

BETTER TO GIVE THAN TO RECEIVE: EVALUATING RECENT IP DONATION TAX POLICY CHANGES

DON MACBEAN¹

ABSTRACT

Over the past decade, charitable contributions of intellectual property have grown rapidly. This growth has coincided with tremendous abuse as firms have sought inflated valuations of donated intellectual property in order to claim larger tax deductions. In 2004, Congress responded by passing section 882 of the American Jobs Creation Act, which drastically changed the rules governing donations of intellectual property. This iBrief argues that Congress, in addressing overvalued intellectual property donations, went too far in its efforts by failing to fully consider the importance of positive donor incentives. After discussing other proposed policies, this iBrief suggests a hybrid policy that combines strong donor incentives with protective measures against overvaluation.

INTRODUCTION

¶1 For many corporations, donating “orphan patents”² and other intellectual property (IP) to tax-exempt entities is much more than just a philanthropic endeavor. Tax deductions for these donations³ make them an effective means of cutting costs.⁴ While the Internal Revenue Service (IRS)

¹ J.D. Candidate 2006, Duke University School of Law; B.A. in Economics, 2003, Brigham Young University. He is currently serving as managing editor of the Duke Law & Technology Review.

² Orphan patents are patents that are inconsistent with a company’s main technologies, are poor candidates for licensing to third parties, and have no defensive competitive market purposes. RON LAYTON & PETER BLOCH, IP DONATIONS: A POLICY REVIEW 5 (Int’l Intellectual Prop. Inst. 2004) at http://www.iipi.org/reports/IP_Donations_Policy_Review.pdf [hereinafter IP DONATIONS].

³ See I.R.C. § 170(a)(1) (LexisNexis 2005) (providing a general deduction for charitable contributions).

⁴ DR. DAVID MARTIN, SPECIAL REPORT: PATENT DONATIONS 2 (M-CAM 2003) (identifying beneficial consequences of donating intellectual property) at http://www.m-cam.com/downloads/20030108_donation-whitepaper.pdf. Because maintaining patents requires the payment of annual fees, patent donation not only results in tax deductions but it also lowers the costs of the donor.

has explicitly condoned this practice for at least 40 years,⁵ only recently have corporations begun to see its far reaching benefits.⁶ Unfortunately, the recent proliferation of IP donations has been accompanied with abuse as some donors have overstated the value of their donations in an effort to claim inflated tax deductions.⁷

¶2 In response to this and other concerns, Congress drastically changed the law regarding the charitable donation of IP by enacting section 882 of the American Jobs Creation Act of 2004 (Creation Act),⁸ which is currently part of section 170 of the Internal Revenue Code (IRC).⁹ Instead of permitting a fair market value (FMV) deduction of the donated IP, Congress limited the allowable deduction to the lesser of the property's FMV or cost basis.¹⁰ Section 882 allows additional deductions on the donated property's future revenue on a decreasing sliding-scale basis.¹¹ This iBrief explains the steps leading up to Congress's modification of the tax law that governs IP donations, and focuses on one of Congress's leading motivators: the overvaluation of IP.¹² It then argues that while Congress's legislation effectively deals with the problem of overvalued IP donations, it failed to fully consider the importance of donor incentives. After considering alternative policies, this iBrief proposes a hybrid policy that minimizes the overvaluation of IP while still preserving strong incentives for donations.

⁵ Rev. Rul. 58-260, 1958-1 C.B. 126.

⁶ Ron Layton & Peter Bloch, *Please Donate Patents on the Shelf: Tax Benefits Can be Focused for Greater Good*, 27 LEGAL TIMES 30 (2004) [hereinafter *Greater Good*].

⁷ See 150 CONG. REC. S. 11019-20 (daily ed. Oct. 10, 2004) (statement of Sen. Grassley). See also Fred Stokeld, *EO Provisions in Bush Budget Aimed at Stopping Abuses*, 102 TAX NOTES 699, 700-01 (Feb. 9, 2004) (explaining a proposal aimed at stopping excessive deductions due to overvaluation of intellectual property) [hereinafter *Stopping Abuses*].

⁸ H.R. CONF. REP. NO. 108-755, at 532-35 (2004) (comparing section 682, later changed to 882, of H.R. 4520 with previous law), available at <http://waysandmeans.house.gov/media/pdf/hr4520/hr4520conreptmgrsstatement3.pdf> [hereinafter CONFERENCE REPORT].

⁹ H.R. 4520, 108th Cong. § 882 (2004).

¹⁰ I.R.C. § 170(e)(1)(B) (LexisNexis 2005); H.R. 4520, 108th Cong. § 882 (2004). The cost basis for IP generally consists of the asset's historical cost less accumulated depreciation. See 26 CFR 1.167(a)-6 (2000).

¹¹ I.R.C. § 170(m)(7) (LexisNexis 2005).

¹² See I.R.S. Notice 2004-7, 2004-3 I.R.B. 310 (listing four primary concerns of the IRS with respect to charitable contributions of IP).

I. EVENTS LEADING UP TO THE NEW LEGISLATION.

A. *History of Charitable IP Donations*

¶3 The practice of claiming charitable deductions for donated IP is of fairly recent origin.¹³ The IRS first addressed this practice in the late 1950s through Revenue Ruling 58-260,¹⁴ giving taxpayers explicit authority to claim deductions for IP donated to certain qualified entities such as universities.¹⁵ Despite this ruling, the level of charitable IP donations remained stagnant¹⁶ until the Bayh-Dole Act of 1980¹⁷ provided a conducive environment for donations. This Act empowered universities and other not-for-profit organizations to reap the commercial benefits of patents developed through federally funded research¹⁸ and provided incentive for these entities to develop the infrastructure necessary to accept large-scale IP donations.¹⁹ Only then did the charitable contribution of IP begin to proliferate.²⁰

¶4 Prior to the enactment of Section 882, the IRS permitted IP holders to deduct the FMV of IP donated to qualified not-for-profit entities.²¹ The policy behind this long-standing tradition was to encourage philanthropy by allowing taxpayers to contribute to their chosen charitable organizations at a subsidized cost.²² However, faith in this system began to waiver due to a variety of abuses during the late 1990s, such as the overvaluation of corporate IP donations.²³ Responding to growing discord, the IRS issued a series of statements²⁴ and notices,²⁵ including one specifically warning

¹³ IP DONATIONS, *supra* note 2, at 4.

¹⁴ *Id.*

¹⁵ Rev. Rul. 58-260, 1958-1 C.B. 126; IP DONATIONS, *supra* note 2, at 4; *See* I.R.C. § 501(c) (2000) (defining exempt organizations).

¹⁶ IP DONATIONS, *supra* note 2, at 4.

¹⁷ 35 U.S.C. § 200-12 (2000).

¹⁸ *Id.*

¹⁹ *Id.* at 5.

²⁰ *See* IP DONATIONS, *supra* note 2, at 4.

²¹ I.R.C. § 170(e)(B) (2000); CONFERENCE REPORT, *supra* note 8, at 532.

²² JACOB MERTEN, MERTENS LAW OF FEDERAL INCOME TAXATION § 31:01 (Westlaw 2003). The cost is subsidized in the sense that the allowable tax deductions for the value of a charitable donation reduces the economic cost of the donation.

²³ Press Release, Sen. Chuck Grassley, U.S. Sen. Comm. on Finance, Grassley Advances Crackdown on Car, Intellectual Property Donation Abuses (Oct. 6, 2004), at <http://finance.senate.gov/press/Gpress/2004/prg100604d.pdf> [hereinafter Press Release]; Fred Stokeld, *JOBS Act Would Halt Inflated Values of Charitable Donations*, 44 EXEMPT ORG. TAX REV. 285 (Jun. 2004).

²⁴ *See, e.g., Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities, Hearing Before the Comm. on Finance, U.S.*

taxpayers and IP “promoters and appraisers”²⁶ that abuse of the charitable donation provisions of the tax code may result in penalties.²⁷

B. What Caused the Abuse?

¶5 By the early 1990s, the growing importance of IP resulted in creation of a “new measure of corporate assets: IP Asset Management.”²⁸ In response, several national accounting firms formed special consulting groups to help corporations manage their inventory of patents and other IP.²⁹ Consultants soon realized that many corporations “were spending millions of dollars a year on [patent] maintenance fees,”³⁰ some of which were protecting orphan patents that were not even being used.³¹ Consultants and company executives alike realized that prudent cost management required donating or abandoning these orphan patents.³² For many corporations, the tax benefits associated with donation made it an attractive option.³³ The goodwill generated by charitable contributions, both within the community and with the donee, provided corporations with another reason to donate IP.³⁴

1. Factors Facilitating the Abuse

¶6 Given the financial benefits of donating orphan patents and other IP, some abuse of the system is not surprising. This abuse has been facilitated primarily by the difficulty of valuing IP³⁵ and the lack of strict

Senate, 108th Cong. (June 22, 2004) (written statement of Mark W. Everson, Commissioner of Internal Revenue), *available at* <http://finance.senate.gov/hearings/testimony/2004test/062204metest.pdf>.

²⁵ I.R.S. Notice 2004-7, 2004-3 I.R.B. 310; *see also* Rev. Rul. 2003-28, 2003-1 C.B. 594.

²⁶ I.R.S. Notice 2004-7, 2004-3 I.R.B. 310.

²⁷ *Id.*; *see also* I.R.C. §§ 6662, 6700, 6701, 6694 (West Supp. 2004).

²⁸ IP DONATIONS, *supra* note 2. Corporations often divide their assets into subgroups for accounting and other purposes (e.g. accounts receivable). IP Asset Management is one such subgroup, comprised solely of IP.

²⁹ *Id.*

³⁰ *Greater Good*, *supra* note 6 (describing the wasted fees of “innovative companies like the IBM Corp.”).

³¹ *Id.*

³² IP DONATIONS, *supra* note 2.

³³ *See* Barnaby J. Feder, *Patent Donations Are Novel Corporate Gift*, N.Y. TIMES, Nov. 17, 2002, at §3 page 5 (explaining that one corporation experienced a 3% reduction in its average tax rate due to patent donations); *see also Greater Good*, *supra* note 6 (relating that a company claimed a savings of over \$40 million during a five year period from donating patents).

³⁴ MARTIN, *supra* note 4.

³⁵ Terri W. Cammarano & Richard F. Riley, Jr., *Valuation Remains the Toughest Issue When Donating Patents*, 7 VALUATION STRATEGIES 18 (2003);

appraisal standards and guidelines.³⁶ Valuation of IP is difficult in part because patents confer a right to prevent someone else from doing something, making their value somewhat dependent on the willingness of the holder to sue.³⁷ Also, value depends on possible future income streams, the property's technical feasibility, and many other factors that are similarly difficult to predict.³⁸ Further complicating the issue is the inadequacy of IRS guidance with respect to valuation methods of IP.³⁹ Today, there are several different methods of pricing,⁴⁰ each of which may result in widely varying estimates of the same IP.⁴¹ For example, one corporate executive of a company experienced in donating patents reported remarkably divergent estimates on the value of a patent, with the highest appraisal being four times greater than the lowest appraisal.⁴²

¶7 Another problem that facilitated abuse was the IRS's relaxed standards with respect to "qualified appraisers."⁴³ The IRS guidelines define a "qualified appraiser" merely as someone who "holds himself or herself out to the public as an appraiser"⁴⁴ and who signs a document acknowledging that he or she understands the legal consequences of intentional overvaluation.⁴⁵ While the IRS requires the donor to show the valuation's accuracy,⁴⁶ the subjective nature of valuing IP⁴⁷ makes any rebuttal difficult except in the most extreme cases. These regulations hardly facilitate uniform valuation standards, and may have led in part to many of the overvaluation abuses.⁴⁸

2. What Abuses Were Most Common?

Brenda Sandburg, *Tax Write-Offs, Written Off: The IRS Cracks Down on Patent Donation Deductions*, 04 IP LAW & BUS. 16 (Mar. 2004); *Greater Good*, *supra* note 7.

³⁶ IP DONATIONS, *supra* note 2, at 40.

³⁷ Sandburg, *supra* note 35.

³⁸ Cammarano & Riley, *supra* note 35, at 28.

³⁹ IP DONATIONS, *supra* note 2, at 40.

⁴⁰ Methods of pricing include the income method, the market approach, and the cost method. Milton Cerny, *Technology Transfer and the New Economy*, 47 EXEMPT ORG. TAX REV. 39, 46 (Jan. 2005); Cammarano & Riley, *supra* note 37; *Smith v. Commissioner*, 41 T.C.M. (CCH) 1427 (1981).

⁴¹ IP DONATIONS, *supra* note 2, at 7; *Greater Good*, *supra* note 7.

⁴² IP DONATIONS, *supra* note 2, at 7.

⁴³ *Id.* at 40-41.

⁴⁴ 26 C.F.R. § 1.170A-13(c)(5)(i) (West 2005).

⁴⁵ *Id.* at § 1.170A-13(c)(5)(i)(D).

⁴⁶ Cammarano & Riley, *supra* note 35.

⁴⁷ *Greater Good*, *supra* note 6 (arguing that patent valuations are often subjective and unreliable).

⁴⁸ IP DONATIONS, *supra* note 2, at 41.

¶8 The IRS has listed four areas of abuse for which it has particular concern: (1) excessive valuation of donated property; (2) inadequate substantiation of donations; (3) claiming excessive deductions when consideration is received; and (4) claiming deductions for the transfer of a partial interest.⁴⁹ This iBrief considers the problem of overvaluation.

¶9 As suggested above, a common method of abuse involved inflating the price of donated patents, thereby permitting donors to take larger than appropriate deductions.⁵⁰ SBC Communications, which has been accused of claiming a deduction of over \$7 million for donating an allegedly worthless patent,⁵¹ is just one example of this type of abuse. Companies such as Dupont and Eaton Corporation have also taken large deductions for patents of questionable value.⁵²

¶10 By the year 2000, donees began to realize that some IP cost more in annual maintenance fees than their alleged value.⁵³ The University of Virginia, for example, ended up losing money on a donated patent valued at more than \$7 million.⁵⁴ A professor involved later commented that “[t]he bottom line is that it cost us money with no benefit.”⁵⁵ By 2001, most universities adapted to this reality by requiring donors to help pay for maintenance fees on any IP they accepted.⁵⁶ Soon, stories of inflated valuations and other abuses involving charities became common knowledge, even implicating accounting giant KPMG.⁵⁷ By 2004, the abuse was so prevalent that Congress, after discussing several legislative proposals,⁵⁸ passed section 882 of the Creation Act.

⁴⁹ I.R.S. Notice 2004-7, 2004-3 I.R.B. 310.

⁵⁰ 150 CONG. REC. S. 11019-21 (daily ed. Oct. 10, 2004) (statement of Sen. Grassley); Press Release, *supra* note 24; *Stopping Abuses*, *supra* note 8.

⁵¹ Teresa Riordan, *Patent Donations Are Criticized*, N.Y. TIMES, Mar. 17, 2003, at C1.

⁵² MARTIN, *supra* note 4, at 7-8, 10-11.

⁵³ See Feder, *supra* note 33 (explaining that some patents are not worth their cost in maintenance fees).

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ IP DONATIONS, *supra* note 2, at 6.

⁵⁷ *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities, Hearing Before the Comm. on Finance, U.S. Senate, 108th Cong.*, at 7 (June 22, 2004) (statement of Jay D. Adkisson, Editor of Quatloos.com), available at <http://finance.senate.gov/hearings/testimony/2004test/062204jatest.pdf>.

⁵⁸ Jerry J. McCoy, *Contributions of Property: Winds of Change Blowing?*, SK041 ALI-ABA 369, 376 (2004). See, e.g., S. 1637, 108th Cong. § 494 (2004); Everson, *supra* note 24.

II. SECTION 882

A. *The Framework*

¶11 Section 882 attempts to curtail overvaluation of IP by limiting any deductions to the lesser of the property's FMV or cost basis.⁵⁹ Subject to the following four requirements, the donor may receive additional deductions based upon the revenue the donee generates from the donated property.⁶⁰ First, additional deductions are limited to the aggregate donee earnings generated from the donated property that exceed the original donor deduction.⁶¹ For example, suppose company A donates a patent to university B valued at \$2 million dollars with a basis of \$100,000. Assume further that during the first (the year of donation), second and third years, B earns \$50,000, \$75,000 and \$100,000, respectively. For the first year, the donor will be able to deduct the lesser of the patent's FMV or its basis; here, \$100,000. A would not be able to deduct any additional amount during the first year because $\$50,000 < \$100,000$. In the second year A would be able to deduct \$25,000 ($\$50,000 + \$75,000 - \$100,000 = \$25,000$).

¶12 Second, Section 882, now part of the IRC, creates a sliding scale that decreases the amount a donor can deduct based on earnings of the donee in future years.⁶² During the first (year of donation) and second years after the donation, aggregate earnings that surpass the deduction allowed for the initial charitable gift are completely deductible.⁶³ In subsequent years, a sliding scale reduces the deductibility of the donee's earnings.⁶⁴ During the third year after the donation, the donor may deduct 90% of the donee's earnings.⁶⁵ The rates drop to 80% and 70% for the fourth and fifth years, respectively.⁶⁶ The lowest rate of 10% is reached during the tenth year, and no deductions are permitted after the twelfth year of the donation.⁶⁷ Returning to the example above, university B earned \$50,000, \$75,000 and \$100,000 in the first through third years, respectively. Applying the sliding-scale rule will not effect the deduction of \$25,000 in the second year, but will limit A's deduction to \$90,000 as opposed to \$100,000 in the third year ($\$100,000 \times .9 = \$90,000$).

⁵⁹ I.R.C. § 170(e)(1)(B) (LexisNexis 2005); see also CONFERENCE REPORT, *supra* note 10, at 534; Fred Stokeld, *ETI Repeal Bill Would Tighten Rules on Vehicle, Patent Donations*, 105 Tax Notes 293, 294 (Oct. 18, 2004).

⁶⁰ I.R.C. § 170(m)(1) (LexisNexis 2005).

⁶¹ *Id.* at (m)(2).

⁶² *Id.* at (m)(7).

⁶³ *Id.* at (m)(1), (2), (7).

⁶⁴ *Id.* at (m)(7).

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.* at (m)(5).

¶13 The IRC also prohibits the donor from deducting the value of any earnings beyond the donated IP's life.⁶⁸ Finally, the IRC makes the deductibility of future earnings contingent on certain filing requirements. For example, after the donor informs the donee of its intent to take additional deductions,⁶⁹ the donee must then file annual returns reporting the earnings generated by the donated IP.⁷⁰ The donor must also acquire written substantiation from the donee concerning those earnings.⁷¹

III. WHERE DO WE GO FROM HERE?

A. Does it Really Matter?

¶14 There is much at stake in our nation's patent and IP donation policy. A strong relationship between the private business sector and our nation's research institutions would help create jobs, fuel the economy, and develop the technology to "improve the lives of our citizens."⁷² Furthermore, the International Intellectual Property Institute⁷³ has associated lagging international competitiveness and innovation, the risk of failing to fully exploit current resources due to inefficient markets for innovation, and the loss of patents and ideas through abandonment with poor IP donation policies.⁷⁴ Together, these considerations make a compelling case for taking IP donation policy seriously.

B. What Does a Good Policy Contain?

¶15 Derek Bok, faculty chair of the Hauser Center on Non-profits at Harvard University, has advised Congress that one of the biggest concerns in the area of charitable contributions is that of over-legislating and therefore doing more harm than good.⁷⁵ Because of this concern, Bok asserts that the best approach to addressing problems with charitable

⁶⁸ *Id.* at (m)(6). The life of IP is the time period for which the property is protected by a patent.

⁶⁹ *Id.* at (m)(8)(B).

⁷⁰ I.R.C. § 6050L(b)(1) (LexisNexis 2005).

⁷¹ *Id.*

⁷² Cerny, *supra* note 40, at 47.

⁷³ A not-for-profit organization "dedicated to increasing awareness and understanding of the use of intellectual property as a tool for economic growth." INT'L INTELLECTUAL PROP. INST., at http://www.iipi.org/nav_about/background.asp (last visited Mar. 17, 2005).

⁷⁴ IP DONATIONS, *supra* note 2, at 11-12.

⁷⁵ *Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities, Hearing Before the Comm. on Finance, U.S. Senate, 108th Cong.,* (Jun. 22, 2004) (statement of Derek Bok, chair of Hauser Center on Non-profits and Philanthropy, Harvard University), available at <http://finance.senate.gov/hearings/testimony/2004test/062204dbtest.pdf>.

contributions is to target known abuses first,⁷⁶ such as overvaluation, and then to proceed with caution. With respect to IP specifically, in addition to targeting known abuses, this iBrief argues that a good policy should also create appropriate incentives for IP holders to donate their property to organizations capable of putting it to good use,⁷⁷ thereby benefiting society.⁷⁸

C. Analysis of Section 170

¶16 *Overvaluation.* Section 170 deals effectively with the problem of overvaluation. However, rather than rigorously defining valuation standards,⁷⁹ the provision combats this problem by limiting a donor's deduction to the lesser of the property's FMV or cost basis.⁸⁰ Substantiation of the earnings is accomplished by requiring the donor to acquire financial information from the donee regarding earnings from the patent.⁸¹ This information must be reported to the IRS for the donor's future deductions to be valid.⁸²

¶17 *Incentives.* Section 170 falls drastically short in the area of incentives, primarily because the future earnings of the donation are only partially deductible.⁸³ Rightfully, this provision has been widely criticized as being donor unfriendly.⁸⁴ Some practitioners have noted that many patents do not become profitable until several years after their donation,⁸⁵ preventing donors from taking larger deductions for profitable patents. One expert speculates that this provision may limit corporations to deducting no more than 20% of the donated patent's FMV.⁸⁶ If true, this could significantly reduce the flow of IP from corporations to universities and not-for-profit entities.⁸⁷ Therefore, while Section 170 resolves the overvaluation problem, its chilling effect on donations in general is problematic. Certainly, a superior policy would encourage donations while also correcting the overvaluation problem.

⁷⁶ *Id.*

⁷⁷ See IP DONATIONS, *supra* note 2, at 9 (arguing that only donees with strong research technologies should be eligible for donated patents).

⁷⁸ See Cerny, *supra* note 40, at 47.

⁷⁹ See IP DONATIONS, *supra* note 2, at 40 (arguing that the lackadaisical IRS guidelines are largely responsible for charitable contribution abuses).

⁸⁰ I.R.C. § 170(e)(1)(B) (LexisNexis 2005).

⁸¹ I.R.C. § 6050L(b)(1) (LexisNexis 2005).

⁸² *Id.*

⁸³ See *id.* at § 170(m)(7) (displaying the sliding scale rate reduction).

⁸⁴ *Stopping Abuses*, *supra* note 7.

⁸⁵ *Id.*

⁸⁶ *Id.* This is because FMV measurements typically include the future expected revenues from an asset for a specified period of time.

⁸⁷ See *id.*

D. Possible Alternatives

1. American Society of Appraisers

¶18 The American Society of Appraisers (ASA) has made some valuable suggestions⁸⁸ for improving the previous FMV donation system.⁸⁹ First, the IRS must strictly define a “qualified appraiser.” Current regulations allow almost anyone, even someone without professional training, to work as a qualified appraiser.⁹⁰ Such a standard hardly promotes accurate and consistent valuation. Second, the ASA suggests that the IRS establish mandatory valuation guidelines for the appraisal of property.⁹¹ Finally, the ASA has argued that the IRS should monitor for high value donations,⁹² allowing the agency to identify donations with uncharacteristically high valuations.

¶19 *Overvaluation.* While the ASA’s call for specific standards for qualified appraisers and appraisal methods addresses Congress overvaluation concerns, the ASA’s confidence that workable standards could be set remains questionable,⁹³ especially considering the inherent difficulty involved in valuing IP.⁹⁴ Still, the IRS could set standards that, if nothing else, would bring consistency to the process.

¶20 *Incentives.* This approach would continue to create incentives for IP holders by allowing a full market value deduction for their patent. The ASA’s suggestions, however, stop short of creating incentives for the donor to find the best suited donee for their donation.

2. Consistent Policy?

¶21 Proponents of another plan argue that the recent changes to Section 170 are inconsistent with other tax laws and have therefore criticized lawmakers for failing to use consistent policy rationales in crafting tax legislation.⁹⁵ They recommend a more consistent policy with an additional safeguard for large donations. For example, the law could require two appraisals for any donation exceeding a certain amount. Further, both appraisals would have to come from members of an appraisal society

⁸⁸ The ASA’s suggestions, while valuable, should be viewed with caution. Clearly the ASA benefits from a system which grants a substantial amount of responsibility to appraisers.

⁸⁹ IP DONATIONS, *supra* note 2, at 40-41.

⁹⁰ See 26 C.F.R. § 1.170A-13(c)(5)(i) (West 2005).

⁹¹ IP DONATIONS, *supra* note 2, at 41.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Greater Good*, *supra* note 6.

⁹⁵ *Stopping Abuses*, *supra* note 7, at 701.

required to follow strict ethical guidelines.⁹⁶ The final amount of the deduction could be the average of the two estimates. A final addition to this plan might limit donations to certain qualified research institutions that would be capable of taking advantage of complex patents and other IP products.⁹⁷

¶22 *Overvaluation.* This plan addresses the overvaluation problem only insofar as professional appraisers are able to develop their own valuation guidelines and follow them. Without consistent valuation guidelines throughout the industry, appraisals will likely continue to vary widely depending on the appraiser used.⁹⁸

¶23 *Incentives.* This proposal would encourage donations of IP by assuring a FMV deduction. The provision requiring the donation to go to a qualified donee is a good addition, although it could be more targeted. Many institutions have research technologies, but some are better suited than others, depending on the IP. A policy that encourages donors to give IP to those entities best able to exploit it would increase the likelihood of productive uses beneficial to society.⁹⁹

E. Hybrid Proposal

¶24 The major disadvantage of the proposals outlined above is that they lack a mechanism to ensure that orphan patents and other IP get into the hands of the right donee.¹⁰⁰ While Section 170 does provide donors with incentive to find a good donee,¹⁰¹ the broader incentives for the actual donation are too limited.¹⁰²

¶25 A possible alternative combines the use of an initial FMV deduction with an additional component to help insure the best suited donee has access to the IP. Under this plan, an IP holder will be able to donate orphan patents and deduct their FMV as determined by a qualified appraiser. Deduction of

⁹⁶ See *id.* at 700 (suggesting additional, independent appraiser chosen by an appraisal society).

⁹⁷ *Id.*; IP DONATIONS, *supra* note 2, at 9.

⁹⁸ See IP DONATIONS, *supra* note 2, at 7 (arguing that even appraisals made in good faith may vary substantially depending on the appraiser used); see also, Cammarano & Riley, *supra* note 36 (showing that valuation of IP is very difficult).

⁹⁹ See Cerny, *supra* note 40, at 47; IP DONATIONS, *supra* note 2, at 8 (arguing that efficient allocation of IP benefits society).

¹⁰⁰ See Feder, *supra* note 33.

¹⁰¹ An incentive for the donor to find a good donee is created because the former is allowed additional future deductions if the IP generates sufficient revenue within the first 11 years of the donation. See I.R.C. § 170(m)(7) (LexisNexis 2005).

¹⁰² See *Stopping Abuses*, *supra* note 7, at 700.

the full amount will occur only if the company uses a third party broker whose primary goal is matching donors with appropriate donees.¹⁰³ The broker will be either a government entity or a not-for-profit organization paid by the government for this purpose. The funding for such a program will be generated from the increased tax revenue resulting from more accurate valuations.

¶26 The third party broker must have expertise with a wide variety of IP and be in contact with universities and other appropriate donees on a regular basis to keep apprised of what types of donations they are capable of exploiting. This will by no means be an easy task, but does not seem to be beyond the realm of possibility. Perhaps much of the work could be done pro bono by working professionals. Obviously, conflicts of interest would need to be monitored carefully.

¶27 For this plan to work, the IRS must set rigorous guidelines and standards for qualified appraisers and their valuation methods.¹⁰⁴ While the difficulty of coming up with valuation guidelines remains an obstacle, presumably, the private sector would be willing to help the IRS develop an appropriate methodology. As for getting the donated IP into the appropriate hands, some organizations have already begun to assist donors in finding donees for their patents.¹⁰⁵ Such organizations could be instrumental in helping bring about this reform.

¶28 *Valuation.* This policy would effectively solve the overvaluation problem that has plagued the previous FMV donation system by requiring the IRS to set clear guidelines and standards regarding appraisers and their valuation methods. Again, while not perfect, this proposal would at least add considerable consistency to a valuation process which is currently completely subjective.¹⁰⁶

¶29 *Incentives.* More importantly, this plan requires a donor to use an IP broker, thereby increasing the likelihood that the IP goes to a donee capable of taking full advantage of the charitable gift's potential. This plan is a big step in the right direction as it increases the likelihood that donated IP will not go to waste.

¹⁰³ See *id.* at 10 (advocating a third party broker scheme).

¹⁰⁴ See *id.* at 40-41 (arguing that the relaxed regulations promulgated by the IRS have led to much of the charitable donations related abuses in recent years).

¹⁰⁵ *Id.* at 10.

¹⁰⁶ See *Greater Good*, *supra* note 6 (explaining that the valuation of IP is extremely subjective).

CONCLUSION

¶30 Section 882 of the American Jobs Creation Act of 2004 has drastically changed the law with respect to charitable donations of IP.¹⁰⁷ While it effectively deals with the overvaluation problems common in the previous system, it fails to fully consider the importance of strong donor incentives. Other suggested alternatives may adequately address the importance of promoting donations, but fail to provide a mechanism by which the IP ends up in the hands that have the best capability to exploit its benefits. A hybrid policy that solves the overvaluation problem while still providing incentives for donors to give patents to a well-suited donee is a superior alternative. The policy would permit donors to take FMV deductions, but only where a donor has acquired an appraisal from a qualified appraiser. Strict appraiser qualifications and valuation standards would also be implemented as part of the policy. Further, donors would work with a broker whose sole responsibility would be to help find an appropriate donee for the IP, thus minimizing the likelihood that the IP would go to waste. Such a policy would help to curb overvaluation, and thus accomplish the designs of Congress without seriously undermining the incentive to donate IP.

¹⁰⁷ CONFERENCE REPORT, *supra* note 8 (explaining the differences between section 882, now part of section 170 of the IRC, and the previous law).