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Websites and Intangible Asset Amortization Under 26 U.S.C. § 197: A Marriage that Bears Little Fruit

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COMMENTS

Websites and Intangible Asset Amortization Under 26 U.S.C. § 197: A Marriage That Bears Little Fruit

I. INTRODUCTION

Websites are not only an important part of our electronic lives, they are an important financial and business asset in their own right.[1] With the growth of the internet as a commercial, informational, and recreational resource, companies utilize websites as an important part of their corporate financial portfolio and structure. The increased value of websites that comes from this growth has made websites a valuable asset that companies seek to use as they would other business assets.[2] One important consideration is how the value of websites will be treated upon sale or exchange. In other words, is the website an asset that can be merely capitalized and act as a recovery of basis,[3] or can it be amortized and written off before being sold to a different buyer?[4]

The tax code and regulations provide several potential methods to answer this question. This Comment will explore the interactions between some of those tax code provisions, specifically 26 U.S.C. § 197, and to a lesser degree, I.R.S. Revenue Procedure 2000-50, and the intellectual property rights associated with websites. Part II of this Comment presents a hypothetical, which will demonstrate how a website's intellectual property rights interact with some of the current tax laws. Part III will briefly explore how the intellectual property

1. For example, witness the power of www.Amazon.com; without the website, Amazon's entire business strategy would be virtually impossible.

2. Such as equipment used for a trade or business. *See* 26 U.S.C. § 167(a)(1) (2006).

3. Like unimproved land, *see* 26 U.S.C. § 174(c) (2006), or cash.

4. For example, the owner of an apartment building or equipment used in a trade or business can depreciate the basis over the statutory life.

rights of copyright, patent, and trademark apply to websites, with particular emphasis on the issues that copyrights have with websites. Part IV will explore the history of intangible asset amortization, which culminated in the creation of 26 U.S.C. § 197 in 1993. Part IV will discuss the way websites' intellectual property rights interact with section 197 and Revenue Procedure 2000-50. Part V of this Comment will discuss conclusions and some potential solutions for the problems presented by the tax code and regulations.

II. GOGOL AND MICROEVIL[5]: THE CORPORATE TAKEOVER FROM THE SILICON VALLEY

Let us pretend that there exists a company called Microevil, Inc. This company, flush with cash from a release of an operating system upgrade that no one needed, but that the company "encouraged" its customers to use, looks out upon the tech landscape and finds a plucky Silicon Valley company, called Gogol, that created a web browser, which has become all the rage on the internet. Microevil decides that it wants to acquire Gogol and all of the software, patents, copyrights, trademarks, and other assets that Gogol has.

At the time of Microevil's purchase attempt, Gogol has the following rights that are germane to the problem at issue in this comment[6]: First, Gogol has the web browser itself, on which it holds some registered copyrights. Second, Gogol holds a patent that covers at least some of the software that runs its browser. Third, Gogol has registered copyrights that protect some of the software. Fourth, Gogol holds a trademark on its corporate name and the name of its browser.[7] All of these assets are sought by Microevil in its acquisition of Gogol.

Microevil succeeds in its quest and Gogol is now nothing more than the trademarked name of a web browser and search engine, which is a wholly owned piece of the Microevil Empire. At the end of the year, Microevil's CEO and board calls you, their intrepid attorney, into the boardroom to explain to them the tax ramifications of the acquisition of Gogol's intellectual property rights.[8] You understand the intellectual

5. These names are made up. Any similarity to actual parties is completely coincidental.

6. For the purposes of this hypothetical, it will be assumed that either no one has challenged any of the intellectual property rights listed, or that the rights have been held valid.

7. Most corporate setups will be far more complicated, but for the purposes of this comment, a simple hypothetical works best.

8. Any corporate merger or acquisition will have far more tax consequences than what

property implications of the transferred rights that Microevil acquired earlier that year, but you need a moment to think of the tax ramifications of the Gogol acquisition. You know that the bottom line increased with increased ad sales, but you wonder now if some sort of loss exists that you can deduct from these profits.[9] Then you remember from the mists of a tax class or CLE you attended about how intellectual property rights are sometimes called intangible assets. Success! Microevil may have some deductions for this year's corporate tax return. First, let us see how all of these intellectual property rights and tax provisions work. Then, we will see how they work for Microevil and your report to the CEO and Board.

III. WEBSITES AS INTELLECTUAL PROPERTY

All of the major categories of intellectual property may offer protection to websites.[10] Although this fact is true, this Comment will focus more closely on copyrights because copyrights pose some of the most interesting issues for the tax law discussed in this Comment.[11] However, at least a brief discussion of the patent and trademark issues surrounding websites is necessary to provide a full picture of the intellectual property landscape that websites occupy. Accordingly, after a more lengthy discussion of the copyrights a website may qualify for, a brief discussion of a website's potential patents and trademarks will follow.

A. Copyright

Since December 1980, computer programs can be protected by copyrights.[12] Websites are a form of computer software that courts and

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is discussed in this comment, but this comment concerns only one narrow issue of corporate tax policy involving intellectual property rights.

9. While I use the term "loss" here, no actual loss, as in a decrease in the value of the asset, may have occurred. In tax terms, deductions like section 197 are sometimes referred to as "paper losses." This type of loss is different from something like an actual loss because of fire or disaster, which can be a real and permanent loss. With a "paper loss" the property still is in the hands of the owner. Upon sale, the taxpayer would have to pay taxes on any value he, she, or it depreciated.

10. Since websites are a form of computer software, they can be protected, potentially, by any intellectual property right that a piece of computer software can (e.g. copyright and patent). *Infra* Part III.

11. Specifically for section 197 and its accompanying regulations.

12. Patent and Trademark Laws, amendment, PUB. L. NO. 96–517, § 10, 94 Stat. 3015, 3028 (1980) (Congress tacked the changes concerning copyrights of computer software to the Copyright Act onto the end of this law). *See also* 17 U.S.C. § 101 (2006); Apple Computer Inc. v. Franklin Computer Corp., 714 F.2d 1240, 1248 (3d Cir. 1983) (finding that the 1980 Act

regulators analyze in those terms. When it comes right down to the nitty-gritty, websites are simply another form of computer software. Although a website may have specialized uses (e.g. Amazon.com for the sale of goods, Google as a search engine, or CNN.com for news and current events information), at their core, websites are simply another form of computer program. Therefore, websites must be analyzed as a type of computer software, and computer software is a suitable format for protection through copyrights.[13]

Where this maxim becomes more difficult is how the classification of the software as copyrightable affects its tax status under section 197, which the Comment discusses later.[14] On the other hand, this section of the Comment concerns only how the nature of a website affects how copyright law applies to it. In that vein, two separate copyright questions arise in the context of a website: (1) whether the software that runs, operates, and allows the website to function can be copyrighted; and (2) whether the actual material posted on the website can be protected by copyrights.[15] This section will address these two issues in turn, and will then address how the two forms of protection may, sometimes, interact.

1. Copyright Requirements in General

All copyrights, including computer programs and software, must comply with the limitations Congress placed on the right. Therefore, websites must be a work of authorship that is both original and fixed in some tangible medium.[16] If the website, in either its programming and software or its content, is not a work of original authorship, the website will not be copyrighted at all. Finally, the work a party seeks to protect must be within the sphere of copyright protection. In other words, the work must fit into one of the eight delineated categories in section 102, or the work will not be eligible for copyright protection.[17] Thus, I will

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made computer programs protectable under the Copyright Act).

13. *See, e.g.*, JustMed, Inc. v. Byce, 600 F.3d 1118, 1123–25 (9th Cir. 2010) (analyzing how computer software receives copyright protection).

14. *Infra* Part IV.

15. The first question concerns materials that actually run the website or computer program. For example, such a program as the operating system of a computer would be covered by this question. *See, e.g.*, Apple Computer, Inc. v. Franklin Computer Corp., 714 F.2d 1240 (3d Cir. 1983). The second question concerns the actual material on the website. This material includes such items as writing, pictures, or the whole arrangement and compilation of the material, to name a few examples.

16. H.R. REP. NO. 94–1476, § 102 (1976).

17. 17 U.S.C. § 102 (2006).

begin this section with a brief recitation of the two core copyright concepts and the subject matter copyright protects. Then, I will analyze how the elements affect websites.

a. Originality

For a work of authorship to be copyrighted, it must be original.[18] In the words of Justice O'Connor, "[t]he *sine qua non* of copyright is originality."[19] The Supreme Court, in detail, explained that originality was important because it went to the very essence of the power the Constitution granted Congress.[20] Thus, for any material to be copyrighted, it must be an original work.

The question facing the Court in *Feist v. Rural Telephone Co.*, however, was what originality exactly meant within the 1976 Copyright Act ("the 1976 Act"). The Court noted that the 1976 Act did not change the definition of original works.[21] No new doctrines needed to be formulated to deal with this issue. Instead, the Court looked to its own jurisprudence in the subject and made the following observations and decisions that shaped the meaning of originality for copyrights: unlike patents, where the work in question must be novel,[22] copyright, where the work must be original, imposes a far lower standard for the applicant or work to meet.[23] The work need only be slightly original.[24] Indeed, if two separate authors create the same exact work independently of the other, the works are still original and eligible for copyright protection.[25] Thus, originality is not a high bar for a work to meet.

Despite the low bar that a work must meet to be original under the 1976 Act, not all works meet this level of creativity. The greatest debate

18. Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 345 (1991).

19. *Id.*

20. *Id.* at 347. "The originality requirement is *constitutionally mandated* for all works." (quoting Patterson & Joyce, *Monopolizing the Law: The Scope of Copyright Protection for Law Reports and Statutory Compilations*, 36 UCLA L. Rev. 719, 763, n. 155 (1989)). *Id*.

21. *Id.* at 355 (citing H.R. REP. NO. 94-1476, p. 51 (1976)). The Court cited the House Report on the 1976 Act, which explicitly stated that the definition of originality was unchanged, and the definition courts used prior to the 1976 Act would continue to be used. *Id.*

22. *See* 35 U.S.C. § 102 (2006); Graham v. John Deere Co., 383 U.S. 1, 9 (1966).

23. *Fiest*, 499 U.S. at 345.

24. Indeed, the Court noted that most works could meet this criteria because most works have "some creative spark 'no matter how crude, humble[,] or obvious' it might be." *Id.* (quoting M. Nimmer & D. Nimmer, 1 NIMMER ON COPYRIGHT, § 1.08(C)(1) (1990)).

25. *Id.* at 345–46 (citing Sheldon v. Metro-Goldwyn Pictures Corp., 81 F.2d 49, 54 (2d Cir. 1936)).

over this fact comes in the realm of compilations.[26] Several different types of compilations exist.[27] The most difficult type of compilation to quantify, for purposes of originality, is the factual compilation because facts themselves cannot be copyrighted.[28] "[F]acts do not owe their origin to an act of authorship. . . . The first person to find and report a particular fact has not created the fact; he or she has merely discovered its existence."[29] A *compilation* of facts may be creative enough to satisfy the originality requirement.[30] The originality does not stem from the facts themselves, but rather from the author's actions regarding the facts.[31] The author must make decisions on the use of the facts: (1) whether to include certain facts; (2) where to place the facts in relation to each other; or (3) in the format in which the facts will be presented to the public.[32]

Consequently, while originality is a very low bar for a work to pass, it is still a limit on what may be copyrighted because allowing a person to copyright a general fact would remove that fact from the public domain.[33] That prospect is the antithesis of Congress's grant of authority in the realm of copyrights: "not to reward the labors of authors, but 'to promote the Progress of Science and useful Arts.'"[34]

b. Fixation in a Tangible Medium

The second requirement of copyright is that the work be fixed in some tangible medium.[35] The definition for this term creates a two-part

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26. *See id.* at 347–48.

27. For example an anthology of short stories could be a literary compilation. An academic journal could also qualify as a compilation in the same way. Factual compilations are more difficult to quantify because these works seem relatively uncreative, but the Court has found that these works can indeed be copyrighted if the arrangement is original enough. *Feist*, 499 U.S. at 348. These forms of compilation, however, require somewhat stricter scrutiny and the copyright is relatively weak because of the low level of creativity. *See id.* at 348–49.

28. *Id.* at 347.

29. *Id.* The Court then states that the Census takers would be a good example of this maxim. *Id.* The census taker discovers the population, he or she does not create it. *Id.*

30. *Id.* at 348.

31. *Id.* In other types of compilations, and other copyright issues, this concept is referred to as the idea/expression, or fact/expression, dichotomy. *Id.* at 350.

32. *Id.* This list is by no means exhaustive of the potential choices an author may make, but it is merely meant to be illustrative.

33. *Id.* (quoting Miller v. Universal Studios, Inc., 650 F.2d 1365, 1369 (5th Cir. 1981)).

34. *Id.* at 349 (quoting U.S. Const., Art. I, § 8, cl. 8).

35. The term "fixed in a tangible medium" is defined in 17 U.S.C. § 101 (2006) as follows:

> A work is "fixed" in a tangible medium of expression when its embodiment in a

test that must be satisfied for a work to be fixed in a tangible medium: (1) the work must be in a medium where it can be perceived; and (2) it must be fixed for a more than a transitory period of time.[36] The tangible medium can be one of any number of mediums. Photographs, video recordings, compact discs, and books are only a few examples of mediums that may qualify.[37]

The time requirement has become more complicated with the advent of computer technology, but it essentially holds that the work must exist in the tangible medium for longer than a transitory period of time.[38] This test is fact specific because of the nature of the medium.[39] Thus, the duration of the period of the copy depends upon the work, the medium it is transmitted through or on, and the actual length of the occurrence.

c. Subject-Matter Under 17 U.S.C. § 102

Although it is somewhat axiomatic to say, if a work is not one of the defined works under section 102 of the 1976 Act, it cannot be copyrighted. The 1976 Act protects eight categories of expression.[40] Generally, if your work is not covered by one of these categories, you cannot receive a copyright from the government, and you have no protection from some other party copying your work. Computer software, as will be explored, does not have this problem, however, because it can be classified under two potential types of subject matter under section 102: literary works and compilations.[41]

> copy or phonorecord, by or under the authority of the author, is sufficiently permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration. A work consisting of sounds, images, or both, that are being transmitted, is "fixed" for purposes of this title if a fixation of the work is being made simultaneously with its transmission.

36. Cartoon Network LP, LLLP v. CSC Holdings, Inc., 536 F.3d 121, 127 (2d Cir. 2008) (citing NIMMER ON COPYRIGHT, § 8.02[B][3], at 8-32 (2007)); Adv. Computer Servs. of Michigan, Inc. v. MAI Sys. Corp., 845 F. Supp. 356, 363 (E.D. Va. 1994).

37. The qualifying mediums are closely related to the subject matter that the 1976 Act protects under section 106. *See* 17 U.S.C. § 106 (2006). Within the definitions of the exclusive rights a copyright holder possesses, the act describes some potential tangible mediums. *See, e.g.*, 17 U.S.C. § 106(5) (2006) ("including the individual images of a motion picture or other audiovisual work").

38. *See* 17 U.S.C. § 101 (2006). *See also Cartoon Network*, 536 F.3d at 127–30.

39. *See Cartoon Network*, 536 F.3d at 130.

40. 17 U.S.C. § 102 (2006).

41. *Infra* Part III.A.2.

2. Copyright Law Applied to Websites and Computer Software

As previously stated, computer software can be protected under the Copyright Act.[42] This protection, however, was not inevitable. When Congress enacted the 1976 Act, it chose not to include computer programs as a class of copyrightable material.[43] This decision came about in large part because, two years before the passage of the 1976 Act, Congress created a commission to study the effects of computers and technology on intellectual property.[44] Subsequent to the commission's report, Congress passed the 1980 amendment that, for the first time, defined what a computer program was within the meaning of the 1976 Act.[45] With Congress's passage of this amendment, the floodgates of litigation opened, and many computer software developers, businesses, programmers, and other people and entities clamored for the protection of copyrights.

The first question the courts had to answer was what parts of computer programs could actually be protected via copyright. Like other forms of expression,[46] not all parts of computer software or programs are eligible for copyright protection. Beyond that issue, however, lay the dichotomy of the computer age concerning copyright: what, precisely, in the realm of computer software can receive copyright protection, and what parts are the mere facts? In other words, what is the idea and what is the expression in computer software. After that question we must ask what "fixed in a tangible medium" means for computer software. Once those questions are answered, the scope of copyright protections for computer software coalesces.

Like other works, computer programs may qualify for multiple types of copyrights. In particular, computer software and programs qualify as two types of subject matter under sections 102 and 103: (1) literary

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42. JustMed, Inc. v. Byce, 600 F.3d 1118, 1125, n.3 (9th Cir. 2010) (citing Johnson Controls, Inc. v. Phoenix Control Sys., Inc., 886 F.2d 1173, 1175 (9th Cir. 1989)).

43. Apple Computer, Inc. v. Franklin Computer Corp., 714 F.2d 1240, 1247 (3d Cir. 1983).

44. *Id.* (citing Pub. L. No. 93–573, § 201, 88 Stat. 1873 (1974)).

45. Patent and Trademark Laws, amendment, Pub. L. No. 96–517, § 10, 94 Stat. 3015, 3028 (1980).

46. *Feist*, 499 U.S. at 348. "The mere fact that a work is copyrighted does not mean that every element of the work may be protected. Originality remains the *sine qua non* of copyright; accordingly, copyright protection may extend only to those components of a work that are original to the author." *Id.* (citing Patterson & Joyce, *Monopolizing the Law: The Scope of Copyright Protection for Law Reports and Statutory Compilations*, 36 UCLA L. REV. 719, 800–02 (1989)).

works,[47] and (2) a form of compilation.[48] However, these two forms of subject matter may protect different parts of the computer program.

The two types of works at issue with computer software or programs, including websites, are the literal works and the non-literal works. Courts refer to the part of the computer program called either the source code or object code as the literal element of the software or program;[49] thus, this part of the computer software is protected as a literary work.[50] The non-literal works, on the other hand, are more akin to compilations, and these parts of the software or program may also receive copyright protection.[51]

No doubt exists that computer programs and software are a form of literary work. Congress itself acknowledged that computer programs are a form of literary work under the 1976 Act, and the courts accept that determination.[52] Accordingly, no real debate exists over whether the actual computer code itself can be copyrighted.[53]

On the other hand, the non-literal components of the computer software or program also may qualify for copyright protection. This component is essentially a compilations issue because it usually concerns the way in which certain commands, information, or facts are either used or presented by the author.[54] Consequently, the rationale used by the Court in *Feist* applies rather well to this area of copyrights for non-literal computer components.[55]

In sum, computer software qualifies for two types of copyrights, literary and compilation. The copyrights apply to different parts of the software, but both types must meet the core tests of copyright, that is, the work must be original and fixed in a tangible medium. If a website's computer software meets these tests, the website owner possesses valid

47. 17 U.S.C. § 102(a)(1) (2006).

48. 17 U.S.C. § 103 (2006).

49. Fonar Corp. v. Domenick, 105 F.3d 99, 104 (2d Cir. 1997) (quoting Computer Assocs. Int'l, Inc. v. Altai, Inc., 982 F.2d 693, 702 (2d Cir. 1992)).

50. Computer Assocs. Int'l, Inc. v. Altai, Inc., 982 F.2d 693, 702 (2d Cir. 1992).

51. Gen. Universal Sys., Inc. v. Lee, 379 F.3d 131, 142 (5th Cir. 2004) (per curiam).

52. Whelan Assocs., Inc. v. Jaslow Dental Lab., Inc., 797 F.2d 1222, 1234 (3d Cir. 1986) (citing H.R. REP. NO. 1476, 94th Cong., 2d Sess. 54).

53. Courts use several different terms for the computer code. The two most common, and accepted, are the source and object code. Fonar Corp. v. Domenick, 105 F.3d 99, 104 (2d Cir. 1997) (quoting Computer Assocs. Int'l, Inc. v. Altai, Inc., 982 F.2d 693, 702). *See also* Williams Elecs., Inc. v. Artic Int'l, Inc., 685 F.2d 870, 876–77 (3d Cir. 1982).

54. Compaq Computer Corp. v. Procom Tech., Inc., 908 F. Supp. 1409, 1418 (S.D. Tex. 1995).

55. *See, e.g.*, *Computer Assocs.*, 982 F.2d at 711–12.

copyrights for the computer software. Finally, the actual material physically on the website itself may qualify for copyright protection as a compilation.[56] Accordingly, websites are the source of at least three different types of copyrights,[57] which could prove valuable to a corporate owner.

B. Patents and Websites

When talking about patents and websites, the exact thing that a person acquires a patent for is the computer software; thus, the question that must be asked is whether a website's computer software qualifies for patent protection. Computer software can qualify for a patent, but this determination was not an inevitable result.[58] In fact, the exact parameters are still up for debate and modification even today.[59] In *Bilski v. Kappos*, the Supreme Court declined to give any greater clarity to the situation, but the Court did hold that the machine-or-transformation test was not the sole method of determining if a process patent was valid, but "just an important and useful clue."[60] Whatever the parameters and length of this debate,[61] the important fact for the purposes of this Comment is that computer software can qualify for patent protection.[62] Of course, any patent, including a patent for a piece of software, must meet the statutory requirements "that the invention be novel, see section 102, nonobvious, see section 103, and fully and particularly described, see section 112."[63] For the purposes of this Comment, it will be assumed that any patent discussed in the Microevil

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56. For example, a way of presenting an electoral map on CNN, or the arrangement of information on the website could qualify for a copyright exclusive of the computer software that runs the site.

57. If a party sold their copyright to some actual literary work to some corporate body, who then placed the copyrighted material on the website, that copyright would be valid as well. However, that copyright is not really a part of the structure of the website.

58. *See, e.g.*, Gottschalk v. Benson, 409 U.S. 63, 71–73 (1972) (first case on patentability of computer software).

59. *See* Bilski v. Kappos, 130 S. Ct. 3218 (2010).

60. *Id.* at 3226.

61. And this debate will continue for some time if the amount of ink that courts and scholars have spilled over this issue is any indication.

62. *See* 1 DONALD S. CHISUM, CHISUM ON PATENTS § 1.03[6] (2011) (explaining the history of process patents, in particular with reference to computer software). *See also* Robotic Vision Sys., Inc. v. View Engineering, Inc., 249 F.3d 1307, 1311–13 (Fed. Cir. 2001) (analyzing a case involving the on-sale bar, which involved a patent that included computer software).

63. *Bilski*, 130 S. Ct. at 3225. All internal statutory citations refer to Title 35 of the United States Code.

hypothetical meets all of the statutory requirements and is a valid computer software patent.

C. Trademarks and Websites

In terms of trademarks and websites, two potential trademarkable items leap to mind: (1) the website owners own corporate trademark, and (2) the website's domain name.[64] That a corporate trademark can receive protection is no great surprise.[65] Thus, like patents above, I will not bore the reader with the intricacies of basic trademark law in relation to a corporate trademark. Suffice it to say, a corporate name can qualify for trademark protection if it meets the normal tests of whether the mark in question points distinctly to the company that created the product,[66] is not functional,[67] and is used in commerce.[68] Trademarks can encompass a wide variety of subject matter including words, names, and symbols.[69] Consequently, it is likely that the corporate name of a company would potentially qualify for trademark protection, and for the purposes of this Comment, it will be assumed that the corporate name and logo have qualified for trademark protection.

The more complicated question is whether the domain name itself can qualify for trademark protection. At least some parties believe that a domain name can qualify for trademark protection.[70] It must be acknowledged that some court cases have called into question whether a domain name can be trademarked, but it still may be possible if the

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64. By the corporate trademark, I refer to the corporate name. One example of this would be Amazon.com. The name Amazon may be trademarked as a corporate logo, and could qualify for § 197 amortization. Whether or not the domain name of Amazon.com itself can receive trademark protection is still something of an open question. *See infra* section III(C) of this Comment.

65. Otherwise, trademark protection would be worthless. All a person needs to do is ask a company like McDonald's, Louis Vuitton, or Wal-Mart what their brand name is worth to them, and it can clearly be demonstrated that these are valuable trademarks.

66. When a person thinks of the Golden Arches, it points to McDonald's the company, not the arches themselves or the hamburgers. *See also* 1-1 JEROME GILSON, GILSON ON TRADEMARKS § 1.03[1] (2011).

67. "It is the province of patent law, not trademark law, to encourage invention by granting inventors a monopoly over new product designs or functions." 74 AM. JUR. 2d *Trademarks and Tradenames*, § 32 (2001) (citing Genesee Brewing Co., Inc. v. Stroh Brewing Co., 124 F.3d 137 (2d Cir. 1997)).

68. 15 U.S.C. § 1051(a)(3)(C) (2006).

69. *See, e.g.*, Samson Cordage Works v. Puritan Cordage Mills, 211 F. 603 (6th Cir. 1914).

70. Xuan-Thao N. Nguyen & Jeffrey A. Maine, *Taxing the New Intellectual Property Right*, 56 HAST. L.J. 1 (2004–2005).

domain name passes the normal tests for a trademark.[71] In spite of this hesitance on the part of the courts, I have found no case where a court explicitly stated that a domain name cannot be trademarked.[72] Thus, for the sake of argument, this Comment will assume that Gogol.com was able to qualify for a trademark. Even if the domain name did not qualify, the name Gogol itself qualifies for trademark protection as a corporate logo, so it is likely that under the Anti-Cybersquatting Consumer Protection Act[73] the mark would be protected from infringing domain names that include the corporate logo. Consequently, the domain name would receive some tangential protection because of the trademark on the corporate name.

Now that the potential intellectual property rights a website may qualify for are clear, the next area of law that must be discussed is the tax law in question, specifically, the tax law related to the amortization of intangible assets in trade or business sales and exchanges.

IV. THE EVOLUTION OF TAX LAW FOR INTANGIBLE ASSETS

The law regarding the amortization of intangible assets has a lengthy history.[74] Since almost the beginning of the United States tax code, at least some intangible assets have been eligible for some form of amortization.[75] Of concern to this Comment is the application of the amortization of intangible assets to intellectual property rights. Before briefly discussing the history of amortization as applied to intellectual property rights, I will first explain the basic mechanics of amortization. Then I will briefly detail the evolution of amortization as applied to intellectual property. Finally, I will explain the current section 197, and how it applies to intellectual property in general, and websites in

71. *See, e.g.*, *In re* 1800Mattress.com IP, LLC, 586 F.3d 1359 (Fed. Cir. 2009) (finding a specific domain name did not meet the test for a trademark, but the case never held that domain name categorically could not qualify for trademark protection).

72. Although I will state that I also have not found a case where the court did allow a domain name to be trademarked either. At best this area of law seems to be somewhat in a standoff mode with no court categorically denying the right, but also no court actually letting such a trademark exist. Thus, this area of the law is in a state of flux.

73. 15 U.S.C. § 1125(d) (2006). The Anti-Cybersquatting Consumer Protection Act was enacted by Congress in 1999 to protect trademarks from cyber piracy. Pub. L. No. 106–113, 113 Stat. 1536, 1501A-545–48 (1999). *See also* 1-4 PAUL D. MCGRADY, JR., MCGRADY ON DOMAIN NAMES, § 4.02.

74. *See, e.g.*, Catherine L. Hammond, Note, *The Amortization of Intangible Assets: S 197 of the Internal Revenue Code Settles the Confusion*, 27 CONN. L. REV. 915 (Spring 1995) (explaining the history behind the amortization of intangible assets, which includes intellectual property rights).

75. *Id.* at 916–17.

particular.

A. Amortization in a Nutshell

Amortization is a process that operates much like depreciation.[76] The principle of amortization can best be communicated via an example. Company A purchases Company B for $50,000,000. While evaluating its new purchase, Company A values a patent it acquired from its purchase at $12,000,000. How does the company amortize the value of the patent it gained from this business transaction?

Under the current section 197,[77] that patent can be amortized over fifteen years using a straight-line method of amortization.[78] Thus, Company A may deduct $800,000 per year over the next fifteen years. This calculation, of course, assumes that the purchase occurred in the first month of the year. Under section 197, if the purchase occurs in some other month, the first year's deduction equals one year's worth of amortization times the number of months out of twelve. For example, if Company A purchased Company B in July, Company A would qualify for six months of amortization in the first year,[79] or $400,000. For the next 14 years Company A could take its $800,000 deduction, and then in year sixteen, the company would take the remaining $400,000 amortization deduction left over from the first year. Company A would now have no basis remaining, and the patent would now be "worthless" from a tax cost recovery standpoint.[80] In fact, the patent may be worthless from a non-tax standpoint by this time as well, or for some

76. In fact, the operation of both amortization and depreciation are so similar that courts have often conflated the two, but "Black's Law Dictionary tells us that intangible assets are amortized, while tangible assets are depreciated." Newark Morning Ledger Co. v. United States, 507 U.S. 546, 571 n.1 (1993) (Souter, J. dissenting). In reality, the two processes are virtually the same except for name.

77. 26 U.S.C. § 197(a) (2006).

78. 26 U.S.C. §§ 197(a), (d)(1)(C)(iii) (2006). The straight-line method of amortization or depreciation simply means that the entity deducts the same amount every taxable year rather than at some other statutory accelerated method, such as accelerated cost recovery under 26 U.S.C. § 168(b)(1)-(2) (2006).

79. Under section 197, Company A would use the first of July as the date calculation of amortization. *See* 26 U.S.C. § 197(a) (2006); 26 C.F.R. § 1.197–2(f)(1). Since Company A would have possession of the patent for six months (July through December) of the first year, the company could depreciate half the values of one-year's amortization, or $400,000.

80. In tax, the amortization deductions are taken from the adjusted basis (AB) of an asset. In this hypo, the AB of the patent was twelve million dollars before amortization began. Once the amortization finished, the AB of the patent is zero. Consequently, if the patent were to be sold, Company A would pay tax on the full sales price because no basis exists any longer for Company A to recover.

time before the deductions ran out.[81] At its simplest, this method is how the amortization of intangible assets operates.[82]

B. A Brief History of the Amortization of Intangible Assets

As stated earlier, intangible asset amortization is almost as old as the Internal Revenue Code, but its history is lengthy and tortured. Several other authors have analyzed the history of amortization as applied to intangible assets;[83] therefore, I will only briefly cover this history for sake of completeness.

1. The Beginning of Intangible Asset Amortization and Section 167

The amortization of intangible assets first entered the American tax structure in 1919.[84] As with the later section 167, the amortization was limited to items that possessed a finite lifespan in trade or business.[85] After briefly flirting with the idea of allowing the amortization of goodwill for a business that died,[86] the Eighth Circuit Court of Appeals ended that flirtation when it decided that goodwill could not be exhausted in a trade or business.[87] This decision set the stage for the constant battles the IRS and taxpayers had in moving assets out of the goodwill column and into the intangible asset column.

When Congress passed the Internal Revenue Code of 1954, section

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81. If the patent expired by the end of the amortization, the patent likely has little value to Company A because it now faces competition from potential competitors. If the patent has only one year or two left before expiration, it will literally be decreasing in value every day the patent gets closer to its expiration.

82. Please note that other issues could affect how, when, and where this deduction may be applied. For example, in a partnership context, amortization would be affected by the special allocation rules found in 26 U.S.C. § 704(c). This Comment, however, will discuss the mechanics of amortization in only its most basic form, and it will not delve into the more complex mechanics of amortization and depreciation.

83. *See, e.g.*, Catherine L. Hammond, Note, *The Amortization of Intangible Assets: S 197 of the Internal Revenue Code Settles the Confusion*, 27 CONN. L. REV. 915 (Spring 1995) (providing a general history of intangible asset amortization); Andrew F. Halaby, Comment, *Treatment of Goodwill by the Seller Under I.R.C. Section 197*, 43 U. KAN L. REV. 903 (July 1995) (explaining history of intangible asset amortization in relation to goodwill). For a history written in conjunction with an intellectual property topic see Xuan-Thao N. Nguyen & Jeffrey A. Maine, *Taxing the New Intellectual Property Right*, 56 HAST. L.J. 1, 12–22 (2004–2005).

84. Hammond, *supra* note 74, at 916 & n.8.

85. *Id.* at 916.

86. *Id.* at 916–17. The Department of Treasury's "generosity" was brought on by liquor distributors suffering the effects of prohibition. *Id.* at 916 (citing Newark Morning Ledger Co. v. United States, 507 U.S. 546, 574–75 n.2 (1993) (Souter, J., dissenting)).

87. Red Wing Malting Co. v. Willicuts, 15 F.2d 626, 633 (8th Cir. 1926).

167 became the section of the Code dedicated to the depreciation and amortization of business assets.[88] While the statute spoke in generalities about what property is eligible for amortization, it specifically excluded trademarks and trade names from amortization,[89] but section 167 allowed the amortization of both patents and copyrights.[90] From an intellectual property standpoint, this situation was most unfair to businesses that held high value trademarks, trade names, and trade secrets.[91] In a broader context, companies and the IRS fought for decades over the classification of assets,[92] but two events would eventually end most of the squabbles the IRS and Corporate America had over goodwill and other intangible assets of indeterminate length.

2. Newark Morning Ledger Co. v. United States and the 1993 Revenue Reconciliation Act

All of the confusion and fuss came to a head in 1993. Two events, one judicial and one legislative, occurred that enacted a sea of change in the process of intangible asset amortization. First, the United States Supreme Court handed down its decision in *Newark Morning Ledger Co. v. United States*.[93] Second, Congress passed the 1993 Omnibus Revenue Reconciliation Act (the "Revenue Act"),[94] which created § 197 of the Internal Revenue Code. These two actions changed the landscape of intangible asset amortization.

a. Newark Morning Ledger Co. v. United States

The events that created this case began in 1976, when the Herald

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88. Hammond, *supra* note 74, at 918.

89. 26 U.S.C. § 167(r) (1988).

90. 26 U.S.C. § 167 (1988).

91. To illustrate the problem, imagine if a company like Maytag were bought by another company. The Maytag trade name has great value because of its history and the Maytag Corporation's investment in its name. Under section 167, pre-1993, *see, e.g.*, 26 U.S.C. § 167(r) (1988), the purchasing corporation would not have been able to amortize the cost of Maytag acquiring the trademark and name. The best that the purchasing company may have been able to do is capitalize the costs into the basis and take advantage of the recovery of basis when it sold the Maytag "name." Given the potential value of these names, most companies would not sell these assets piecemeal (if ever). Therefore, the basis recovery would likely occur only when the company was acquired in whole through a merger or sale, or potentially as part of a bankruptcy.

92. *See, e.g.*, Houston Chronicle Publ'g Co. v. United States, 481 F.2d 1240 (5th Cir. 1973); Richard S. Miller & Sons, Inc. v. United States, 537 F.2d 446 (Ct. Cl. 1976).

93. 507 U.S. 546 (1993).

94. Omnibus Budget Reconciliation Act of 2003, Pub. L. No. 103-66, 107 Stat. 312 (1993).

Company bought a company called Booth Newspapers, Inc.[95] The Herald Company continued to publish Booth's newspapers.[96] Herald estimated the fair market values of all of the assets it got in its merger with Booth.[97] For three years, 1977–1980, Herald deducted an amount calculated in a straight-line method, which the IRS then disallowed because the subscriber list was too much like the business concept of goodwill.[98] Thus, the *Newark Morning Ledger* lawsuit began.

Eventually, the Newark Morning Ledger Co. (Newark) completed a merger/takeover of the Herald Company, and it became the plaintiff in this suit.[99] At the District Court level, Newark proved, through statistics and expert witnesses, that the paid subscriber list had a finite lifespan;[100] therefore, the company argued that it qualified for amortization under section 167. The IRS offered no counter evidence, except for contesting some of the valuation figures.[101] Instead, the IRS argued that the paid subscriber database was an analogue to business goodwill; thus, the asset could not be amortized under the Code of that time.[102] The District Court found for Newark, holding that the paid subscriber base had a finite lifespan, and the IRS then appealed to the Third Circuit.[103] The Third Circuit ruled in the IRS's favor, and Newark then appealed to the Supreme Court, which granted certiorari.[104] The Court[105] held that Newark could amortize the paid subscriber list because Newark "bor[e] successfully its substantial burden of proving that 'paid subscribers' constitutes an intangible asset with an ascertainable value and a limited useful life, the duration of which can be ascertained with reasonable accuracy."[106] Thus, Newark could amortize this intangible asset.

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95. Newark Morning Ledger Co. v. United States, 507 U.S. 546, 549 (1993).

96. *Id.* The eight papers Herald bought were published in Michigan. *Id.*

97. *Id.* at 549–50. Herald bought the company for approximately $328,000,000. *Id.* at 549. It gave a value to certain assets (e.g. cash, securities, equipment, etc.), but it also valued paid subscribers at $67,800,000. *Id.* at 550.

98. *Id*. at 550. As previously explained, goodwill could not be amortized under § 167 because no good way existed to calculate its length. *See supra* Part IV.B.1.

99. *Newark Morning Ledger Co*., 507 U.S. at 549. The merger completed in 1987.

100. *Id*. at 551.

101. *Id*.

102. *Id*. at 552–53.

103. *Id*.

104. *Id*. at 553 (citing Newark Morning Ledger Co. v. United States, 503 U.S. 970, 970 (1992) (granting Newark's cert petition)).

105. *Id*. at 548. Justice Blackmun wrote the majority decision for a 5-4 Court.

106. *Id.* at 570. The Court also emphasized that any expectation of continued customer patronage was irrelevant because Newark proved that the paid subscribers asset fulfilled all of the necessary conditions of § 167. *Id*.

Four justices dissented. Justice Souter wrote that "[s]ince the days of Justice Story, we have understood the concept of 'goodwill' to be anchored in the patronage a business receives from 'constant or habitual' customers."[107] The dissenters saw nothing different between Newark's subscriber lists and the traditional idea of goodwill, which could not be amortized.[108] The dissenters would have held that the subscribers lists were indistinguishable from goodwill, and therefore, non-amortizable as a matter of law.[109] At its core, the dissenting justices believed that the Court should not upset a longstanding doctrine of law without some sort of Congressional action.[110] That Congressional action was soon to come.

b. 1993 Revenue Act

Congress had contemplated action on the intangible asset front for some time, and it had considered several different proposals.[111] Eventually, Congress passed the Revenue Act and included within it Congress's new policy. In a nutshell, the 1993 Revenue Act ended the idea that an intangible asset needed a finite lifespan.[112] Specifically, the Revenue Act created 26 U.S.C. § 197, which supplemented and supplanted some of the purview of section 167 of the Code.[113] This section greatly impacted intellectual property rights because trademarks and trade secrets could be amortized, instead of capitalized.[114] Consequently, for the first time, all the major bodies of intellectual property law became eligible for amortization.

3. Section 197 in Brief

Section 197 is now the main vehicle for amortization of intangible assets.[115] This section became a part of the Internal Revenue Code as a

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107. *Id*. at 572 (Souter, J., dissenting) (citing Metropolitan Bank v. St. Louis Dispatch Co., 149 U.S. 436, 446 (1893)).

108. *Id.* at 573 (Souter, J., dissenting).

109. *Id.* at 581–82 (Souter, J., dissenting).

110. *Id.* at 582 (footnote omitted).

111. Hammond, *supra* note, 74 at 932–33.

112. The 1993 Revenue Act changed many other things as well (including helping Republicans win the House and Senate in 1994), but for the purpose of this comment, all that is of concern in the Revenue Act is the creation of section 197.

113. 107 Stat. 312, 532–41 (1993).

114. *Compare* 26 U.S.C. § 197(d)(1)(F) (2006) (adding trademarks and trade names to the list of intangible assets potentially eligible for amortization) *with* 26 U.S.C. § 167(r) (1988) (specifically excluding trademarks and trade names from amortization).

115. Even with the creation of section 197, section 167 contains some vestigial

result of numerous litigation battles.[116] Congress acted to correct many of the unanswered questions and problems that section 167 and the myriad of court cases over its intangible asset provisions spawned. In a macro sense, for the first time goodwill was unquestionably amortizable,[117] and, in the micro sense, all the major forms of intellectual property patents, copyrights, and trademarks, were eligible for amortization.[118] Some of the mechanics have already been described in the *Amortization in a Nutshell* section of this comment,[119] but I will briefly elaborate on the actual operation of what section 197 does here.

Section 197 applies only in a business transaction context where a sale or exchange of good happened.[120] Self-created intellectual property rights are ineligible under this section of the Code.[121] In addition, all intellectual property rights now potentially qualify for amortization under section 197.[122] Another large change from the days of amortization under section 167 is that the "life" of the asset no longer matters for amortization.[123] Instead, section 197 imposes a uniform fifteen-year amortization period on section 197 intangible assets.[124] The mechanics of the operation of amortization were already explained in the *Amortization in a Nutshell* section of this Comment; therefore, I will not rehash the actual operations here.[125] In brief, this passage describes the general structure and operation of section 197, but this section of the Internal Revenue Code becomes more complex when a website is thrown into the mix, as will soon become clear.

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intangible asset amortization provisions in relation to intellectual property rights, specifically, patents and copyrights. 26 U.S.C. § 167(f) (2006); 26 C.F.R. § 197–2(a)(2). However, these rights will not apply at all if section 197 can be used by the business entity for that intangible. JEFFREY A. MAINE & XUAN-THAO N. NGUYEN, INTELLECTUAL PROPERTY TAXATION: TRANSACTION AND LITIGATION ISSUES 242 (BNA Books 2003).

116. The ultimate case being Newark Morning Ledger Co. v. United States, 507 U.S. 546 (2003).

117. 26 U.S.C. § 197(d)(1)(A) (2006).

118. 26 U.S.C. §§ 197(d)(1)(C)(iii), 197(d)(1)(F) (2006).

119. *Supra* Part IV.A.

120. 26 U.S.C. § 197(c)(1)(B) (2006).

121. 26 U.S.C. § 197(c)(2) (2006).

122. 26 U.S.C. §§ 197(d)(1)(C)(iii), 197(d)(1)(F) (2006).

123. Under section 167, amortization occurred over the lifetime of the asset. For example, if the purchased patent had thirteen years left until expiration that is the time period the company could amortize the costs over thirteen years, the lifetime remaining in the patent. This timing issue changed with the adoption of section 197.

124. 26 U.S.C. § 197(a) (2006).

125. *Supra* Part IV.A.

V. THE TAXATION OF WEBSITES: INTELLECTUAL PROPERTY AND COMPUTER SOFTWARE

At this point in time, several different Code provisions and regulations govern the tax benefits surrounding websites. While section 197 and its regulations alone are important, they cannot be looked at in isolation. Other equally important portions of the tax code affect the tax treatment of these assets.[126] This section of the comment explains how section 197 specifically affects websites and computer software. Then, I will briefly explain how IRS Revenue Procedure 2000-50 interacts with computer software. Then I will elaborate on the problems with the current tax regime. After providing that background information, I will apply that information to the Microevil hypothetical to give greater clarity to the situation by providing a tangible example for the reader. Finally, at the end of this section, there is a short discussion on some of the implications the current tax regime has for websites and other similar pieces of intellectual property. Along with these implications, some potential solutions will be proposed.

A. Section 197, Its Regulations, and Revenue Procedure 2000-50: Their Application to Websites

Pertinent to websites, computer software, as defined section § 197, has several severe restrictions for amortization.[127] These restrictions, discussed in greater detail below, have severe ramifications for a corporation or partnership that purchases a website and its associated rights. Those ramifications will now be discussed in greater detail.

1. Section 197 and Its Regulations

To fully understand the interactions of the various Code provisions and Regulations, the pertinent parts of the Code and Regulations must be singled out. The first important provisions are the Code sections that explain the method of amortization used for section 197 intangibles, which have already been discussed earlier in this Comment;[128] thus, these sections need not be covered again. The second section of the

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126. *See, e.g.*, Rev. Proc. 2000-50, 2000–52 I.R.B. 601 § 5 (citing 26 U.S.C. § 174(a)) (explaining how the Internal Revenue Code handles software development costs like R & D expenditures).

127. 26 U.S.C. § 197(e)(3) (2006). The Treasury regulations elaborate upon this point in greater detail (as is true with most tax provisions). *See, e.g.*, 26 C.F.R. § 1.197–2(c)(4) (no amortization for computer software available to the general public), § 1.197–2(c)(4)(iv) (definition of computer software from section 197 elaborated upon by the IRS).

128. *Supra* Part IV.A.

Code is the part which defines the intellectual property rights of patents, copyrights, and trademarks as section 197 intangibles.[129] At first glance, section 197 would appear to protect all the potential intellectual property rights for which a website can qualify.[130] However, this conclusion fails to take into account one of the key exceptions Congress included in section 197 itself, and that the Department of the Treasury, through the IRS, enacted to govern these taxable transactions.

This third provision is the restrictions on the amortization of computer software[131] that cause massive problems for all business holders of intellectual property rights associated with computer software.[132] The problem becomes especially acute when websites are involved in the process because of the many potential intellectual property rights that a website represents. Section 197 defines "computer software" as "any program designed to cause a computer to perform a desired function. Such term shall not include any data base or similar item unless the database or item is in the public domain and is incidental to the operation of otherwise qualifying computer software."[133]

a. Patents

On its own, this definition has some bad implications for intellectual property rights. For example, the phrase "any program designed to performed a desired function," potentially precludes a process patent, which for computer software would likely be a program or algorithm designed to perform desired functions. This definition potentially prevents a computer software process patent from amortization under section 197.

b. Copyrights

Not only patents have difficulty clearing this hurdle. Both types of computer software copyrights face problems with section 197. Like the

129. 26 U.S.C. §§ 197(d)(1)(C)(iii), 197(d)(1)(F) (2006).

130. *Id*.

131. 26 U.S.C. § 197(e)(3); 26 C.F.R. § 1.197–2(c)(4).

132. Beyond the problems that this Comment covers, section 197(e)(3)(A) also precludes from amortization "computer software which is readily available for purchase by the general public, is subject to a nonexclusive license, and has not been substantially modified" and that was not acquired in a trade or business transaction. While this exclusion is important, it is beyond the scope of this Comment's subject matter; therefore, it will not be mentioned in any greater detail throughout this Comment. 26 U.S.C. § 197(e)(3) (2006).

133. 26 U.S.C. § 197(e)(3)(B) (2006).

process patent, literal computer software copyrights potentially could be foreclosed from amortization under section 197, when computer software is defined the way section 197 defines it. As discussed above, computer software qualifies for copyright protection of the source code as a literary work.[134] Source code, as one court described it,[135] "is code written in a programming language . . . . Object code is produced by rendering those same programming instructions in a binary form that the computer can read."[136] Even more disturbing is the definition the Copyright Act itself gives to a computer program: "A 'computer program' is a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result."[137] When compared to the section 197 definition of a computer program,[138] the definitions are virtually identical; consequently, the literal copyright cannot be amortized under section 197.

Compilation copyrights for computer software are also somewhat endangered by these exceptions. Although the Code itself does not specifically imperil these copyrights, the IRS regulations do. Under the regulations, the database compilation copyright is directly attacked.[139] The regulations state the following:

> [c]omputer software does not include any data or information base . . . of this section unless the data base or item is in the public domain and is incidental to a computer program. For this purpose, a copyrighted or propriety data or information base is treated as in the public domain if its availability through the computer program does not contribute significantly to the cost of the program.[140]

This explanation has the potential to absorb a great many compilation copyrights related to computer software. Unfortunately, no

134. *Supra* Part III.A.

135. *JustMed*, 600 F.3d at 1121 n.1 (9th Cir. 2010). *See also* Softel, Inc. v. Dragon Medical & Scientific Communications, Inc., 118 F.3d 955, 958–59 (2d Cir. 1997) (defining source code and explaining how it performs functions on computers); 17 U.S.C. § 101 (2006).

136. *JustMed*, 600 F.3d at 1121, n.1.

137. 17 U.S.C. § 101 (2006).

138. *Compare* 26 U.S.C. § 197(e)(3)(B) (2006) (definition of computer software under section 197) *with* 17 U.S.C. § 101 (2006) (definition of computer program under the Copyright Act).

139. 26 C.F..R. § 1.197–2(c)(4)(iv).

140. *Id*. The regulations give the example of the dictionary of a spell check program as a data or information base that would be in the public domain for the purposes of this definition.

case or administrative hearing has yet come forward that will help provide some context for this provision of the tax regulations. In the terms of websites and computer software in general, however, this regulation could be devastating. Other than an author or artist posting original works on a website, no other work on the website really qualifies for any other copyright protection. Thus, it is indeed possible for a computer software compilation copyright to qualify as a section 197 intangible and actually survive the computer software exception, but the holder must be very careful about what the copyright covers.

c. Trademarks

In contrast,[141] trademarks get off relatively lightly but not completely unscathed. For the regulations, the core question about trademark and computer software is if the trademark is either acquired for marketing purposes (e.g. the brand name MICROSOFT), or if "[the] trademark or trade name is ancillary to the ownership or use of a specific computer software program in the taxpayer's trade or business."[142] Thus, the corporate logo may survive and so might a domain name if it was used for marketing purposes.[143] In all, section 197 and its regulations seem far less punishing to trademarks than patents and copyrights.

2. Revenue Procedure 2000-50 and Other Tax provisions

Beyond the Code and Regulations, the IRS issued Revenue Procedure 2000-50 in 2000 as a way to streamline and organize how the tax code treats the different provisions related to computer software.[144] This document was the first real comprehensive guidance the IRS gave on the tax treatment of computer software since 1969.[145] It defines computer software almost identically to section 197;[146] therefore, it is little surprise that the Revenue Procedure provides scant help to the holders of intellectual property rights held in conjunction with websites. In fact, section 197 is mentioned sparingly, but tellingly when the

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141. But perhaps not to great surprise given that trademarks generally do not protect the computer software itself.

142. 26 C.F.R. § 1.197–2(c)(4)(iv).

143. For instance, some may remember the Ask Jeeves commercials of the late 1990s, the name Amazon.com, or GoDaddy.com in NASCAR. All of these marks are used for marketing purposes and would likely qualify for amortization because they avoid one of the prongs that would trip this regulation.

144. Rev. Proc. 2000–50, 2000–52 I.R.B 601, 2000–1 C.B. 601.

145. *See id*.

146. *Compare* Rev. Proc. 2000–50, 2000–1 C.B. 601, § 2 *with* 26 U.S.C. § 197(e)(3)(B) (2006).

Procedure states "[t]his revenue procedure does not apply to any computer software that is subject to amortization as an 'amortizable section 197 intangible' as defined in section 197(c)."[147] While this language appears generous, the definitions in section 197 and the regulations obliterate much of the generosity. Almost all "computer software" is not amortizable under section 197; therefore, this revenue procedure may be the only way to actually handle computer software.[148] Whether or not business will challenge these provisions is still unclear, but the potential for litigation is there.[149] Finally, it must be noted that other tax provisions can affect the treatment of intellectual property. To list all of them would turn this paper from a Comment to a treatise, and that work has already been done by others.[150] Thus, referencing their treatise for a more in-depth discussion of the full breadth of intellectual property taxation is highly recommended.

B. Section 197 Applied to the Acquired Gogol Intellectual Property Rights in the Microevil Hypothetical

Returning to the Microevil hypothetical, I will address each of the four potential deductions under section 197 in the following order: (1) the web browser itself and its registered copyrights; (2) the patent that covers at least some of the software that runs the browser; (3) the registered copyrights that protect some of the software; and (4) the trademark of Gogol as the name of its browser.

1. The Web Browser

A web browser is a website, and thus, can qualify for some level of copyright protection. I must note that in this section, I will not be discussing the copyrights attached to the website's software, or other

147. Rev. Proc. 2000–50, 2000–1 C.B. 601, § 4 "Scope."

148. An interesting question this raises is whether the intellectual property rights can be treated the same as computer software. This question could be important because some of the tax provisions for computer software are quite generous. *See, e.g.*, *id*. at §§ 5 & 6 (under section 5 the costs of developing the computer software are treated similarly to R & D costs under 26 U.S.C. § 174, whether or not a copyright or patent applies). As one commentator suggested the IRS may have recognized some of the problems and tried to pre-empt them. Nguyen & Maine, *supra* note 70, at 75 n. 241.

149. Revenue Procedure 2000–50 is important to the realm of computer software taxation, but it is somewhat tangential to the main topic of this Comment, the effect of section 197 of the Internal Revenue Code on Websites. This small introduction to the Revenue Procedure has been provided because it helps give context to the types of regulations that may be in play, from a tax perspective, with a piece of intellectual property.

150. *See, e.g.*, MAINE & NGUYEN *supra* note 115.

copyrights,[151] but rather the copyright protection the website can acquire as a compilation. Copyright protection as a compilation is a trait that many different websites may have or be able to get; therefore, I will focus on that copyright for the actual material on the website.

For a compilation to qualify for a copyright, the primary hurdle, as previously discussed,[152] is whether the compilation is original.[153] Some minimal degree of creativity is required for a compilation of facts to merit copyright protection; thus, an electronic arrangement of facts fixed in a tangible medium would seem to qualify.[154] For the sake of argument, and for the purposes of this Comment, I will assume that Gogol's website has enough originality to qualify it for copyright protection, and because it bears little relation to computer software that runs the website, it is very likely that this compilation copyright will qualify for amortization under section 197. This form of copyright simply is not related enough to the statutory definition of computer software in section 197 to be swallowed by the computer software exception. Thus, the material on the Gogol website likely qualifies for amortization.

2. Patents for Website Software

Software itself can qualify for a patent. The software that runs Gogol's website would be the patentable subject matter, and it could qualify for a process patent.[155] However, as is now clear from the discussion of the tax law,[156] it is likely impossible for a process patent on computer software to ever qualify for amortization under section 197. The definition of software and the regulations promulgated by the IRS combine to make this fact true. Therefore, Gogol's process patent on its software cannot be amortized under section 197.[157]

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151. Other copyrights can be used in conjunction with a website. For example, an author could post his or her copyrighted work to a website or sell it as an e-book. *See, e.g.*, Amazon.com, *available at* http://www.amazon.com. (commercial website that sells copyrighted e-books). For the sake of simplicity, I will not be addressing that issue in this Comment. Suffice it to say that the addition of this copyright could make what is already a complicated tax problem even more complicated.

152. *Supra* Part III.A.

153. Feist Publ'ns, Inc. v. Rural Tel. Serv. Co., 499 U.S. 340, 348 (1991).

154. *See, e.g.*, Cartoon Network LP, LLLP v. CSC Holdings, Inc., 536 F.3d 121, 127-30 (2d Cir. 2008); Adv. Computer Servs. of Michigan, Inc. v. MAI Sys. Corp., 845 F. Supp 356, 362–64 (E.D. Va. 1994).

155. *Supra* Part III.B.

156. *Supra* Part IV.

157. It should be noted that even though section 197 might not allow cost recovery for the patent, or indeed for the copyrights, the vestigial rights contained in section 167(f) may

3. Copyrights of the Software

As discussed above,[158] since the early 1980s courts have recognized that computer software can be protected by the Copyright Act. However, as was made clear from a comparison of the Copyright Act with section 197, the literary copyright will be absorbed by the definition of computer software found in section 197 and it attendant regulations. Therefore, the literary copyright, like the computer software process patent, will not qualify for amortization under section 197.

The compilation copyright is more problematic. In a classic legal response, whether or not this copyright qualifies for amortization under section 197 depends on how closely the compilation entwines with the computer software. If the answer is too close, this copyright also faces absorption into the computer software exception, if it is less entwined the copyright is an amortizable section 197 intangible asset.

4. Trademark of the Gogol Domain Name and Name Gogol as a Corporate Name

As Professors Maine and Nguyen have studied exhaustively,[159] domain names of websites could and should qualify for trademark protection. This protection is limited, of course, by the domain name fulfilling the legal requirements for trademark protection, but here, we will assume that the domain name does indeed qualify for trademark protection.[160] And even if the domain name itself fails to qualify for trademark protection, if the trademarked corporate logo is a part of the website's domain name, it will be protected as a part of the core logo's trademark protection.[161] Accordingly, the Gogol corporate logo, name, and domain name can be amortized as section 197 intangibles.[162]

In total, the trademarks and compilation copyrights are the only intellectual property rights that will qualify for amortization under section 197. This outcome is not what the Microevil Board of Directors

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potentially allow some cost recovery. Despite the creation of section 197, section 167 still has a part to play in the amortization of some intellectual property. However, that analysis and discussion is somewhat outside the focus of this Comment, but the possibility did have to be mentioned.

158. *Supra* Part III.A.

159. Nguyen & Maine, *supra* note 70.

160. As stated earlier, the current state of domain names and trademarks is in tension, but for the purposes of this Comment it will be assumed that the domain name qualifies for trademark protection.

161. 1-4 PAUL D. MCGRADY, JR., MCGRADY ON DOMAIN NAMES, § 4.02.

162. Although outside the realm of this Comment, it should be noted that the IRS could still object to the value Microevil would potentially place on each of these assets.

expects from their intrepid attorneys, but this answer is the only one that you can give.[163]

C. Potential Solutions to the Problem

As is fairly obvious by now, section 197, intellectual property, and computer software have a dysfunctional marriage. Some of this tension may be explained by the simple fact that so much of computer software and intellectual property are intertwined. The Silicon Valley would not exist without the protection the government offers to inventors, thinkers, dreamers, and makers. However, in section 197, Congress apparently has conflated computer software together with the intellectual property rights held on the software. This conflation gravely decreases the potential tax benefits available to a corporation in mergers, takeovers, purchases, and other similar business transactions.[164] Particularly, in a realm where successful businesses dominate the airwaves[165] but also had some of the biggest busts possible,[166] a tax regime that encourages the orderly takeover of more troubled companies would be beneficial. Unfortunately, the current tax code stands in the way by obliterating much of the advantages a sale of a website could bring, tax wise, to the purchasing company. What follows are some possible solutions to break the log jam.

1. Regulatory Action

Although the regulations are certainly not written in a manner that is helpful to intellectual property rights, the IRS may not have much choice. In the end, the regulatory agencies must work with what Congress gives them, and section 197 itself is inhospitable to the confluence of intellectual property and computer software. Therefore, the IRS may have done all it can do with the issuance of Revenue Procedure 2000-50. While that revenue procedure is not perfect, it at

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163. It must be noted that the Internal Revenue Code does not hate all computer software or intellectual property. Indeed, Revenue Procedure 2000-50, shows the ways in which computer software qualifies for tax benefits. Also, patents in particular are very favored under the tax code. For example, under section 174 R & D costs can be amortized in the year they are incurred successful or not. This Comment is merely meant to show one of the ways in which intellectual property rights are not helped by provisions of the tax code. It is not meant to illustrate that the Internal Revenue Code hates intellectual property.

164. Indeed, the prospective of paper tax losses is good reason for a healthier company to take over a more troubled company. The prospect of those losses, which may help protect other profits, could be a key reason for a purchase.

165. E.g. www.Google.com

166. E.g. the dot com bubble burst on Wall Street.

least brings some order to a relatively chaotic area of the law.[167] On the other hand, in its regulations, the IRS went a little further than it probably had to when it came to absorbing computer software's ancillary rights into the exception;[168] however, given what Congress gave the IRS to work with, this course of action may have been all the IRS had open at the time. Consequently, any real movement in this area will probably have to come from Congress itself.

2. Congress

Congress did a good thing when it created section 197. After many years of litigation in the courts, Congress brought some order to the chaotic field of intangible asset amortization. Congress finally gave equality to all intellectual property rights, but then it laid a knuckleduster on the Silicon Valley by potentially eviscerating the ability of tech companies to actually use their intellectual property rights for beneficial tax treatment. Congress could ameliorate this problem in several ways.

First, Congress could make it possible for companies to elect which tax treatment they want when they first purchase the intellectual property right. Some may say that this will add another record for people to keep as part of their business but it is already done in other areas of the tax code.[169] In fact, when Congress passed section 197, the IRS passed regulations allowing for holders of intangible assets to use section 197 if they bought the asset up to two years before passage.[170] Accordingly, no real record keeping problem exists, and the companies would have the opportunity to make an informed choice about how to handle their tech assets.

Second, Congress could rewrite section 197 over from the beginning. While this option has the advantage of being dramatic, it is not very likely because the code section works quite well in most cases. The real problem is with the interaction between computer software and intellectual property rights; therefore, two other options present themselves for consideration. First, the entire computer software and

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167. *See, e.g.*, Nguyen & Maine, *supra* note 70, at 75 n. 421 (noting that the IRS acted to bring some order to the area of the law by not having parties run three to four different calculations for software tax purposes).

168. 26 C.F.R. § 1.197–2(c)(4)(iv).

169. *See, e.g.*, 26 U.S.C. § 2513 (2006) (gift splitting among married couples, must be elected at the time of the gift tax return, cannot change). In fact, the entire unified credit for estate and gift tax purposes is premised on the idea that people keep these records for life.

170. 26 C.F.R. § 1.197–1T.

intellectual property issue could be taken out of section 197 and placed into its own Code section. Given the incredible importance that computer technology has to the American economy, this area of the economy deserves its own consideration in the Internal Revenue Code. Thus, having a section detailing and explicitly saying how these rights interact with each other would greatly clarify the situation. It would also give more certainty to the business and computer technology world, and would greatly benefit the economy.

Third, Congress could potentially rewrite only the portions of section 197 that contain the computer software exception. This option has several of the benefits of making computer software its own section. At the same time, it may be more doable for Congress because it is likely easier to tweak a Code section than create a new one.[171]

Fourth, perhaps the hardest and easiest option of all, Congress could do nothing. Section 197 is already effective in most respects, and Congress will not want to upset that progress. Additionally, perhaps there is no good way to do what needs to be done at this time. It took decades to create section 197, its regulations, and Revenue Procedure 2000-50. Perhaps Congress requires more evidence before it wades once more into the rapids. Therefore, perhaps this is the best that Congress can do and not rocking the boat at this time may be the safest and easiest path at this time.

VI. CONCLUSION

In the last thirty years, America has become more and more computerized and information driven. As a consequence the business community has used technology to increase their profits and growth. One of the most important tools to come out of this growth is the explosion of the internet, and at the core of the internet is the many websites that comprise it. Websites have become a core part of many businesses' financial portfolios.[172] Everyone from the local corner store to Amazon.com has come to rely on websites for their financial growth, and it is fitting that the tax code encourages the growth of these important engines of the American economy. However, Congress needlessly handicapped the tech community with its section 197 computer software exceptions. To balance the playing field once more, Congress should amend or rewrite section 197 to take into account the

171. Look at the time it took to create section 197 from section 167; more than forty years.

172. *See* Nguyen & Maine, *supra* note 70, at 5.

valuable plane that technological intellectual property rights have in our economy. If it does so, Congress will encourage the business community to invest in websites and e-commerce in greater and greater numbers, which will be a boon for the American economy, and finally level the playing field for all intangible assets under the Internal Revenue Code.

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* Juris Doctor, Marquette University Law School, May 2011; Candidate for LL.M in Taxation Northwestern University School of Law, expected May 2012. I would like to thank all of my family, friends, and teachers who helped me get to this point and aided me in the writing of this comment. I would especially like to thank the editors and staff of the *Marquette Intellectual Property Law Review* for their aid in the writing of this comment.