement, low damages, the inappropriateness of injunctions, and misuse. These arguments are natural extensions of existing case law and are consistent with the policy and philosophical justifications for IP law. This exciting new approach, of fighting tax avoidance by changing IP law, promises to be a fertile area for policymakers, scholars, and litigators.