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Articles

Taxing the New Intellectual Property Right

XUAN-THAO N. NGUYEN* AND JEFFREY A. MAINE**

INTRODUCTION

Imagine you are counsel for a company that would like to capitalize on the heightened interest in popular culture surrounding a new breed of man who is well-groomed, interested in fashion, and unafraid to express his emotions. He is the “metrosexual”—as reported by the *New York Times*.¹ In the literary genre this man is the counterpart to Bridget Jones from the best-selling book, *Bridget Jones’ Diary*. Your CEO excitedly informs you that he has just bought the Internet domain name “men.com” for \$1.3 million at an auction,² and the company is going to build a Web site that will include tips on fashion and grooming, how-to advice, news, and literature, all for this new breed of man. Your CEO then asks you, “What are the tax consequences of purchasing this domain

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1. Warren St. John, *Metrosexuals Come Out*, N.Y. TIMES, June 22, 2003, at 9.1 (noting that the term “metrosexual” was originated by Mark Simpson); see also Peter Gotting, *Rise of the Metrosexual*, THE AGE (Melbourne), Mar. 11, 2003, available at <http://www.theage.com.au/articles/2003/03/10/1047144914842.html>; Richard Trubo, *Metrosexuals: It’s a Guy Thing!*, WEBMD (“An emerging breed of man, the metrosexual, shows his soft, sensitive, feminine side.”), at <http://content.health.msn.com/content/article/71/81366.htm> (July 28, 2003).

2. *Domain Name Prices Rise Again*, INVESTOR’S BUS. DAILY, Dec. 29, 2003, at A02 (reporting the recent purchase of domain name “men.com” for \$1.3 million by a group of entertainment executives), available at 2003 WL 65869423.

name?" You realize you have no answer. Of course, you know the tax consequences of purchasing traditional intellectual property assets such as patents, copyrights, and trademarks. But you have no idea what to do with this new type of intellectual property, especially when the name is generic, like "men.com." The company could save or lose hundreds of thousands of dollars depending on your answer, so you promise your CEO you will get back to him as soon as you find out exactly where domain names fit in the current tax regime.

With the arrival of global electronic commerce transactions on the Internet, new forms of intellectual property rights, such as Internet domain names, have emerged. Today, Internet domain names are some companies' most valuable assets.³ Yet law professors, attorneys, and judges struggle with the legal nature of domain names, which is far from settled. Questions drawing recent attention include: How should domain names be valued?⁴ Can domain names be used as collateral in secured transactions, and how does one perfect a security interest in domain names?⁵ What will happen to domain names in bankruptcy?⁶ Another puzzling question, which has received little attention, is how should domain names be treated for federal tax purposes? Although there are tax rules governing traditional intellectual property rights, there are no rules dealing specifically with domain names. This article addresses these parallel questions: Are domain names merely variations of traditional forms of intellectual property and other intangible rights to which the existing tax regime can be applied? Or are domain names new intangible rights that need their own set of tax laws?

Current, albeit arbitrary, rules exist governing the tax treatment of

3. For a discussion of the rise of domain names as valuable business assets, see *infra* Part I.A.

4. See, e.g., Ian C. Ballon, *Domain Names*, 661 PLI/PAT 39, 59 (2001); Ted A. Berkowitz, *Internet Issues in Bankruptcy Law*, 755 PLI/PAT 727, 753 (2003); Francis G. Conrad, *Dot.coms in Bankruptcy Valuations Under Title 11 or www.snipehunt in the Dark.Noreorg/Noassets.com*, 9 AM. BANKR. INST. L. REV. 417, 430-31 (2001).

5. See, e.g., Brent R. Cohen & Thomas D. Laue, *Acquiring and Enforcing Security Interests in Cyberspace Assets*, 10 J. BANKR. L. & PRAC. 423, 433-42 (2001); Xuan-Thao N. Nguyen, *Commercial Law Collides with Cyberspace: The Trouble with Perfection—Insecurity Interests in the New Corporate Asset*, 59 WASH. & LEE L. REV. 37, 73-82 (2002); Alexis Freeman, *Internet Domain Name Security Interests: Why Debtors Can Grant Them and Lenders Can Take Them*, COMPUTER & INTERNET LAW., June 2003, at 7.

6. See, e.g., Marjorie Chertok & Warren E. Agin, *Restart.com: Identifying, Securing and Maximizing the Liquidation Value of Cyber-Assets in Bankruptcy Proceedings*, 8 AM. BANKR. INST. L. REV. 255, 280 (2000); A. Mechele Dickerson, *From Jeans to Genes: The Evolving Nature of Property of the Estate*, 15 BANKR. DEV. J. 285, 301-09 (1999).

traditional forms of intellectual property, such as patents, trade secrets, copyrights, trademarks, and trade names.⁷ Under present law, most patent creation costs are deductible when incurred,⁸ whereas patent acquisition costs are deductible either over an arbitrary fifteen-year period (if the patent was purchased as part of the acquisition of a trade or business) or the useful life of the patent (if the patent was purchased separately).⁹ Certain trade secret creation costs are deductible when paid or incurred, whereas others are deductible over fifteen years.¹⁰ Trade secret acquisition costs, however, are always deductible over fifteen years regardless of whether they were acquired separately or with a trade or business.¹¹ Copyright creation costs are immediately deductible for some creators, but recoverable over the copyright's useful life for other creators.¹² Copyright acquisition costs are deductible either over fifteen years (if the copyright was purchased as part of the acquisition of a trade or business) or the useful life of the copyright (if the copyright was purchased separately).¹³ The costs of building the goodwill in a trademark or trade name are deductible,¹⁴ whereas trademark and trade name acquisition costs must be recovered over an arbitrary fifteen-year period.¹⁵ Current rules also exist governing the tax treatment of other intangible rights, such as government licenses and service contracts, the costs of which are usually deductible over fifteen years.¹⁶

While tax principles exist for these traditional intellectual property and intangible rights, specific tax rules do not exist for new intellectual property rights, such as domain names, that are emerging with the arrival of global electronic commerce transactions on the Internet. This article explores the proper tax treatment of domain name registration and acquisition costs.¹⁷ Part I of this article explains the rise of valuable

7. For a thorough treatment of intellectual property taxation, see generally JEFFREY A. MAINE & XUAN-THAO N. NGUYEN, *INTELLECTUAL PROPERTY TAXATION: TRANSACTION AND LITIGATION ISSUES* (BNA 2003).

8. *See id.* at 174–81.

9. *Id.* at 259–65.

10. *Id.* at 181–84.

11. *Id.* at 266–68.

12. *Id.* at 184–91.

13. *Id.* at 269–76.

14. *Id.* at 193–94.

15. *Id.* at 276–79.

16. *See infra* Part II.B.3.

17. This article will focus solely on the deductibility of domain name registration and purchase costs, and will not address the tax treatment of domain names sales. For the likely tax treatment of

domain names as a new intellectual property right having uncertain tax consequences. Part II analyzes the historical and current tax rules governing traditional intellectual property and other intangible rights. Part III then examines the legal nature of domain names to determine whether they can readily fit within the current tax regime for intangible rights. It also explores whether domain names should be treated for tax purposes as governmental licenses, service contracts, or intangible property; and, if treated as property, whether domain names can be classified within a category of intangible property covered by existing tax principles, specifically goodwill and trademarks.

Part IV of this article concludes that domain names that function as source identifiers should be treated under the current tax regime applicable to trademarks, so that costs of acquiring such domain names should be recovered ratably over fifteen years. Generic domain names, in contrast, possess “inherent” goodwill not dealt with by the existing intangible tax regime. The disparate treatment between domain names functioning as source identifiers and generic domain names illustrates the inadequacies of tax law in dealing with the expansion of intellectual property rights for existing intangible assets as well as the emergence of new intellectual property rights. Part IV criticizes the ad hoc response by administrative tax agencies in dealing with cyber-assets, and calls for Congress to revisit the current tax regime for intangibles. With the increase of global, electronic commerce transactions on the Internet, the nature of cyberspace will undoubtedly require new tax rules.

I. RISE OF A NEW INTELLECTUAL PROPERTY RIGHT HAVING UNCERTAIN TAX CONSEQUENCES

A. RISE OF DOMAIN NAMES AS VALUABLE CYBER-ASSETS

The explosive growth of the Internet in recent years has provided a new medium for electronic commerce and communication across national borders.¹⁸ This network connects computers around the world,

domain names sales, see MAINE & NGUYEN, *supra* note 7, at 401–08.

18. See, e.g., Aldo Forgiione, *Weaving the Continental Web: Exploring Free Trade, Taxation and the Internet*, 9 LAW & BUS. REV. AM. 513, 556 (2003) (“The surging popularity of the Internet and the recent growth of e-commerce dramatically changed the nature and economics of global business.”); Dale M. Cendali & Brian V. Ellner, *How to Ensure That Your Web Site Complies with Consumer Protection Laws*, COMPUTER & INTERNET LAW., Dec. 2002, at 1 (“To understand the relevance of rules regulating Internet advertising, one must recognize that the growth of the Internet and e-commerce has been explosive.”).

facilitates changes in technology,¹⁹ and allows different forms of commerce such as B2B,²⁰ B2C,²¹ and C2C²² to emerge. Despite the recent economic downturn and the “dot.com” bubble bursting, the Internet continues to be a critical component of daily life and commerce.²³ As of September 2003, there were at least thirty-three languages “spoken” on the Internet,²⁴ and 803 million people connected to the global network.²⁵

19. See, e.g., Barbara A. Cherry, *Utilizing “Essentiality of Access” Analyses to Mitigate Risky, Costly and Untimely Government Interventions in Converging Telecommunications Technologies and Markets*, 11 *COMMLAW CONCEPTUS* 251, 254 (2003) (discussing government plan to support “research on advanced infrastructure technology and government use of e-commerce broadband applications in an effort to achieve major economic growth and productivity gains in the United States by making affordable broadband Internet connections available to American homes, schools and small businesses”); Andrew J. McClurg, *A Thousand Words Are Worth a Picture: A Privacy Tort Response to Consumer Data Profiling*, 98 *Nw. U. L. REV.* 63, 100 (2003) (stating that the Internet, the World Wide Web, and information technology change daily).

20. Business-to-business (B2B) is the dominant form of online commerce. Benjamin C. Elacqua, *The Hague Runs Into B2B: Why Restructuring the Hague Convention of Foreign Judgments in Civil and Commercial Matters to Deal with B2B Contracts is Long Overdue*, 3 *J. HIGH TECH. L.* 93, 94–96 (2004) (discussing B2B contracts on the Internet); see also Corby C. Anderson & Ted P. Pearce, *The Antitrust Risks of Information Sharing*, 23 *FRANCHISE L.J.* 17, 21 (2003) (explaining that “business-to-business exchanges, which are Internet-based electronic markets designed to permit businesses (but not individual consumers) to communicate and transact business with each other through a website or portal,” may raise antitrust concerns).

21. Business-to-consumer (B2C) commerce is still in the early stages of growth, as one study indicated, with only a quarter of online users “reporting they make purchases online and under fifteen percent doing any of the other transactional activities. Despite all of the sound and fury, business to consumer commercial online transactions are but in their earliest stages.” *STANFORD INSTITUTE FOR THE QUANTITATIVE STUDY OF SOCIETY, STUDY OF THE SOCIAL CONSEQUENCES OF THE INTERNET* (providing and analyzing online consumers’ usage of the Internet) (emphasis omitted), at http://www.stanford.edu/group/siqss/Press_Release/press_detail.html (last modified July 6, 2001); see also Elacqua, *supra* note 20, at 96 (noting that B2C transactions are mainly for personal transactions and “the most recognizable B2C contracts are transacted through ebay”).

22. Daniel Doda, *Antitrust Concerns in the B2B Marketplace: Are They “Bricks and Mortar” Solid or a “Virtual” Haze?*, 27 *WM. MITCHELL L. REV.* 1733, 1736 (2001) (“Consumers can also transact with other consumers (“C2C”). Online auctions, such as eBay, Inc., where individuals can purchase items from other individuals, is [sic] an example of a C2C transaction.”).

23. Studies reveal that consumers use the Internet for communication, information, entertainment, and commercial transactions. E.g., *STANFORD INSTITUTE FOR THE QUANTITATIVE STUDY OF SOCIETY, supra* note 21 (reporting that consumers use Internet email for communication; conduct Internet research to obtain information about hobbies, travel, and general interest; use the Internet as an entertainment source; and engage in commercial transactions ranging from common purchases to e-banking).

24. Global Reach, *Global Internet Statistics (by Language)* (providing global Internet statistics by language and population), at <http://www.global-reach.biz/globstats/index.php3> (last revised Mar. 30, 2004). English, European (non-English) languages, and Asian languages dominate the languages online. *Id.*

25. *Id.* (estimating that globally, there are more than 287.5 million English-language online users and 516.7 million non-English online users); see also Elacqua, *supra* note 20, at 94 (2004) (stating that “[b]y the year 2007, the number of Internet users is projected to be approximately 1.46 billion”).

Consumers use the Internet to exchange information, communicate, and conduct business.²⁶ The number of online users continues to increase and e-commerce continues to grow. For example, worldwide figures for e-commerce growth indicate that in 2000, Internet sales totaled \$657 billion. In 2003, just three years later, the number jumped to \$3.98 trillion.²⁷ In 2004, this figure is projected to reach \$6.8 trillion.²⁸

The arrival and explosive growth of a networking medium has facilitated the genesis of a new form of cyber asset, the domain name. A company must have a Web site and domain name to provide information, communication, goods, or services online.²⁹ Many Internet companies, unlike traditional companies, own mostly intangible assets such as business know-how, Web pages, copyrights, databases, trademarks, and domain names.³⁰ Domain names can be the name of the

26. Within two years, from 2002 to 2004, the number of online users increased from approximately 605 million to 802 million worldwide. See Nua Internet Surveys, *How Many Online?* (reporting survey results for estimated online population for 2002), at http://www.nua.com/surveys/how_many_online (last visited Oct. 4, 2004); Global Reach, *Global Internet Statistics* (reporting the estimated online population for 2004), at <http://www.global-reach.biz/globstats/index.php3> (last revised Sept. 30, 2004). In the United States, 44.5% of online users engage in commercial transactions. UCLA CENTER FOR COMMUNICATION POLICY, *THE UCLA INTERNET REPORT: SURVEYING THE DIGITAL FUTURE, YEAR THREE 18* (Feb. 2003), at <http://www.digitalcenter.org/pdf/InternetReportYearThree.pdf>. Further, only 24 percent of Americans are truly offline in that they have no direct or indirect experience with the Internet. AMANDA LENHART, *THE PEW INTERNET & AMERICAN LIFE PROJECT, THE EVER-SHIFTING INTERNET POPULATION: A NEW LOOK AT INTERNET ACCESS AND THE DIGITAL DIVIDE 3* (Apr. 16, 2003), at http://www.pewinternet.org/pdfs/PIP_Shifting_Net_Pop_Report.pdf; see also Ronnie Cohen & Janine S. Hiller, *Towards a Theory of CyberPlace: A Proposal for a New Legal Framework*, 10 RICH. J.L. & TECH. 2, ¶ 57 (2003) ("In truth, the Internet is a place where people meet to communicate, where businesses meet consumers and sell their products, and where investments in web site development and presence are electronic versions of property."), at <http://law.richmond.edu/jolt/v10i1/article2.pdf>.

27. Global Reach, *Forrester Projects \$6.8 Trillion for 2004* (providing Forrester Research report on worldwide e-commerce growth for 2000, 2001, 2002 and 2003), at <http://glreach.com/eng/ed/art/2004.ecommerce.php3> (last revised Nov. 23, 2001). The figures include both B2B and B2C transactions online.

28. *Id.* (providing Forrester Research prediction for B2B and B2C e-commerce for 2004). The major growth areas are expected in the United States, Asia Pacific, and Western Europe. *Id.*

29. Segal, *infra* note 51, at 11 ("In order to provide information, goods, or services on the Web, it is necessary for an individual or company to have a web site or a homepage presence, which of course includes a domain name.").

30. See, e.g., Robert Brady et al., *Determining and Preserving the Assets of Dot-Coms*, 28 DEL. J. CORP. L. 185, 185 (2003) (noting that unlike "old economy companies," dot-com companies "possess less tangible, but not necessarily less valuable, assets like customer lists, data, software technology, trademarks, copyrights, patents, domain names, and other intellectual property"); Farah Z. Usmani, *Information Privacy and Internet Company Insolvencies: When a Business Fails, Does Divestiture or Bankruptcy Better Protect the Consumer?*, 8 FORDHAM J. CORP. & FIN. L. 273, 276 (2003) (noting that when many e-companies declared bankruptcy, among their most valuable assets were domain names,

company itself or the name of a brand, product, or service.³¹ The more recognizable the domain name, the more value it has in the online market. For example, “business.com” was sold for \$7.5 million,³² “loans.com” for \$3.0 million, “wine.com” for \$3.0 million,³³ “autos.com” for \$2.2 million,³⁴ and “men.com” for \$1.3 million.³⁵ Offers reached eight million dollars for “cool.com,” and ten million dollars for “america.com.”³⁶

Some Internet companies have been willing to spend a large amount of money for a memorable, easy-to-type domain name, because the name helps increase traffic to their Web sites.³⁷ Internet users often search for a company, product, or service by typing a domain name address in a location bar or entering key words in a search engine.³⁸ A memorable and easy-to-type domain name will attract more visitors than a long, complicated, or cumbersome domain name. For example, “loans.com” received more than 3,000 visitors a day even though there were no active

licensed technology, and customer lists).

31. *Sallen v. Corinthians Licenciamentos LTDA*, 273 F.3d 14, 19 (1st Cir. 2001) (noting that domain names are often company names and names of products and services).

32. S. A. Mathieson, *It's All in a Name: Can You Still Find a Good Domain Name for Your Business?*, THE GUARDIAN (London), Oct. 30, 2003 (reporting the sale of the domain name “business.com” for \$7.5 million and “if.com” for one million dollars), available at <http://www.guardian.co.uk/print/0,3858,4785236-111113,00.html>.

33. DomainMart, *Most Valuable Domain Names*, at <http://www.domainmart.com/interact/most-valuable.htm> (last visited Oct. 5, 2004).

34. *Id.* Among the car-related domain names, “Cars.com” was a subject of litigation, and a federal court found that the service mark “CARS.COM” was a “famous mark[.]” *Classified Ventures, LLC v. Softcell Mktg., Inc.*, 109 F. Supp. 2d 898, 900–01 (N.D. Ill. 2000) (finding that plaintiff had developed “CARS.COM” into a strong and famous mark within one year and noting that “[g]iven the nature of communication, particularly over the Internet, even marks advertised but a year can develop strength and fame” and that the site’s overnight success is “evident by the activity on the Cars.com Site, which is one of the most heavily trafficked auto-related web sites on the Internet”).

35. *Domain Name Prices Rise Again*, INVESTOR’S BUS. DAILY, Dec. 29, 2003, at A02 (reporting that domain name prices are on the rise again as evident by the purchase of “men.com” for \$1.3 million by a group of entertainment executives from Rick Schwartz).

36. *Cool.com: Most Valuable Domain Name?*, MSNBC, Mar. 30, 2000 (reporting various offers for purchasing domain names “cool.com” and “america.com”), at http://www.zdnet.com/2100-9595_22-519606.html.

37. David P. Miranda, *The Master of Your Domain Name*, 18-2 INTELL. PROP. L.N. 23 (2000) (stating that as “websites on the Internet continue to proliferate, the value of memorable domain names have skyrocketed”); INTERNET MAGAZINE, NOV. 1, 2003, at 26 (stating that users visit Web sites by typing domain names directly as a URL address and thus having a memorable domain name is important), available at 2003 WL 2144367.

38. See, e.g., *Brookfield Communications, Inc. v. W. Coast Entm’t Corp.*, 174 F.3d 1036, 1044–45 (9th Cir. 1999) (describing search methods on the Internet).

Web pages connected with the domain name.³⁹ Bank of America understood how users search for information, products, and services on the Internet, so the company did not hesitate to purchase a domain name for the high ticket price of three million dollars.⁴⁰ To establish a presence on the Internet, a company must distinguish itself among the vast network of Web sites.⁴¹ One way to do this is to possess a memorable domain name that appeals to customers much like a brand name.⁴² This realization has led to speculation in domain name values in recent years. A notable case showing the effect speculation can have on a domain name's value is "sex.com," which was reportedly worth as much as \$250 million.⁴³

One of the reasons for the spectacular rise in domain name values is the scarcity problem.⁴⁴ Another reason is the structure of the domain

39. Daniel Joelson, *Banks Square Off Over Internet Domain Names*, BANK TECH. NEWS, Nov. 22, 2000, at 1 (reporting the number of visitors to "loans.com" without having an active Web site), available at 2000 WL 17153605.

40. *Id.* (reporting banks attempting to establish their presence on the Internet).

41. Gayle Weiswasser, *Domain Names, The Internet, and Trademarks: Infringement in Cyberspace*, 20 SANTA CLARA COMPUTER & HIGH TECH. L.J. 215, 224 (2003) (stating that in order for Internet companies to communicate effectively to their customers, it is essential that they have a unique domain name that is easily recognizable to customers). Domain names are seen as the "corporate identity in the information age" and "the electronic signs on the virtual storefronts." *Id.*; see also David P. Krivoshik, *Intellectual Property: Paying Ransom on the Internet*, N.J. L.J., Oct. 23, 1995, at 10 (discussing valuable domain names in e-commerce); Steve Higgins, *What's in an Internet Name? To On-Line Marketers, Lots*, INVESTOR'S BUS. DAILY, Oct. 17, 1995, at A10 ("Catchy addresses are as important to on-line merchants as prime retail space is to conventional merchants, cybernauts say. It's easier to order jewelry from a business that can be reached by typing 'gold.com,' for example, than it is to buy it from another vendor with a forgettable address.").

42. See Peter B. Maggs, *The 'US' Internet Domain*, 50 AM. J. COMPUTER L. 297, 298 (2002) (noting that because "domain names are used by people to identify businesses and institutions, it is important that they be easy to remember, easy to use, and have positive connotations"); Minqin Wang, *Regulating the Domain Name System: Is the "Biz" Domain Name Distribution Scheme an Illegal Lottery?*, 2003 U. ILL. L. REV. 245, 271 (2003) ("[W]ith the emergence of the Internet as a market place for products and services, the ownership of a domain name can be very valuable, especially if it is an easy to guess or easy to remember name representing a company, industry, product, or service."); Shelley Rowland & Tim Jackson, *Protecting Your IP*, INDEP. BUS. WKLY., June 19, 2002 (recommending companies to "consider domain name registrations as a part of an overall branding strategy"), available at 2002 WL 11115753.

43. See Jon Swartz, *Sex.com Ownership Ruling Expected; Domain Name Hotly Disputed*, USA TODAY, Aug. 2, 2000, at 3B. The "sex.com" site had reportedly received twenty-five million visitors daily. Elen Lewis, *Sex Education*, NEW MEDIA AGE, June 28, 2001, available at 2001 WL 11319111; see also Joseph Menn, *Tangled Tale of the Pilfered Porn Site Courts: Stephen Cohen, One of the Internet's Most Successful Entrepreneurs, Made His Fortune by Stealing the Sex.com Site*, L.A. TIMES, Mar. 26, 2001, at C-1 (reporting on the litigation over ownership of the "sex.com" domain name).

44. The scarcity of domain names is attributable to four key factors: the technical uniqueness, the semantic uniqueness, the economic uniqueness, and the origin uniqueness of domain names.

name assigning system. Top-Level-Domain (“TLD”) names (“.com,” “.net,” and “.org”) are assigned on a first-come, first-served basis.⁴⁵ Domain names are designed to make the Internet friendly to use, by replacing hard-to-remember Internet Protocol numbers with mnemonic names.⁴⁶ Each computer or host on the Internet has an Internet Protocol address composed of a long string of numbers, which is quite difficult for users to remember.⁴⁷ The domain name system employs alphanumeric names for ease of use.⁴⁸ As a result, almost all of the words in the English language have already been registered as domain names.⁴⁹ Individuals or companies that wish to obtain a domain name often discover that the name is no longer available for registration.

To ease the domain name scarcity problem, ICANN,⁵⁰ a nonprofit

CHRISTOPHER REED, *INTERNET LAW: TEXT AND MATERIALS* 38 (2000). Some commentators, however, believe that the scarcity is artificially created by the lack of democratic participation in the control of Top-Level-Domains. See Jay P. Kesan, *Private Internet Governance*, 35 *LOV. U. CHI. L.J.* 87, 116 (2003) (summarizing critiques of the domain name assigning systems).

45. Christopher S. Lee, *The Development of Arbitration in the Resolution of Internet Domain Name Disputes*, 7 *RICH. J.L. & TECH.* 2, ¶¶ 7–10 (2000) (stating that NSI is the registrar that provided domain name registration services for domain names in the TLDs “.com,” “.org,” and “.net”), at <http://law.richmond.edu/jolt/v7i1/article2.pdf>.

46. A. Michael Froomkin & Mark A. Lemley, *ICANN & Antitrust*, 2003 *U. ILL. L. REV.* 1, 6 (2003) (noting that because Internet Protocol “numbers are hard for people to remember, Internet standards provide for the creation of mnemonic names [or domain names] for resources”); Viktor Mayer-Schönberger, *The Shape of Governance: Analyzing the World of Internet Regulation*, 43 *VA. J. INT’L L.* 605, 657 (2003) (stating that the Internet domain name system makes “it easier for humans to memorize where in cyberspace a particular piece of information is located or how a particular communication partner can be reached” and that “[i]n essence, a domain name is mnemonic shorthand for the hard-to-remember numerical Internet address”).

47. Tamarah Belczyk, *Domain Names: The Special Case of Personal Names*, 82 *B.U. L. REV.* 485, 489 (2002) (noting that host computers connected to the Internet are identified and located by numerical Internet Protocol addresses that “consist of a series of numbers separated by periods, for example 123.456.789.12”).

48. Steven Blackerby, *Flat Broke and Busted, But Can I Keep My Domain Name? Domain Name Property Interests in the First, Fifth, and Eleventh Circuits*, 11 *J. INTELL. PROP. L.* 117, 121 (2003) (noting that “[b]ecause people remember names better than [a long string of] numbers,” the Domain Name System was designed to translate domain names used by humans into the numeric Internet Protocol addresses used by computers connected to the Internet).

49. Anupam Chander, *The New, New Property*, 81 *TEX. L. REV.* 715, 793 n.437 (2003); Jessica Litman, *The DNS Wars: Trademarks and the Internet Domain Name System*, 4 *J. SMALL & EMERGING BUS. L.* 149, 158 (2000) (noting that essentially every word in the English dictionary has been registered as a domain name).

50. Internet Corporation for Assigned Names and Numbers (“ICANN”) is an internationally organized, non-profit corporation that is “responsible for managing and coordinating the Domain Name System (“DNS”) to ensure that every address is unique and that all users of the Internet can find all valid addresses. It does this by overseeing the distribution of unique IP addresses and domain names. It also ensures that each domain name maps to the correct IP address.” ICANN, *FAQs*, at

company that controls the domain name assigning system, has introduced more TLDs for registration.⁵¹ The introduction of new TLDs, however, neither eliminates the domain name scarcity problem nor reduces the value of domain names that have been registered in the “.com” TLD.⁵² Domain names in the “.com” TLD are often viewed as most desirable⁵³ because “.com” represents “.commercial,” and therefore Internet companies believe that having a “.com” name means they are serious about e-commerce.⁵⁴

B. UNCERTAIN TAX TREATMENT OF DOMAIN NAMES

Despite the great value of domain names to many online businesses, rules do not exist that specifically govern their proper tax treatment. It would appear that the costs of purchasing an existing domain name would not be immediately deductible, but rather would have to be capitalized.⁵⁵ Under Treasury regulations issued in 2004, a taxpayer is required to “capitalize amounts paid to another party to acquire [an]

<http://www.icann.org/faq/#WhatisICANN> (last modified June 9, 2004).

51. David E. Roberts, *Top Level Domain Reorganization: A Constitutional Solution to Legislative Attempts at Internet Regulation*, 36 IND. L. REV. 883, 904 (2003) (stating that ICANN responded to the saturation of the “.com” TLD by creating seven new TLDs); Pamela Segal, *Attempts to Solve the UDRP's Trademark Holder Bias: A Problem That Remains Unsolved Despite the Introduction of New Top Level Domain Names*, 3 CARDOZO ONLINE J. CONFLICT RESOL. 1, ¶¶ 18–20 (2001) (noting the new TLDs introduced by ICANN in 2000), at <http://www.cardozojcr.com/vol3no1/notes02.html>.

52. Orion Armon, *Is This as Good as It Gets? An Appraisal of ICANN's Uniform Domain Name Dispute Resolution Policy (UDRP) Three Years After Implementation*, 22 REV. LITIG. 99, 103–04 (2003) (noting that the introduction of the new TLDs such as .info and .biz, among others, will not “markedly reduce the number of Internet domain name . . . disputes, because the availability of new TLDs has not prompted companies to abandon their old <.com> domains” and many new domain name registrations in the new TLDs “are being used as ‘pointers’ to forward Internet browsers to websites in the <.com> TLD”).

53. Connie L. Ellerbach, *Domain Name Dispute Remedies: Tools for Taming the World Wide Web*, 759 PLI/PAT 513, 516 (2003) (noting that the “.com” TLD “has become the [TLD] of choice, desired by both commercial and non-commercial entities”).

54. Litman, *supra* note 49, at 158–59 (stating that “[b]ecause of successful advertising, a large segment of the public had come to view .com as the only ‘real’ domain”).

55. Most taxpayers prefer to fully recover costs through immediate deductions rather than spread those costs over a number of years (i.e., amortize the costs) or recover those costs when the property is disposed of (i.e., subtract the costs from the amount realized on a sale to determine gain realized). Unfortunately, there are a number of overriding Code provisions that prevent the current deductibility of otherwise allowable expenditures. Thus, what may seem to be a deductible expense under one provision may be classified as a non-deductible expenditure under another overriding provision. A major overriding provision is one that disallows the immediate deduction of costs that are considered “capital expenditures.” See I.R.C. § 263(a) (2000) (providing for nondeductibility of capital expenditures); see also *id.* § 263A(a) (2000) (requiring a taxpayer to capitalize all direct and indirect expenditures incurred to produce certain property).

intangible from that party in a purchase or similar transaction.”⁵⁶ This rule “merely reflects [well-established] law requiring capitalization of the purchase price . . . paid to acquire property from another.”⁵⁷ The regulations list some examples of intangible assets that must be capitalized if the intangible is acquired from another person in a purchase transaction. Although domain names are not listed, acquired domain names would seemingly fall within the capitalization rule.

As with the costs of purchasing a domain name, it would appear that the registration costs to obtain a domain from a domain name registrar could not be immediately deducted and would also have to be capitalized. Treasury regulations issued in 2004 require taxpayers to capitalize amounts paid to another party to create eight categories of created intangibles.⁵⁸ One category encompasses certain rights obtained from a governmental agency.⁵⁹ For example, a taxpayer must capitalize amounts paid to a governmental agency to obtain or renew a trademark, trade name, or other similar right granted by a governmental agency.⁶⁰ Even if domain names do not fall within this or one of the other categories, the regulations also require taxpayers to capitalize amounts paid to another party to create a “separate and distinct intangible.”⁶¹ A separate and distinct intangible asset is defined as (1) “a property interest of ascertainable and measurable value in [money or] money’s worth” (2) “that is subject to protection under applicable State, Federal or foreign law,” and (3) “the possession and control of which is intrinsically capable of being sold, transferred, or pledged.”⁶²

If the costs of registering or acquiring a domain name are not immediately deductible, but rather are capitalized, then the next issue is whether the capitalized costs may nevertheless be eligible for deductions

56. Treas. Reg. § 1.263(a)-4(c)(1) (2004). The reason such acquisition costs are not currently deductible is that the resulting property is not consumed or used within the year, but rather persists and generates income over a period of years. If the costs incurred to acquire such property were deductible in full in the current year, then there would be a mismatching of income and expenses that produced that income. Income would be understated in the year of acquisition and overstated in later years. This problem is avoided by prohibiting the immediate deduction of capitalized acquisition costs.

57. Preamble, 67 Fed. Reg. 77701, 77703 (Dec. 19, 2002).

58. Treas. Reg. § 1.263(a)-4(d)(1).

59. *Id.* § 1.263(a)-4(d)(5).

60. *Id.* The preamble to the proposed regulations notes that this general rule is directed at the initial fee paid to a governmental agency. Preamble, 67 Fed. Reg. at 77703. Later, this article argues that domain names are not similar to governmental rights.

61. Treas. Reg. § 1.263(a)-4(b)(1).

62. *Id.* See *infra* Part III, for the legal nature of domain names.

over time through an appropriate amortization allowance under an Internal Revenue Code provision or some administrative pronouncement. Unfortunately, none of the current amortization provisions in the Code specifically address domain names.⁶³

II. TAX TREATMENT OF TRADITIONAL INTELLECTUAL PROPERTY RIGHTS AND OTHER INTANGIBLE ASSETS

A. PRE-1993 TAX LAW

Prior to 1993, the tax law governing intangible assets favored certain traditional intellectual property rights (patents and copyrights) over other traditional intellectual property forms (trade secrets, trademarks, and trade names). Treasury regulations provided that the costs of acquiring intangible assets having a useful life substantially beyond the taxable year were not currently deductible, but rather capitalized.⁶⁴ If, however, an acquired intangible asset could be shown to have a limited useful life, then the capitalized acquisition costs were recoverable (deductible) over that asset's lifetime.⁶⁵ As a corollary, the capitalized cost of an intangible asset that had no definite useful life was not

63. Just as there are no tax rules dealing with the amortization of domain name acquisition costs, there are no tax rules governing the sale of domain names.

Because of the unique characteristics of domain names (registrant is not the owner and may lose use for failure to pay renewal fees), it is important first to ascertain whether payments [received] in consideration for the transfer of a domain name are for services (which cannot qualify for capital gains treatment) or for property (which may or may not qualify for capital gains treatment).

MAINE & NGUYEN, *supra* note 7, at 401. Presumably, if a domain name is considered property, the next step would be to determine whether section 1253 applies to a domain name transfer. If the transfer of a domain name is not within the scope of section 1253, then other tax provisions, such as sections 1221, 1222, 1231, and 1245, would presumably govern the character of the gain or loss. For the likely tax treatment of domain name sales, see MAINE & NGUYEN, *supra* note 7, at 401-08.

64. Treas. Reg. § 1.263(a)-2(a) (1960). The reason such intangible asset acquisition costs are not currently deductible is that the resulting acquired intangibles are not consumed or used within the year, but rather persist and generate income over a period of years. If the costs incurred to acquire such intangible assets were deductible in full in the current year, then there would be a mismatching of income and expenses that produced that income. Income would be understated in the year of acquisition and overstated in later years. This problem is avoided by prohibiting the immediate deduction of capitalized acquisition costs.

65. *Id.* § 1.167(a)-3.

If an intangible asset is known from experience or other factors to be of use in the business or in the production of income for only a limited period, the length of which can be estimated with reasonable accuracy, such an intangible asset may be the subject of a depreciation allowance.

Id.

recoverable through amortization, but could only be recovered upon abandonment or disposition of the asset.⁶⁶

I. *Traditional Intellectual Property Rights*

Under this legal framework, patents and copyrights were eligible for amortization due to the fact that they have limited useful lives (statutory legal lives of twenty years in the case of patents and 70, 95, or 120 years in the case of certain copyrights).⁶⁷ Moreover, the capitalized costs of acquiring patents and copyrights did not have to be amortized over their long legal lives, but could be recovered over much shorter periods. The regulations provided that the useful life of an intangible was not necessarily the statutory legal life of the asset, but rather was the period over which the asset may reasonably be expected to be useful to the taxpayer in his trade or business or in the production of income.⁶⁸ A taxpayer could establish the useful life of a patent or copyright for amortization purposes based upon his own experiences with similar property; if such experiences were inadequate, a taxpayer could establish the useful life based upon general industry standards.⁶⁹ Furthermore, a taxpayer had to establish the useful life only with "reasonable accuracy."⁷⁰ According to one court, "[e]xtreme exactitude in ascertaining the duration of an asset is a paradigm that the law does not demand. All that the law and regulations require is reasonable accuracy in forecasting the asset's useful life."⁷¹

In contrast to patents and copyrights, other traditional intellectual property rights were not eligible for amortization since they do not have limited lives. There is no specific term of protection for trade secrets; the protection is available as long as confidential proprietary information is

66. *Id.* ("An intangible asset, the useful life of which is not limited, is not subject to the allowance for depreciation.")

67. Indeed, the regulations specifically mentioned patents and copyrights as intangible assets eligible for amortization. *Id.* A patent confers the right to exclude others from making, using, selling, offering for sale, or importing the claimed invention for a certain term of years (currently twenty years from the date of application). 35 U.S.C. §§ 154(a)(2), (d) (2000). Ownership of a valid copyright confers five exclusive rights for a limited time. The Copyright Act, over the years, has lengthened the term of copyright protection. Currently, a work of authorship enjoys a term of the life of the author and seventy years thereafter. 17 U.S.C. § 302(a) (2000). For works created under the doctrine of works made for hire, the term is ninety-five years after first publication or 120 years after creation. *Id.* § 302(c).

68. Treas. Reg. § 1.167(a)-1(b) (as amended in 1972).

69. *Id.*

70. Treas. Reg. § 1.167(a)-3 (1960).

71. *Houston Chronicle Publ'g Co. v. United States*, 481 F.2d 1240, 1253-54 (5th Cir. 1973).

kept in secrecy, which could be indefinite.⁷² Likewise, there is no specific term of protection for trademarks and trade names; the protection is available as long as the trademark or trade name is used in commerce and has not been abandoned.⁷³ Accordingly, under pre-1993 law, all trade secret, trademark, and trade name acquisitions costs had to be capitalized and could only be recovered upon abandonment or disposition of those assets.⁷⁴

2. *Goodwill*

The same was true for goodwill. Under pre-1993 tax law, the capitalized costs of acquiring goodwill were not eligible for amortization allowances, as goodwill does not have an ascertainable limited life.⁷⁵ Lest there be any doubt, Treasury regulations clarified that “[n]o deduction for depreciation [was] allowable with respect to goodwill.”⁷⁶ The capitalized costs of obtaining goodwill could only be recovered upon abandonment or disposition of the goodwill.

Prior to 1993, “goodwill” was viewed as an umbrella covering all intangible assets of a business. This historical concept of goodwill led to considerable controversy between taxpayers and the Internal Revenue Service. While taxpayers attempted to argue that a wide variety of intangible assets were independent assets severable from goodwill (and eligible for amortization provided they had a limited useful life), the Service strongly held to the position that these intangible assets were indistinguishable or inseparable from goodwill (and not eligible for amortization). The controversy over whether to characterize intangible assets as goodwill was eventually settled with the Supreme Court’s

72. See UNIFORM TRADE SECRETS ACT (amended 1985), 14 U.L.A. 433 (1990).

73. Under federal trademark law, abandonment is presumed if nonuse of the trademark extends for three years. 15 U.S.C. § 1127 (2000). Token uses of a trademark for the purpose of reserving trademark rights do not prevent a finding of abandonment. *Exxon Corp. v. Humble Exploration Co.*, 695 F.2d 96, 99–103 (5th Cir. 1983). In addition, abandonment of a trademark could occur if the owner failed to police the trademark so that it becomes the generic name for the product or service with which it is used. 15 U.S.C. § 1127.

74. I.R.C. § 177 (repealed 1986) permitted taxpayers to elect to amortize any trademark or trade name expenditures over a period of five years or more.

75. The prohibition against amortizing the cost of goodwill first appeared in Treas. Reg. § 1.167(a)-3, which stated that “[n]o deduction for depreciation is allowable with respect to good will.” This prohibition first appeared in the regulations in 1927. See Kevin R. Conzelmann, 533-2d T.M., *Amortization of Intangibles*, A-5 & A-5 n.31 (2001) (citing T.D. 4055, VI-2 C.B. 63; Reg. 69, Art. 163 (Revenue Act of 1926)).

76. Treas. Reg. § 1.167(a)-3 (1960); see Conzelmann, *supra* note 75, at A-5 & A-5 n.31 (citations omitted).

decision in *Newark Morning Ledger Co. v. United States*.⁷⁷ The Supreme Court held in that case that amortization of an intangible asset depends on whether the asset is capable of being valued and whether the asset has a limited useful life. The Court rejected the Service's argument that a taxpayer must also prove that the intangible is separate and distinct from goodwill.

3. *Governmental Rights and Contract Rights*

Prior to the Supreme Court's decision in *Newark Morning Ledger*, the tax treatment of goodwill often impacted the tax treatment of other intangible assets, including, for example, service contracts. Under pre-1993 tax law, if a service contract was a distinct and identifiable asset severable from the concept of goodwill, it was amortizable if the contract had a useful life. No depreciation deduction would be allowed if the contract were inseverable from goodwill or if the contract had an indefinite useful life.

A typical case under pre-1993 law dealing with service contracts was *KFOX, Inc. v. United States*.⁷⁸ In *KFOX*, the buyer of a radio station allocated the total purchase price among the various tangible and intangible assets obtained. More specifically, the buyer allocated \$400,000 to disc jockey and station manager contracts and depreciated that amount over the life of the contracts.⁷⁹ The Service denied this allocation completely, holding that these contracts were intangible assets inseparable from the concept of goodwill and as such were nondeductible.⁸⁰

The Claims Court first addressed whether these contracts were severable from the general concept of goodwill. Relying on *Meredith Broadcasting Co. v. United States*,⁸¹ the Claims Court concluded that goodwill was divisible into its identifiable parts, and that service contracts of significant and identifiable value could be severed from goodwill, where goodwill was defined generally.⁸² The Claims Court determined in

77. 507 U.S. 546 (1993). The controversy was settled by the later enactment of I.R.C. § 197, which is discussed *infra* Part II.A.3.

78. 510 F.2d 1365 (Ct. Cl. 1975).

79. *Id.* at 1376.

80. *Id.*

81. 405 F.2d 1214 (Ct. Cl. 1968) (concluding that where "goodwill" is used as a catch-all term for all of a going business' intangible assets that are associated with its profitability, it is clearly divisible into its component parts).

82. *KFOX*, 510 F.2d at 1376-77.

KFOX that the disc jockey and station manager contracts (1) “had significant and measurable value independent of their direct contribution to the value of [the institution’s] goodwill,” (2) “were necessary assets for the continued profitability of the [radio] station,” and (3) “provided nothing to *KFOX*’s institutional goodwill inasmuch as radio or television audiences are not loyal to a particular station so much as an individual star or format.”⁸³ Accordingly, the court concluded that the contracts were independent assets severable from the radio station’s goodwill and could be treated separately for tax purposes.⁸⁴

The Claims Court then addressed whether these contracts, even though severable from goodwill, were amortizable. As noted above, the cost of an intangible asset which could be shown to have a limited useful life was recoverable through an amortization allowance over that asset’s lifetime.⁸⁵ It had previously been determined that, with respect to service contracts, the reasonable useful life was the contract’s stated term.⁸⁶ It had also been determined that the existence of a renewal option did not necessarily mean that the life of a contract was indefinite,⁸⁷ and that the useful life of a contract may include renewal options in some cases.⁸⁸ Accordingly, the Claims Court in *KFOX* held that the disc jockey and station manager contracts were amortizable over the contract life, which was measured by the contract term plus a single renewal option.⁸⁹ The four disc jockey contracts were amortizable over five years (they “were to last two years, each with an option of renewal by the station for an additional three-year term”).⁹⁰ The station manager contract was amortizable over four years (it was to last two years, with a two-year

83. *Id.* at 1377.

84. *Id.*

85. See Treas. Reg. § 1.167(a)-3 (1960), discussed *supra* notes 65-67, 70, 75-76 and accompanying text.

86. *Triangle Publ’ns, Inc. v. Comm’r*, 54 T.C. 138, 147 (1970); *Hoffman v. Comm’r*, 48 T.C. 176, 177-78 (1967).

87. Of course, as with any other intangible asset, an amortization deduction would not be allowed if the contract had no definite useful life, as in the case of a service contract subject to revocation upon notice. *Comm’r v. Ind. Broad. Corp.*, 350 F.2d 580, 581 (7th Cir. 1965); *Westinghouse Broad. Co. v. Comm’r*, 309 F.2d 279, 282-83 (3d Cir. 1962).

88. See Rev. Rul. 71-137, 1971-1 C.B. 104 (addressing proper tax treatment of acquisition costs of football player contracts with option clauses); Rev. Rul. 67-379, 1967-2 C.B. 127 (addressing tax treatment of a baseball player contract with renewal or reserve clause giving purchaser the right to renew the contract upon expiration of the one-year term).

89. 510 F.2d at 1378.

90. *Id.* at 1374.

renewal option).⁹¹ It is important to note that, in *KFOX*, the disc jockey and station manager contracts had a single renewal option. Under pre-1993 law, if contracts for services had automatic renewal provisions, they would have no ascertainable useful life and thus be ineligible for amortization.

This same treatment applied to governmental licenses (such as FCC television and radio broadcast licenses). Under pre-1993 law, governmental licenses were generally ineligible for amortization because such licenses tended to be renewed repeatedly and hence had no determinable useful lives.⁹² For example, in *Meredith Broadcasting Co. v. United States*, the Claims Court held that a taxpayer was not entitled to an amortization deduction for an FCC license because such licenses do not have determinable useful lives.⁹³ The Claims Court, in *Forward Communications Corp. v. United States*, later held that FCC radio broadcasting licenses were generally ineligible for amortization because they tend to contain automatic renewal provisions and, thus, have no reasonably ascertainable limited useful life.⁹⁴

B. POST-1993 TAX LAW

The Revenue Reconciliation Act of 1993 (RRA of 1993) dramatically changed the tax treatment of traditional forms of intellectual property and other intangible rights, including goodwill, by enacting section 197 of the Code.⁹⁵ Prior to the enactment of section 197 in 1993, as discussed above, the costs of acquiring intangible assets could be amortized only if the intangible assets had a useful life that could be determined with reasonable accuracy.⁹⁶ This seemingly simple rule for recovering the costs of intangible assets created several problems.

One problem with the historical tax regime for intangibles was that it caused much litigation concerning the identification of intangible assets

91. *Id.*

92. See, e.g., *Richmond Television Corp. v. United States*, 354 F.2d 410, 413-14 (4th Cir. 1965); *KWTX Broad. Co. v. Comm'r*, 31 T.C. 952 (1959), *aff'd per curiam*, 272 F.2d 406 (5th Cir. 1959); *Forward Communications Corp. v. United States*, 608 F.2d 485, 494 (Ct. Cl. 1979).

93. 405 F.2d 1214, 1230 (Ct. Cl. 1968).

94. 608 F.2d 485, 494-96 (Ct. Cl. 1979).

95. Revenue Reconciliation Act of 1993, P.L. 103-66, 107 Stat. 416 (1993) (codified as amended at 26 U.S.C. § 197 (2000)).

96. See *Treas. Reg. § 1.167(a)-3* (as amended in 2000), discussed *supra* notes 65-67, 70, 75-76 and accompanying text.

and their useful lives.⁹⁷ No deduction for depreciation was allowable with respect to goodwill,⁹⁸ so taxpayers tried to distinguish intangible assets from goodwill, and the Internal Revenue Service often challenged those determinations.⁹⁹ In 1991, the government estimated that the Internal Revenue Service assessed eight billion dollars in deficiencies against taxpayers who attempted to amortize intangibles that the Service claimed were part of non-amortizable goodwill.¹⁰⁰ In 1993, it was estimated that \$14.4 billion in proposed adjustments relating to amortization of intangible assets had been made by the Service at various levels of audit and litigation.¹⁰¹ Of course, taxpayers who had the resources to litigate over the identification, valuation, and establishment of limited useful lives of intangible assets were better off than those taxpayers who lacked resources. Needless to say, with so much litigation and uncertainty, there was a need to simplify the tax law relating to intangibles.¹⁰²

A second problem arose as commentators questioned the courts' well-established theory that goodwill retains its value indefinitely and, therefore, is nondepreciable.¹⁰³ The recent activities of a business determine goodwill, "(i.e., the ability to generate excess earnings)"; if a business makes no effort to create new goodwill, it will diminish.¹⁰⁴ Furthermore, it was inequitable that taxpayers were able to depreciate the assets used to create goodwill, yet unable to depreciate purchased goodwill.¹⁰⁵ However, by definition, goodwill does not have an ascertainable useful life or necessarily declines over time, so it cannot be said to "depreciate."¹⁰⁶

97. See Catherine L. Hammond, *The Amortization of Intangible Assets: § 197 of the Internal Revenue Code Settles the Confusion*, 27 CONN. L. REV. 915, 918 (1955) ("Because the determination of whether an intangible can be amortized was a question of fact, the outcome of such litigation varied widely according to the circumstances of each particular case.").

98. See *supra* notes 65-67, 70, 75-76 and accompanying text, for a discussion of Treas. Reg. § 1.167(a)-3.

99. Hammond, *supra* note 97, at 918 ("Additional confusion and litigation arose because the term 'goodwill' is not defined in the Code or in the regulations.").

100. See Conzelmann, *supra* note 75, at A-3 (citing Gen. Accounting Office, *Tax Policy: Issues and Policy Proposals Regarding Tax Treatment of Intangible Assets*, GGD-91-88 (Aug. 9, 1991)).

101. *Id.* (citing TAX NOTES TODAY, Oct. 4, 1993).

102. *Id.* (citing Newark Morning Ledger Co. v. United States, 507 U.S. 546, 570 (1993)).

103. Walburn, *infra* note 108, at 468.

104. *Id.* at 468-69 (citing Walter C. Frank, *Goodwill Is Not Immortal: A Proposal to Deduct the Exclusion of Purchased Goodwill*, 23 J. TAX'N 380, 381 (1965)).

105. *Id.* at 469-70.

106. Peter J. Cannici, *Appreciating the Depreciation of Intangible Assets*, 55 OHIO ST. L.J. 1159, 1178-79 (1994).

A third problem stemmed from the fact that the rule for recovering the costs of acquired intangible assets differed dramatically from the corresponding set of rules for recovering the costs of acquired tangible assets. In contrast to the regulatory rule governing intangible assets, the Internal Revenue Code contained a detailed set of arbitrary recovery rules for all tangible assets. More specifically, the relevant Code provisions provided arbitrary conventions and methods for recovering costs of tangible assets and, more importantly, provided artificially low recovery periods (3, 5, and 7 year recovery periods) for many tangible assets that arguably have longer useful lives.¹⁰⁷ This disparate treatment between intangible and tangible assets created distortions that were unfair to taxpayers.¹⁰⁸ For example, taxpayers who acquired businesses with mostly tangible assets fared better than taxpayers who acquired businesses with mostly intangible assets, a problem that worsened as more and more valuable business assets took the form of intangible assets.¹⁰⁹ To mitigate these distortions, many saw the need to reconcile the treatment of acquired intangible assets with the treatment of acquired tangible assets.¹¹⁰

Section 197, which was enacted in 1993 to address these problems, created an arbitrary fifteen-year recovery period for certain intangible assets. Specifically, section 197 provides a fifteen-year amortization deduction for the capitalized costs of an “amortizable section 197 intangible,” and prohibits any other depreciation or amortization deduction with respect to that property.¹¹¹ Section 197 defines an “amortizable section 197 intangible” as any “section 197 intangible” acquired after August 10, 1993, and held in connection with the conduct

107. I.R.C. §§ 167, 168 (2004) (providing a set of arbitrary rules for determining the appropriate depreciation allowance for all forms of tangible property, both personal and real).

108. See Allen Walburn, *Depreciation of Intangibles: An Area of the Tax Law in Need of Change*, 30 SAN DIEGO L. REV. 453, 454-56 (1993) (explaining that inequity between similarly situated taxpayers resulted in noncompliance and much litigation, which unnecessarily burdened the administration of tax law).

109. See Conzelmann, *supra* note 75, at A-3 & A-3 n.7 (citing *Newark Morning Ledger Co. v. United States*, 507 U.S. 546, 570 (1993), and noting that taxpayers with resources “had a much better success rate in litigation than poorer taxpayers”).

110. *Id.*

111. I.R.C. § 197(a)-(b). The amortization deduction under section 197 is determined by amortizing the capitalized costs ratably over a fifteen-year period beginning on the first day of the month in which the property is acquired and held in connection with a trade or business or activity conducted for profit. *Id.* § 197(a); Treas. Reg. § 1.197-2(f)(1) (as amended in 2000); see I.R.C. §§ 162 (trade or business expenses) & 212 (activity conducted for profit).

of a trade or business or an activity conducted for profit.¹¹² Section 197 provides a list of intangible assets that fall within the definition of "section 197 intangible" and are subject to fifteen-year amortization. Section 197 also specifically excludes certain intangible assets. If section 197 does not apply to an intangible asset (i.e., the asset is not listed as a section 197 intangible or is specifically excluded from the definition), amortization continues to be governed by pre-section 197 law.¹¹³ Thus, an intangible asset that is not covered by section 197 and its fifteen-year amortization will be subject to an amortization allowance only if the asset has a limited useful life, the duration of which can be ascertained with reasonable accuracy.¹¹⁴

Section 197 dramatically changed the tax treatment of many forms of intangible assets. Section 197 provided an arbitrary fifteen-year recovery period for many intangible assets that were already amortizable over their useful lives under pre-section 197 law.¹¹⁵ More importantly, it provided for the first time an arbitrary fifteen-year recovery period for many intangible assets that have unlimited useful lives and, as a result, were not at all amortizable under pre-section 197 law.¹¹⁶ It also left the law as it was for several other forms of intangible assets, permitting them to be recovered over their reasonable useful lives.¹¹⁷ What was clear after the enactment of section 197 was that the capitalized costs of creating or acquiring traditional forms of intellectual property rights and many other intangibles were deductible over some recovery period (either fifteen years or the asset's useful life).¹¹⁸

In January 2004, the Treasury department issued final regulations under section 167 providing a fifteen-year safe harbor amortization period for certain intangible assets that do not have readily ascertainable

112. I.R.C. § 197(c)(1).

113. Treas. Reg. § 1.167(a)-14(a) (providing that intangibles excluded from section 197 are amortizable only if they qualify as property subject to the allowance for depreciation under section 167(a)).

114. *Id.* § 1.167(a)-3 (pre-section 197 law and current law for intangibles otherwise excluded from section 197).

115. *See supra* notes 67-71 and accompanying text (discussing pre-section 197 treatment of patents and copyrights acquired as part of a trade or business).

116. *See supra* notes 72-74 and accompanying text (discussing pre-section 197 treatment of trade secrets, trademarks, and trade names).

117. *See supra* notes 67-71 and accompanying text (discussing pre-section 197 treatment of patents and copyrights acquired separately).

118. For further discussion of section 197, *see infra* notes 125-160.

useful lives.¹¹⁹ Under the safe harbor, amortization is determined using a straight-line method consistent with amortization under section 197.¹²⁰ The regulations provide that the safe harbor amortization does not apply to intangibles acquired from another party.¹²¹ The regulations also provide that the safe harbor amortization does not apply if amortization periods are already prescribed under existing law,¹²² or if intangibles already have readily ascertainable useful lives on which amortization can be based.¹²³ Thus, the safe harbor provision apparently governs only self-created intangible assets that are not governed by section 197 and do not

119. These regulations were first issued as proposed regulations in December 2002. Prop. Treas. Reg. § 167, 67 Fed. Reg. 77701 (Dec. 19, 2002), amended by Prop. Treas. Reg. § 167, 68 Fed. Reg. 4969 (Jan. 31, 2003).

120. Treas. Reg. § 1.167(a)-3(b) (as amended in 2000) (providing that the basis of the intangible asset, without regard to salvage value, is amortized ratably over the fifteen-year amortization period beginning on the first day of the month in which the intangible asset is placed in service by the taxpayer).

121. Treasury regulation section 1.167(a)-3(b)(1)(ii) provides that “a taxpayer may treat an intangible asset as having a useful life equal to 15 years *unless* . . . [t]he intangible asset is described in § 1.263(a)-4(c) (relating to intangibles acquired from another person).” Treas. Reg. § 1.167(a)-3(b)(1)(ii) (as amended in 2000) (emphasis added). Treasury regulation section 1.263(a)-4(c) states: “A taxpayer must capitalize amounts paid to another party *to acquire an intangible from that party in a purchase or similar transaction.*” Treas. Reg. § 1.263(a)-4(c)(1) (2004) (emphasis added). That regulation goes on to provide a nonexhaustive list of intangibles within the scope of the provision, provided they are “acquired from another party in a purchase or similar transaction.” *Id.* § 1.263(a)-4(c)(1)(i)-(xv) (stating that intangibles within the scope of section 1.263(a)-4(c) “include, but are not limited to” fifteen types of intangibles within the section’s scope provided they are “acquired from another party in a purchase or similar transaction”). For a discussion of whether only those fifteen types of intangibles listed in section 1.263(a)-4(c)(1)(i)-(xv) are excluded from the safe harbor amortization under section 1.167(a)-3(b)(1)(ii) if acquired from another party in a purchase or similar transaction, or, instead, whether all intangibles acquired from another party are excluded from the safe harbor amortization, see *infra* notes 385–391 and accompanying text.

122. Treas. Reg. § 1.167(a)-3(b)(1)(i). For example, section 167(f)(1) prescribes a special thirty-six-month amortization period for certain computer software, the creation costs of which were not immediately deductible under Revenue Procedure 2000-50. I.R.C. § 167(f)(1) (2004); Rev. Proc. 2000-50, 2000-2 C.B. 601. Also, section 197 already prescribes a fifteen-year amortization period for self-created trademarks and trade names. I.R.C. § 197(a), (c), (d)(1)(F).

123. Treas. Reg. § 1.167(a)-3(b)(1)(iii). Self-created patents, for example, have an ascertainable useful life since the term of a patent extends for twenty years from the date a patent application is filed. Likewise, self-created copyrights have determinable useful lives; in the case of works of authorship, the term of a copyright extends for the life of the author and seventy years thereafter; for works created under the doctrine of works made for hire, the term is ninety-five years after publication or 120 years after creation. Accordingly, the safe harbor amortization does not apply to otherwise capitalized costs of creating patents and copyrights. To the extent the costs of creating patents and copyrights are not currently deductible under the Code, (see I.R.C. sections 162 (permitting deduction for ordinary and necessary business expenses) and 174 (permitting current deduction for research and experimental expenditures)), such costs may be recovered over their useful lives under existing law. I.R.C. § 167(a); Treas. Reg. § 1.167(a)-3(a).

have determinable useful lives. Consequently, an acquired intangible asset that is not governed by section 197 and does not have a determinable useful life would not be amortizable at all.¹²⁴

The following discussion applies current tax law to the traditional forms of intellectual property (patents, trade secrets, copyrights, trademarks, and trade names), as well as to goodwill, governmental rights, and contract rights.

I. *Traditional Intellectual Property Rights*

Subject to important exceptions noted below, a “section 197 intangible” generally includes any patent, copyright, formula, process, design, pattern, know-how, format, package design, computer software, or interest in a film, sound recording, videotape, book, or other similar property.¹²⁵ A “section 197 intangible” also includes any trademark or trade name.¹²⁶ A trademark includes any word, name, symbol, device, or any combination thereof, adopted and used to identify goods or services and distinguish them from those provided by others.¹²⁷ A trade name includes any name used to identify or designate a particular trade or business or the name or title used by a person or organization engaged in a trade or business.¹²⁸ A trademark or trade name includes any trademark or trade name arising under statute or applicable common law, and any similar right obtained by contract.¹²⁹ The renewal of a trademark or trade name is treated as an acquisition of the trademark or trade name.¹³⁰

Although the definition of “section 197 intangible” appears broad enough to encompass nearly all forms of intellectual property, there are several important exceptions. First, most *self-created* forms of intellectual property are specifically excluded from the definition of section 197 intangibles.¹³¹ The regulations define a “self-created intangible asset” as an “intangible created by a taxpayer to the extent that the taxpayer

124. The Internal Revenue Service has said: “The [fifteen-year] safe harbor amortization period does not apply to intangibles acquired from another party or to created financial interests. These intangibles are generally not amortizable, are amortizable under section 197, or are amortizable over a period prescribed by other provisions of the Code or regulations.” Prop. Treas. Reg. § 167, 67 Fed. Reg. 77701, 77709 (Dec. 19, 2002).

125. Treas. Reg. § 1.197-2(b)(5) (2000).

126. Treas. Reg. § 1.197-2(b)(10).

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. I.R.C. § 197(c)(2) (2004); Treas. Reg. § 1.197-2(d)(2).

makes payments or otherwise incurs costs for its creation, production, development, or improvement, whether the actual work is performed by the taxpayer or by another person under a contract with the taxpayer entered into before the contracted creation, production, development, or improvement.”¹³² There is one important exception to the exclusion for self-created intangibles. Section 197 does apply to self-created trademarks and trade names.¹³³ As a result, taxpayers may amortize over fifteen years the capitalized costs incurred in connection with the development or registration of a trademark or trade name.¹³⁴ All other intellectual property creation costs that must otherwise be capitalized (i.e., nondeductible costs incurred in developing patents, trade secrets and know how, and copyrightable works) are not eligible for the fifteen-year amortization treatment of section 197.¹³⁵

Other exceptions in section 197 pertain to certain *purchased* intangibles. More specifically, several exceptions in section 197 apply to intellectual property that is *not* acquired in a transaction (or series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof.¹³⁶ For example, the term “section 197 intangible” does not include any interest (including an

132. Treas. Reg. § 1.197-2(d)(2)(i)-(ii). Thus, even a process or know-how that is developed specifically for a taxpayer under an arrangement with another person or organization pursuant to which the taxpayer retains all rights to the process or know-how is to be considered created by the taxpayer. See H.R. REP. NO. 103-213, at 672, 684 (1993), *reprinted in* 1993 U.S.C.C.A.N. 1088, 1361, 1373.

133. I.R.C. § 197(d)(1)(F); Treas. Reg. § 1.197-2(b)(10).

134. According to the legislative history, “the capitalized costs incurred in connection with the development or registration of a trademark or trade name are to be amortized over the [fifteen year] period.” H.R. CONF. REP. NO. 103-213, at 684 (1993), *reprinted in* 1993 U.S.C.C.A.N. 1088, 1373. The law is not clear, however, when a taxpayer must begin amortizing such costs. It should be noted that there are certain expenses associated with trademarks that are not required to be capitalized and amortized over fifteen years. There is some recent authority suggesting that advertising expenditures and costs incurred to create package designs may be deducted in full in the year paid or incurred. In Revenue Ruling 92-80, the IRS ruled that advertising expenditures are currently deductible notwithstanding the fact that they often produce benefits that give rise to distinctive intellectual property assets such as trade dress, trademarks, and trade names. Rev. Rul. 92-80, 1992-2 C.B. 57. Revenue Ruling 92-80 was recently applied by the Tax Court in a trade dress development case. See *RJR Nabisco, Inc. v. Comm’r*, 76 T.C.M. (CCH) 71 (1998) (holding that advertising campaign and execution expenditures were currently deductible even though they provided long-term benefits—statutory rights and common-law trademark rights that attach to “trade dress”). More recently, the Treasury department issued final regulations clarifying that the costs of creating a package design are currently deductible and do not have to be capitalized. Treas. Reg. § 1.263(a)-4(b)(3)(v) (2004).

135. I.R.C. § 197(e)(3)-(4); Treas. Reg. § 1.197-2(c)(7).

136. I.R.C. § 197(e). A trade or business that is acquired in a series of related transactions will be considered acquired in one transaction for applying section 197. *Id.* § 197(e)(4).

interest as a licensee) in a patent, patent application, or copyright that is not acquired as part of a purchase of a trade or business.¹³⁷ The term "section 197 intangible" also does not include any interest (including an interest as a licensee) in a film, sound recording, videotape, book, or other similar property if the interest is not acquired as part of a purchase of a trade or business.¹³⁸ Trade secrets, know-how, trademarks, and trade names are not included within the exception for separately acquired assets. Thus, these forms of intellectual property are subject to fifteen-year amortization under section 197 regardless of whether they were acquired as part of a trade or business or separately.

Whether the exception for separately acquired patents and copyrights applies depends on whether the assets were acquired in a transaction (or series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof.¹³⁹

137. *Id.* § 197(e)(4); Treas. Reg. § 1.197-2(c)(7) ("A patent or copyright includes any incidental or ancillary rights (such as a trademark or trade name) that are necessary to effect the acquisition of title to, the ownership of, or the right to use the property and are used only in connection with that property.").

138. Treas. Reg. § 1.197-2(c)(5).

A film, sound recording, video tape, book, or other similar property includes any incidental and ancillary rights (such as a trademark or trade name) that are necessary to effect the acquisition of title to, the ownership of, or the right to use the property and are used only in connection with that property. . . . [C]omputer software . . . is not treated as other property similar to a film, sound recording, video tape, or book.

Id. Likewise, the term "section 197 intangible" does not include any interest in computer software that is not acquired as part of a purchase of a trade or business. I.R.C. § 197(e)(3); Treas. Reg. § 1.197-2(c)(4).

139. A trade or business that is acquired in a *series of related transactions* will be considered acquired in one transaction for purposes of applying section 197. I.R.C. § 197(e)(4). The assets acquired in a transaction (or series of related transactions) include only assets acquired by the taxpayer and person related to the taxpayer from another person and person related to that other person. For this purpose, persons are related only if their relationship is described in section 267(b) or 707(b) or they are engaged in trades or businesses under common control within the meaning of section 41(f)(1). Treas. Reg. § 1.197-2(e)(3). The following are examples of persons that are related under section 267(b): members of a family (brothers, sisters, spouses, ancestors, and lineal descendants); an individual and a corporation in which more than 50% in value of the outstanding stock is owned, directly or indirectly, by or for such individual; two corporations which are members of the same controlled group (as defined in section 267(f)); and a corporation and a partnership if the same person owns more than 50% in value of the outstanding stock of the corporation and more than 50% of the capital or profit interest in the partnership. I.R.C. § 267(b)(1)-(3), (10), (c)(4). The following are related parties under section 707(b): a partnership and a person owning, directly or indirectly, more than 50% of the capital or profit interest in such partnership; and two partnerships in which the same persons own, directly or indirectly, more than 50% of the capital or profit interest. *Id.* § 707(b)(1). Whether acquired assets constitute a *substantial portion* of a trade or business is to be determined by all the facts and circumstances. Treas. Reg. § 1.197-2(e)(4). The nature and amount of the assets acquired and retained by the transferor are included in the analysis. *Id.* The value of the

This determination is not always easy. For purposes of section 197, an asset or group of assets constitutes a trade or business or a substantial portion thereof if (1) the use of such assets would constitute an active trade or business under section 355,¹⁴⁰ or (2) its character is such that goodwill or going concern value could under any circumstances attach to such group.¹⁴¹ In determining whether goodwill or going concern value could attach to assets, all the facts and circumstances are taken into account, including any continuing employee relationships or covenants not to compete.¹⁴² In some circumstances, the acquisition of a single asset may be treated as the acquisition of a trade or business or a substantial portion thereof.¹⁴³ In such a case, the intellectual property would be removed from the exception for intangibles purchased separately, thus requiring the application of section 197.

assets acquired relative to the value of the assets retained by the transferor is not dispositive of whether the acquired assets constitute a substantial portion of a trade or business. *Id.*

140. Treas. Reg. § 1.1060-1(b)(2)(A) (as amended in 2003). Section 355 deals with corporate divisions, such as spin-offs, split-offs, and split-ups. Under section 355, a corporate division will be eligible for nonrecognition treatment only if it meets several statutory and nonstatutory requirements. One requirement for nonrecognition treatment is that both the distributing corporation and the controlled corporation must be engaged immediately after the distribution in the active conduct of a trade or business. I.R.C. § 355(a)(1)(C), (b). The statutory definition of an “active trade or business” requires that the corporation’s trade or business have been “actively conducted throughout the 5-year period ending on the date of the distribution.” *Id.* § 355(b)(2)(B). Whether a trade or business is “actively” as opposed to “passively” engaged in a trade or business depends upon the facts and circumstances. The regulations provide that a trade or business is required to perform active and substantial management and operational functions. The active conduct of a trade or business does not include the holding of intellectual property for investment purposes or the ownership and operation (including licensing) of real or personal property used in a trade or business, unless the owner performs significant services with respect to the operation and management of the property. Treas. Reg. § 1.355-3(b)(2) (1989).

141. Treas. Reg. § 1.1060-1(b)(2)(i)(B). The regulations under section 1060 define “goodwill” as “the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor.” *Id.* § 1.1060-1(b)(2)(ii). The regulations define “going concern value” as the

additional value that attaches to property because of its existence as an integral part of an ongoing business activity. Going concern value includes the value attributable to the ability of a trade or business (or a part of a trade or business) to continue functioning or generating income without interruption notwithstanding a change in ownership.

Id.

142. Treas. Reg. § 1.197-2(e)(1).

143. See H.R. REP. NO. 103-213, at 678 (1993), *reprinted in* 1993 U.S.C.C.A.N. 1088, 1367 (providing that whether the acquisition of an asset constitutes a trade or business or a substantial portion thereof depends on whether the assets are of such a character that good will or going concern value could attach under any circumstance). One might envision, for example, a situation where the acquisition of a patent or copyright could be an acquisition of a trade or business or, more easily, a substantial portion thereof, especially if such acquisition included ancillary rights and trademarks.

As discussed above, the costs of *creating* many forms of intellectual property and the costs of *separately acquiring* patents and copyrights are not subject to fifteen-year amortization under section 197. It should be remembered, however, that if section 197 does not apply, such costs may nevertheless be recovered over the useful life of the property under section 167 (or any relevant administrative pronouncement) provided the property has an ascertainable useful life. Such recovery period may or may not be longer than the prescribed fifteen-year recovery period of section 197.

2. Goodwill

As outlined above, section 197 now governs the tax treatment of many traditional intellectual property rights, providing an arbitrary fifteen-year recovery period for rights that, under pre-section 197 law, were either not amortizable or were amortizable over a period prescribed by other provisions of the Code or regulations. In a dramatic shift in tax policy, section 197 was also structured to govern the tax treatment of goodwill.¹⁴⁴ The term "section 197 intangible" is defined as including goodwill, which is "the value of a trade or business attributable to the expectancy of continued customer patronage."¹⁴⁵ Accordingly, under current law, a taxpayer can amortize the cost of acquiring goodwill ratably over a fifteen-year period irrespective of the fact that goodwill does not have a limited useful life.¹⁴⁶

Before the enactment of section 197, the capitalized costs of acquiring goodwill were not eligible for amortization allowances, and could only be recovered upon abandonment or disposition of the

¹⁴⁴ I.R.C. § 197(d)(1)(A)-(B).

¹⁴⁵ Treas. Reg. § 1.197-2(b)(1). The term section 197 intangible also includes "going concern value," which is defined in section 197 as "the additional value that attaches to property by reason of its existence as an integral part of an ongoing business." *Id.* § 1.197-2(b)(2). Going concern value also includes the value attributable to the ability of a trade or business to continue to generate income without interruption despite a change in ownership, and the value attributable to the use or availability of a trade or business (e.g., the net earnings that would not have been received had the acquired business not been available or operational). *Id.* As noted by one commentator, the significance of these definitions are "somewhat diminished by the Supreme Court's decision in *Newark* and by the enactment of § 197, which is designed to reduce the tax consequences of whether an intangible asset is or is not part of goodwill." Conzelmann, *supra* note 75, at A-5. For a discussion of *Newark*, see *supra* note 77 and accompanying text.

¹⁴⁶ In contrast to the capitalized costs of purchasing goodwill (which must now be recovered over fifteen years under section 197), expenses to generate (create) goodwill are generally deductible when paid or incurred. See *supra* note 134, for a discussion of the deductibility of goodwill advertising costs.

goodwill.¹⁴⁷ Many commentators had argued that denying amortization of goodwill “did not reflect economic reality,” in that goodwill is a wasting asset that will disappear unless continually maintained.¹⁴⁸ Commentators also pointed out that denial of amortization of goodwill for tax purposes was not in conformity with the treatment of goodwill for accounting purposes, because generally acceptable accounting principles required amortization of goodwill.¹⁴⁹ Moreover, the denial of amortization of goodwill for tax purposes in the United States was inconsistent with the treatment of goodwill in important foreign trading countries, such as Belgium, Canada, Germany, Greece, Italy, Japan, Korea, Luxembourg, the Netherlands, Sweden, and Switzerland.¹⁵⁰

3. Governmental Rights and Contract Rights

Subject to important exceptions noted below, rights granted by governmental agencies, as well as contract rights, are section 197 intangibles amortizable over fifteen years. With respect to governmental rights, the term “section 197 intangible” is defined as including “any license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof,” even if the right is granted for an indefinite period or is reasonably expected to be renewed for an indefinite period.¹⁵¹ With respect to contract rights, the term “section 197 intangible” includes customer-based and supplier-based intangible assets, the latter being defined as “any value resulting from future acquisition of goods or services pursuant to relationships (contractual or otherwise) in the ordinary course of business with suppliers of goods or services to be used or sold by the taxpayer.”¹⁵² The term “section 197 intangible” also

147. For pre-section 197 treatment of goodwill, see *supra* Part II.A.2.

148. See Conzelmann, *supra* note 75, at A-5 (citing N.Y. State Bar Ass'n, Tax Section, *Report on Proposed Legislation on Amortization of Intangibles*, TAX NOTES TODAY, Nov. 25, 1991 at 944-45 [hereinafter *NYSBA Report*]); Walter C. Frank, *Goodwill Is Not Immortal: A Proposal to Deduct the Exhaustion of Purchased Goodwill*, 23 J. TAX'N 380 (1965); Martin Gregorich, *Amortization of Intangibles: A Reassessment of the Tax Treatment of Purchased Goodwill*, 28 TAX LAW. 251 (1975); George Mundstock, *Taxation of Business Intangible Capital*, 135 U. PA. L. REV. 1179 (1987)).

149. See Conzelmann, *supra* note 75, at A-5 (citing Acct. Principles Board Op. No. 17).

150. See *id.* (citing the *NYSBA Report*, *supra* note 148, which reported on these countries).

151. I.R.C. § 197(d)(1)(D) (2004); Treas. Reg. § 1.197-2(b)(8) (providing examples of such rights: (1) a liquor license, (2) a taxi-cab medallion, (3) an airport landing or take-off right, (4) a regulated airline route, or (5) a television or radio broadcasting license).

152. I.R.C. § 197(d)(1)(C)(iv)-(v), (d)(3); Treas. Reg. § 1.197-2(b)(7). The Code and regulations further provide that a section 197 intangible includes property that is similar in all material respects to the listed intangibles (e.g., customer and supplier-based intangibles). I.R.C. § 197(d)(1)(C)(vi); Treas. Reg. § 1.197-2(b)(12).

includes “any right under a license, contract, or other arrangement providing for the use of property that would be a section 197 intangible.”¹⁵³

Certain governmental licenses (rights granted by a governmental unit) and service contracts (rights acquired under a contract) are specifically excluded from the definition. First, the term “section 197 intangible” does not include any right to receive tangible goods or services under a contract or from a governmental unit if the right is not acquired as part of a purchase of a trade or business.¹⁵⁴ The apparent rationale for this exception is that “the acquisition of such rights under these circumstances does not involve the allocation of purchase price issues that arise when a trade or business is acquired and the term of such rights is frequently provided in the agreements involved.”¹⁵⁵ Second, the term “section 197 intangible” does not include any separately acquired right under a contract or granted by a governmental unit if the right has a fixed duration of less than fifteen years.¹⁵⁶ The regulations provide that the duration of a right under a contract or granted by a governmental unit includes any renewal period if, based on the facts and circumstances in existence at any time during the year in which the right is acquired, there is a reasonable expectancy of renewal.¹⁵⁷

If section 197 does not apply to separately acquired rights to receive services, amortization is governed under section 167. Regulations under section 167 provide rules for the treatment of intangible rights that are

153. Treas. Reg. § 1.197-2(b)(11).

154. I.R.C. § 197(e)(4)(B); Treas. Reg. § 1.197-2(c)(6).

155. See PHILIP F. POSTLEWAITE ET AL., FEDERAL INCOME TAXATION OF INTELLECTUAL PROPERTY AND INTANGIBLE ASSETS ¶ 11.03[2][c] (1998).

156. I.R.C. § 197(e)(4)(D); Treas. Reg. § 1.197-2(c)(13)(i)(D)(1). It should be noted that several section 197 intangibles, those that cannot be acquired separately, are specifically omitted from the exclusion for rights of fixed duration. See *id.* § 1.197-2(c)(13)(i)(B) (excluding goodwill, going concern value, information base, covenants not to compete, customer-based intangibles, franchises, trademarks, and trade names). Supplier-based intangibles are not specifically excluded, most likely due to the fact that such intangibles can be acquired separately. Hence, the exception for rights of fixed duration should be available to separately acquired supplier-based intangibles.

157. Treas. Reg. § 1.167(a)-14(c)(3)(i) (as amended in 2003). The regulations also provide, however, that the mere fact that a taxpayer will have the opportunity to renew a contract right or other right on the same terms as are available to others (e.g., in a competitive auction or similar process that is designed to reflect fair market value and in which the taxpayer is not contractually advantaged) will generally not be taken into account in determining the duration of such right provided that the bidding produces a fair market value price comparable to the price that would be obtained if the rights were purchased immediately after renewal from a person in an arm's length transaction. *Id.* § 1.167(a)-14(c)(3)(ii).

excluded from section 197.¹⁵⁸ They provide that the cost of a separately acquired right to receive services over a fixed, nonrenewable period is amortized ratably over the period of the right.¹⁵⁹ If the service contract is renewable, the regulations require amortization of the cost of the service contract over a period that includes the renewal option periods if the facts and circumstances in existence at any time during the taxable year in which the right is acquired indicate that there is a reasonable expectancy of renewal.¹⁶⁰

In sum, fifteen-year amortization is provided under section 197 for *certain* governmental rights and service contracts acquired in a transaction that amounts to the purchase of a trade or business. However, no fifteen-year amortization is permitted under section 197 if such rights are purchased in a transaction that does not amount to the purchase of a business. In the latter case, amortization is allowed under pre-section 197 law over the entire contract term including all renewal options. Unfortunately, many separately acquired service contracts can be renewed annually for an indefinite period for a nominal fee, thus precluding any amortization.

III. TAXING DOMAIN NAMES AS THE NEW INTELLECTUAL PROPERTY RIGHTS

As has been illustrated, tax rules exist governing traditional intellectual property and intangible rights. Tax rules do not exist, however, for new intangible rights, such as domain names, that are emerging with the arrival of global electronic commerce transactions on the Internet. Although the legal nature of domain names is still unsettled, many tax advisors are looking to current tax principles governing familiar intangible rights for guidance. For example, many tax advisors recommend treating domain names like trademarks. But is this appropriate considering domain names have unique characteristics?

This section explores the legal nature of domain names to determine whether they are merely variations of existing intellectual property and

158. See *id.* § 1.167(a)-14(c)(1) (providing amortization rules for separately acquired rights to received services that are excluded from the definition of a section 197 intangible asset under section 197(e)(4)(B)); see also *id.* § 1.167(a)-14(c)(2) (providing amortization rules for separately acquired rights of fixed duration that are excluded from the definition of a section 197 intangible asset under section 197(e)(4)(D)).

159. *Id.* § 1.167(a)-14(c)(1)(ii).

160. *Id.* § 1.167(a)-14(c)(3).

intangible rights to which existing tax law can readily be applied. Part A of this section explores whether domain names should be viewed as governmental licenses for tax purposes. Part B analyzes whether domain names should be treated as “contracts for services” represented by domain name registrations that are performed by registrars. Part C explores whether domain names should be treated as valuable intangible property and, if so, addresses whether such property can be classified within a category of intellectual property and intangible rights covered by existing tax principles (i.e., goodwill and trademarks).

A. DOMAIN NAMES AS GOVERNMENT LICENSES

Any “license, permit, or other right granted by a governmental unit or an agency or instrumentality thereof” is a section 197 intangible.¹⁶¹ If the domain name system were viewed as a form of government licensing, then domain names would seemingly fall within the scope of section 197 and be amortizable over fifteen years.

Domain names should not be considered government licenses for purposes of section 197.¹⁶² An examination of the history of the Internet and the domain name assigning system (“DNS”) reveals that the Internet was the outgrowth of ARPANET, a military program that was designed to enable computers operated by the military, defense contractors, and universities to communicate with one another without the fear of being interrupted by war.¹⁶³ ARPANET provided an example for future development of a civilian network that links host computers globally and enables users to communicate and access vast amounts of information.¹⁶⁴

161. I.R.C. § 197(d)(1)(D); Treas. Reg. § 1.197-2(b)(8); see *supra* notes 92–94, 151–160 (discussion of government licenses).

162. See David E. Hardesty, *Taxation of Internet Domain Names—Can They Be Shoehorned Into the 15-Year Amortization Rules?*, 93 J. TAX’N 367, 372 (Dec. 2000) (suggesting that domain names probably do not fit within the section 197 definition).

163. See *Reno v. ACLU*, 521 U.S. 844, 849–50 (1997) (explaining the history of the Internet); see also Brian C. Smith, *Private Property for Public Use: The Federal Trademark Dilution Act and Anticybersquatting Consumer Protection Act as Violations of the Fifth Amendment Takings Clause*, 11 J. INTELL. PROP. L. 191, 192 (2003) (describing the creation of ARPANET under the authority of the Department of Defense that provided communication links “between scientists and research contractors” and noting that “[r]esearchers adapted the Internet for academic use in the early 1980s and began to appropriate it for civilian use by the late 1980s”).

164. See *Reno*, 521 U.S. at 850 (discussing how ARPANET functioned as the platform for Internet development). The Internet has rapidly flourished as a new medium for global communication. *Id.* at 851–53; see also Lisa J. Beyer Sims, *Mutiny on the Net: Ridding P2P Pirates of Their Booty*, 52 EMORY L.J. 1907, 1910 (2003) (noting the history of the creation of the Internet and explaining how the ARPANET provided a network for direct electronic communication that enabled each individual

In 1993, the government decided to open the Internet to non-military use, including commerce, and left the future of Internet growth and infrastructure to the private sector.¹⁶⁵

The government relinquished direct control over development of the Internet.¹⁶⁶ Indeed, the government permitted Network Solutions, Inc. (“NSI”), a private corporation, to commence the task of assigning domain names in the “.com,” “.org,” “.net,” and “.edu” TLDs.¹⁶⁷ NSI obtained an exclusive status as domain name registrar via a competitive bidding process with the National Science Foundation.¹⁶⁸ The agreement that NSI reached with the National Science Foundation was not a license. It was merely an understanding that NSI would conduct the registration of domain names in certain TLDs.¹⁶⁹

In 1998, the government, through the Department of Commerce, issued a new policy that ended NSI’s exclusive status and opened the domain name registration system to other registrars, allowing more international involvement in the management of the DNS.¹⁷⁰ The policy

computer functioning as a “server” to “send information to, and receive information from, other machines across the network without going through an intermediary server”).

165. See Philip J. Weiser, *The Internet, Innovation, and Intellectual Property Policy*, 103 COLUM. L. REV. 534, 543 (2003) (stating that in “the early 1990s, the government decided to remove the restrictions on the use of the Internet for commerce, privatize the key Internet infrastructure, and leave it to the private sector to chart the Internet’s future growth”).

166. See *id.* at 543–44 (explaining the consequences of government’s withdrawal of direct subsidies and control over the development of the Internet). The government ended its “commitment to supporting an open architecture model for the Internet’s development and invited the introduction of proprietary (and closed) standards in the Internet world.” *Id.*

167. See *Seven Words L.L.C. v. Network Solutions*, 260 F.3d 1089, 1092 (9th Cir. 2001) (noting that in “June 1999, NSI’s status as the exclusive registrar expired, and other companies joined NSI in offering domain name registration services in the ‘.com,’ ‘.net,’ ‘.edu,’ and ‘.org’ top-level domains”); *Lockheed Martin Corp. v. Network Solutions, Inc.*, 194 F.3d 980, 982 (9th Cir. 1999) (“NSI was the sole National Science Foundation contractor in charge of registering domain-name combinations for the top-level domains .gov, .edu, .com, .org, and .net.”).

168. On December 31, 1992, NSF awarded to NSI a federal cooperative agreement to provide exclusive Internet administration and domain name registration services. See *Thomas v. Network Solutions, Inc.*, 2 F. Supp. 2d 22, 26 (D.D.C. 1998). In April 1993, NSI began its registration services. See *Smith v. Network Solutions, Inc.*, 135 F. Supp. 2d 1159, 1161 (N.D. Ala. 2001).

169. See Jonathan Weinberg, *ICANN and the Problem of Legitimacy*, 50 DUKE L.J. 187, 200 (2000) (noting that the National Science Foundation stopped paying fees to NSI for its services per the cooperative agreement and agreed to have NSI charge fees of fifty dollars per domain name registration); see also *Oppedahl & Larson v. Network Solutions, Inc.*, 3 F. Supp. 2d 1147, 1149–53 (D. Colo. 1998) (stating that for the period of 1993–1995 NSF paid NSI for its services).

170. See Gillian K. Hadfield, *Privatizing Commercial Law: Lessons from ICANN*, 6 J. SMALL & EMERGING BUS. L. 257, 260 (2002) (stating that objections to NSI’s monopoly over registration services led to the creation of ICANN and its authority to open up registration services to more competition); David R. Johnson et al., *A Commentary on the ICANN “Blueprint” for Evolution and Reform*, 36 LOY.

facilitated the creation of ICANN, a private, nonprofit corporation, to assume the responsibility for managing the allocation of Internet Protocol numbers and the domain name system.¹⁷¹ Indeed, at its Web site, ICANN states that it is “an internationally organized, non-profit corporation that has responsibility for Internet Protocol (IP) address space allocation, protocol identifier assignment, generic (gTLD) and country code (ccTLD) Top-Level Domain name system management, and root server system management functions.”¹⁷² ICANN also states that these services were “originally performed under U.S. Government contract by the Internet Assigned Numbers Authority (IANA) and other entities. ICANN now performs the IANA function.”¹⁷³

Under the new policy, the domain name registration system became competitive because NSI was no longer the exclusive registrar of domain names; now more registrars offered domain name registration services, reducing the cost according to economic principles of competition.¹⁷⁴ Today, there are hundreds of domain name registrars worldwide.¹⁷⁵ These registrars are not government agencies, for the domain name assigning system has been transformed from quasi-government control to a privatized system.¹⁷⁶ In fact, numerous courts have held that a registrar

L.A. L. REV. 1127, 1128 (2003) (stating that the government and ICANN ended NSI's exclusivity in domain name registration services, and that NSI must comply with ICANN's requirements).

171. See Steven Blackerby, *Flat Broke and Busted, But Can I Keep My Domain Name? Domain Name Property Interests in the First, Fifth, and Eleventh Circuits*, 11 J. INTELL. PROP. L. 117, 123 (2003) (stating that the Clinton administration “pushed for the creation of an international organization to govern domain name registration”).

172. ICANN, *ICANN Information* (describing ICANN's function under the FAQ Section), at <http://www.icann.org/general> (last modified Jan. 13, 2004).

173. *Id.*

174. ICANN began to accredit other entities to become registrars for the domain name registration services. See Froomkin and Lemley, *supra* note 46, at 26–27 (stating that ICANN opened up registration services to new registrars who wished to compete with NSI); see also *Lockheed Martin Corp. v. Network Solutions, Inc.*, 194 F.3d 980, 982 (9th Cir. 1999) (noting that for a long time “NSI was the sole . . . contractor in charge of registering domain-name combinations for the top-level domains,” but that “NSI is no longer the exclusive registrar,” as “a new competitive scheme has been implemented”).

175. An international listing of companies currently accredited and functional in addition to NSI is located on ICANN's Web site. ICANN, *Descriptions and Contact Information for ICANN-Accredited Registrars*, at <http://www.icann.org/registrars/accreditation-qualified-list.html> (last modified Sept. 29, 2004).

176. In addition to the fact that these registrars are not governmental agencies, ICANN itself is not a government agency though it has the power to set standards and make policy with which all registrars must comply. See generally Stefan Bechtold, *Governance in Namespaces*, 36 LOY L.A. L. REV. 1239, 1245 (2003) (noting that “some proponents assert that ICANN is a mere technical standardization and coordination body, critics argue that it more resembles a world government”).

is not a government agency, or a state or federal actor,¹⁷⁷ and an agreement to perform registration services is not a “quintessential” government service agreement.¹⁷⁸

Under ICANN policy, a registrar only provides services “in connection with a TLD when it has an agreement with the TLD’s ‘Registry Operator,’” and the services include “contracting with Registered Name Holders, collecting registration data about the Registered Name Holders, and submitting registration information for entry in the Registry Database.”¹⁷⁹ These services cease if a domain name registrant fails to renew its registration. When a registration expires, the domain name becomes available for others to register.¹⁸⁰ Some domain names due to expire are very valuable.¹⁸¹ There is a lucrative market for the identification and registration of domain names that have expired and are not yet renewed.¹⁸²

By simply providing services, not domain name rights, registrars do not function as licensors.¹⁸³ To have a licensor-licensee relationship, the registrar must own or possess property interests in the domain name

177. *National A-1 Adver., Inc. v. Network Solutions, Inc.*, 121 F. Supp. 2d 156, 168–69 (D.N.H. 2000) (holding that NSI is not a state actor capable of violating First Amendment free speech rights in its denial of certain domain names).

178. *Island Online, Inc. v. Network Solutions, Inc.*, 119 F. Supp. 2d 289, 306–07 (E.D.N.Y. 2000) (holding that despite its Cooperative Agreement with NSF, NSI is not a state or federal actor under the close nexus, public function, and symbiotic relationship tests); see also *Thomas v. Network Solutions, Inc.*, 176 F.3d 500, 511 (D.C. Cir. 1999) (stating that “[a] recent and novel function such as domain name registration hardly strikes us as a ‘quintessential’ government service”).

179. ICANN, *Registrar Accreditation Agreement* § 1.11, at <http://www.icann.org/registrars/ra-agreement-17may01.htm> (May 17, 2001).

180. See *BroadBridge Media, L.L.C. v. Hypercd.com*, 106 F. Supp. 2d 505, 507–12 (S.D.N.Y. 2000) (finding bad faith registration of a domain name in a case where the plaintiff, through neglect, had let its “hypercd.com” domain name registration expire, and the defendant had registered the name almost as soon as it became available while “brainstorming” for new product names); Wayde Brooks, *Wrestling Over the World Wide Web: ICANN’s Uniform Dispute Resolution Policy for Domain Name Disputes*, 22 *HAMLIN J. PUB. L. & POL’Y* 297, 310 (2001) (stating that “[m]any existing domain names are set to expire as the original contracts under which they were issued is typically for two years”).

181. See Brooks, *supra* note 180, at 310 (noting that “[m]any of the older domain names set to expire are more valuable than those currently available as they are typically shorter and encompass common words or phrases that are not presently available”).

182. See Froomkin & Lemley, *supra* note 46, at 65 (stating that intellectual property owners, cybersquatters, and other companies want to be notified when “a particular name becomes available so they can register it” and that a “vibrant competition exists to supply this demand, with companies like SnapNames selling a notification service”).

183. See Warren Agin, *Workouts and Bankruptcy in the eCommerce Economy*, 661 *PLI/FIFTH ANNUAL INTERNET LAW INST.* 947, 999 (2001) (stating that “a license presupposes already existing property rights” and noting that “[i]f no property interest in a domain name exists at the registrar’s level, the registration cannot constitute a license”).

prior to the formation of a license arrangement between the registrar (licensor) and the registrant (licensee) wherein the registrar grants a license to use the domain name to the registrant.¹⁸⁴ However, registrars neither own nor have any rights in domain names prior to attempts by registrants to create such names.¹⁸⁵ Without first having some ownership right, registrars cannot license domain names.¹⁸⁶ Registrars have nothing to convey except providing registration services per an agreement with ICANN. Thus, domain names are not licenses.¹⁸⁷

Arguably, the domain name assigning system bears a minor resemblance to the federal trademark registration system, notwithstanding the fact that the latter is directly controlled by the government. Under the federal trademark registration system, the government is not a licensor. Trademark holders obtain federal trademark registrations from the United States Trademark Office.¹⁸⁸ The Trademark Office does not own or have any rights in trademark registrations, but it has authority to grant or refuse registrations.¹⁸⁹ Each trademark registration is in force for ten years,¹⁹⁰ and renewable thereafter.¹⁹¹ A trademark holder who obtains a federal trademark registration becomes the owner, not a licensee, of that registration. Owners can do whatever they wish with their registration.¹⁹² They can

184. *See id.*

185. *Id.* (noting that “a given domain name does not exist until it is registered”).

186. *Id.* (concluding that Network Solutions, as a registrar, “does not have a property interest that pre-dates registration and therefore does not license or transfer a property interest at the time of registration”).

187. *See id.*

188. *See* 15 U.S.C. § 1051(a)(1) (2004)

The owner of a trademark used in commerce may apply to register his or her trademark . . . by filing in the Patent and Trademark Office a written application and paying into the Patent and Trademark Office the prescribed fee and a verified statement . . . [that] no other person has the right to use such mark in commerce

Id.

189. *See id.* § 1057(a) (“Certificates of registration of marks . . . shall be issued in the name of the United States of America, under the seal of the Patent and Trademark Office, and shall be signed by the Commissioner . . .”).

190. *See id.* § 1058 (“Each certificate of registration shall remain in force for ten years.”).

191. *See id.* § 1059(a) (“Each registration may be renewed for periods of ten years . . . from the end of the expiring periods upon payment of the prescribed fee and the filing of a verified application thereof.”).

192. If the owner of the registration decides to assign the registration to a third party, the owner must record the change of ownership with the Patent and Trademark Office. *Id.* § 1057(d).

A certificate of registration of a mark may be issued to the assignee or the applicant, but the assignment must first be recorded in the Patent and Trademark Office. In case of change of ownership the Director shall, at the request of the owner and upon a proper showing and

assign or license it to others, or they can grant a security interest in the registration to a third party.¹⁹³ Similarly, a domain name registration is the property of the domain name registrant, not of the company that provides the registration service.¹⁹⁴

B. DOMAIN NAMES AS CONTRACTS FOR SERVICES

Some commentators have suggested that, for tax purposes, a domain name represents a contract for services, rather than property, because the rights in a domain name are closely intertwined with the services performed by the domain name registrar.¹⁹⁵ This argument primarily relies on *Network Solutions, Inc. v. Umbro International, Inc.*, a case involving the garnishment of a domain name. In that case, the Virginia Supreme Court held that a domain name was not subject to a seizure and court-ordered sale under Virginia's garnishment statute because the domain name was merely a contract for services.¹⁹⁶ Although there was no federal tax issue involved in the case, a state law characterization of property rights is usually binding for federal tax purposes.¹⁹⁷ Accordingly, the argument goes, federal tax rules governing service contracts, as opposed to those governing intellectual property, should apply to Internet domain names—at least those domain name registrations that are performed by registrars located in Virginia.¹⁹⁸

the payment of the prescribed fee, issue to such assignee a new certificate of registration of the said mark in the name of such assignee, and for the unexpired part of the original period.

Id.

193. See Susan Barbieri Montgomery, *Security Interests in Intellectual Property*, SJO93 ALI-ABA 341, 348 (2004) (discussing security interests in trademark collateral and perfection of such security interests).

194. *Kremen v. Cohen*, 337 F.3d 1024, 1029–30 (9th Cir. 2003) (concluding that a domain name registrant has an intangible property right in the domain name).

195. See Marvin A. Kirsner, *Virginia High Court Decision Could Cause Tax Problem for Domain Name Purchasers*, S. FLA. BUS. J. (June 23, 2000), available at <http://www.gtlaw.com/pub/articles/2000/kirsneroob.htm>; The Masked CPA, *Tips on Proper Reporting of Your Domain Name Sales on U.S. Personal Tax Returns*, DOMAIN NAME J. (Apr. 15, 2003), at http://www.dnjournal.com/columns/tax_tips.htm.

196. *Network Solutions, Inc. v. Umbro Int'l, Inc.*, 529 S.E. 2d 80, 86, 88 (Va. 2000).

197. The Supreme Court has established the respective roles for state law and federal law under the Code: "State law creates legal interests and rights. The federal revenue acts designate what interests or rights so created shall be taxed." See *Morgan v. Comm'r.*, 309 U.S. 78, 80 (1940); see also Paul L. Caron, *The Role of State Court Decisions in Federal Tax Litigation: Bosch, Erie, and Beyond*, 71 OR. L. REV. 781 (1992).

198. One commentator has warned that the IRS could take the position that the *Network Solutions* decision "is binding for all domain name purchases, even if the purchaser is not located in Virginia,

As discussed above, section 197 intangibles include contracts for services, including any value resulting from the future acquisition of services pursuant to contractual relationships with suppliers of services.¹⁹⁹ If domain names were classified for federal tax purposes as “contracts for services” performed by domain name registrars, then their federal tax treatment would depend on whether they were acquired in a transaction that amounts to the purchase of a trade or business. More specifically, if a domain name were acquired as part of the purchase of a trade or business, then its acquisition costs would be amortized over an arbitrary fifteen-year period under section 197.²⁰⁰ If, however, a domain name were acquired separately, its acquisition costs would not be amortizable at all. This is because the cost of a separately acquired service contract that is renewable must be amortized over a period that includes all renewal options if the facts and circumstances indicate that there is a reasonable expectancy of renewal.²⁰¹ Domain names can be renewed periodically for an indefinite period for a nominal fee, in effect precluding any amortization allowance.²⁰²

Strong arguments exist for not classifying domain names as service contracts for federal tax purposes. First, such a classification would treat separately purchased domain names differently from other separately purchased intangible rights. For example, separately acquired trademarks or trade names are not excluded from section 197 amortization, and hence are amortizable over fifteen years. Accordingly, if a taxpayer were to purchase from Pepsi Company only its trademark “Pepsi” and no other assets, the taxpayer would be able to amortize the total cost of purchase over fifteen years under section 197 even though the trademark has no limited life. On the other hand, if the taxpayer were to purchase only the domain name “pepsi.com” and no other assets, the taxpayer would not be permitted any amortization allowance, assuming domain names were treated as contracts for services performed by domain name registrars. The reason, as explained above, is that

since the ‘contract for services’ represented by the domain name registration are performed by Network Solutions in Virginia.” Kirsner, *supra* note 195.

199. I.R.C. § 197(d)(3); Treas. Reg. § 1.197-2(b)(7) (2000).

200. See *supra* Part II.B.

201. Treas. Reg. § 1.167(a)-14(c)(3) (2004).

202. NetworkSolutions, *Renew Services* (providing renewal services for domain name registrations up to one hundred years at a discount rate), at http://www.networksolutions.com/en_us/manage-it/bulk-renewal.jhtml (last visited Nov. 2, 2004).

separately acquired service contracts are specifically excluded from the scope of section 197 and are not amortizable under section 167 since they often have renewal options and, hence, unlimited lives. No apparent policy reason exists for treating a separately purchased trademark or trade name differently from a separately acquired domain name that functions as a trademark just because a domain name might be viewed under state law as a “contract for services” represented by domain name registrations that are performed by registrars.²⁰³

A related problem that would undoubtedly arise if domain names were viewed as contracts for services is that purchasers of domain names would likely take creative steps to ensure that section 197 amortization would be available. Again, contracts for services are not amortizable if purchased in a transaction that does not amount to the purchase of a trade or business. One commentator has suggested that if other assets are purchased from the seller of the domain name, the “no amortization rule” might not be applicable: “For example, if the seller of the domain name also enters into an agreement not to compete with the purchaser, then the purchaser could take the position that there were other assets purchased, and that amortization should be allowed over the usual fifteen[-year] term.”²⁰⁴

Even if domain name purchasers did not engage in such creative transactional planning, they might argue that the acquisition of a single domain name should be treated as the acquisition of a trade or business. Under section 197, the acquisition of a single asset may be treated as the acquisition of a trade or business or a substantial portion thereof if the asset is of such a character that goodwill or going concern value could attach under any circumstance.²⁰⁵ In that case, the asset is removed from the exception for intangibles purchased separately, thus requiring the application of section 197. The section 197 regulations also provide that the acquisition of a trademark or trade name constitutes the acquisition

203. Patents and separately acquired copyrights are specifically excluded from section 197 amortization but are nevertheless eligible for amortization under section 167. Treas. Reg. § 1.167(a)-14 (providing rules for the amortization of certain assets not covered by section 197, such as separately acquired patents and copyrights). Is there any compelling reason for treating a separately acquired patent (e.g., Pepsi’s patent on one of its soda products) differently from a separately acquired domain name (Pepsi’s domain name, “pepsi.com”)?

204. Kirsner, *supra* note 195.

205. H.R. REP. NO. 103-213, at 678 (1993).

of a trade or business.²⁰⁶ One can envision the purchaser of a single contract for services (represented by a domain name registration that is performed by a registrar) making the argument that the acquisition should be deemed the acquisition of a trade or business or, even more easily, a substantial portion thereof, if the acquisition included ancillary rights. Classifying domain names as service contracts for federal tax purposes would create much litigation and uncertainty, with the result that those taxpayers who had the resources to hire creative tax planners and to litigate government challenges would be better off than those taxpayers who lacked similar resources.

Perhaps the best argument for not classifying domain names as service contracts for federal tax purposes can be found by carefully considering the character of domain names and the registration agreement between the registrar and registrant. Typically, an individual or an entity that wants to establish its presence on the Internet must obtain a domain name registration in a particular TLD.²⁰⁷ If someone else has already registered the domain name in a particular TLD, the individual or entity can either attempt to register the same domain name in a different TLD²⁰⁸ or select a different domain name for registration in the same TLD.²⁰⁹ Registering a domain name is a simple process that occurs within minutes over the Internet.²¹⁰ The cost of registration is

206. Treas. Reg. § 1.197-2(e)(2)(i).

207. See Edward P. Davis, Jr. et al., *Potential Liability on the Internet*, 675 PLI/PAT 7, 89 (2001) (“To facilitate finding a company’s presence on the Internet, most companies want their Internet domain name to correspond with the company’s name or trademark followed by the well-known ‘.com’ designation.”).

208. See *Smith v. Network Solutions, Inc.*, 135 F. Supp. 2d 1159, 1162 (“[I]f someone submits an application for a particular domain name that already exists in the Registry WHOIS database by virtue of a prior registration, that name cannot be registered again, and the applicant is advised that the sought domain name is unavailable.” The applicant may choose “another TLD where the initially submitted [domain] name is still available.”).

209. See *id.* (noting that the domain name applicant may choose an alternate domain name, “either by changing or adding or subtracting a letter(s) or number(s) or a dash(es) to his initially submitted [domain] name within the same TLD”). At the registrar-registry level, in order to register a new domain name for an individual end user, the registrar sends to the registry the ADD command as well as the information the registry needs to populate its database, namely the domain name, the IP addresses of the local name servers for that domain name, the registrar, and the expiration date for the registration. The registry, in turn, either enters this information into the central Registry Database and the TLD zone file, or returns an error message if, for example, the domain name is already registered. *Globalsantafe Corp. v. Globalsantafe.com*, 250 F. Supp. 2d 610, 620 n.26 (E.D. Va. 2003).

210. See Connie L. Ellerbach, *Domain Name Dispute Remedies: Tools for Taming the World Wide Web*, 759 PLI/PAT 513, 515 (2003) (noting that the domain name registration process is “a fast, simple, low-cost process that can be executed online in a matter of minutes”). A registration contract “sets

inexpensive, averaging about twenty-five dollars per domain name registration per year.²¹¹ Registration services for multiple years are also available for a very competitive price.²¹² As long as fees are paid, the registrant maintains its domain name registration for the duration of the term.²¹³

There are hundreds of registrars and registrar-intermediaries²¹⁴ providing domain name registration services.²¹⁵ The role of the registrar in the domain name registration process is to provide services to the registrant.²¹⁶ These services include contracting with the registrant, collecting registration data about the registrant, and submitting that

forth the terms under which . . . registration is accepted and will be maintained.” InterNIC, *InterNIC FAQs, The Domain Name System: A Non-Technical Explanation—Why Universal Resolvability Is Important*, at <http://www.internic.net/faqs/domain-names.html> (last updated Sept. 25, 2003). Information and covenants included in the domain name registration contract are determined by the policies of ICANN and of the individual registrars. See ICANN, *Uniform Dispute Resolution Policy*, at <http://www.icann.org/udrp/udrp-policy-24oct99.htm> (Oct. 24, 1999).

211. See Jack Russo et al., *The Past, Present and Future of Domain Name Dispute Resolution*, 683 PLL/PAT 315, 321 (2002) (stating that “domain name registrations occur on a ‘first-come, first-served’ unscreened basis typically through fast, highly-automated, inexpensive, and anonymous computer-based interactions with on-line domain registry services” and that “[t]he cost for a domain name registration is typically under \$25 dollars”).

212. See Russo, *supra* note 211, at 321–22 (noting that “some registration services lower the cost per registration when multiple domain names are being registered and depending on the number of years in which pre-payment is made for the domain name registration(s)”; see also Smith, 135 F. Supp. 2d at 1162 (noting that NSI charges thirty-five dollars per year for a registration fee, and the registration is renewable for up to ten years, and that other registrars charge less than the fees charged by NSI for registration services).

213. See Smith, 135 F. Supp. 2d at 1162 (noting that the registrant has its domain name registration as long it pays for the registration fees).

214. See *Network Solutions, Inc. v. Hoblad, B.V.*, No. 03-1226, 2003 WL 22989688, at *1 (4th Cir. Dec. 19, 2003) (noting that the registrant used one of two domain name services (“the intermediaries”) to submit a registration application to NSI on Appellants’ behalf). The registrant submitted their requested domain names and their contact and billing information to the intermediary at its Web site. *Id.* “The intermediary then submitted the information to NSI on an electronic form. At that time, the intermediary agreed—on behalf of Appellants—to the terms of NSI’s Domain Name Registration Agreement.” *Id.* at 846.

215. See *Barcelona.com, Inc. v. Excelentísimo Ayuntamiento de Barcelona*, 330 F.3d 617, 623 (4th Cir. 2003) (noting that, as of June 2003, there were more than 160 registrars).

216. For example, the registration agreement between Register.com (the registrar) and a registrant “encompasses ‘any errors, omissions or any other actions by any registry administrator arising out of or related to [an] application for and registration of, renewal of, or failure to register or renew a particular domain name.’” *DeJohn v. The .TV Corp. Int’l.*, 245 F. Supp. 2d 913, 920 (C.D. Ill. 2003). In addition, the contract provides that “Register.com cannot guarantee that [an applicant] will be able to register or renew a desired domain name, even if an inquiry indicates that domain name is available, since Register.com cannot know with certainty . . . whether there are inaccuracies or errors in the . . . registration or renewal process.” *Id.*

information for entry in the domain name registry database.²¹⁷ Under a contract with the registrar, the registrant enjoys a presence on the Internet for the duration of the registration.²¹⁸ Thus, a contract between registrar and registrant determines the parties' responsibilities,²¹⁹ not the character or classification of the domain name itself.²²⁰

Indeed, a district court recently found that domain names are not service contracts.²²¹ A contract between a registrar and a registrant does not in itself give rise to the right to use a domain name.²²² Rather, the right to use domain names "exists separate and apart from [the registrar's] various services that make the domain names operational Internet addresses. These services . . . are mere conditions subsequent."²²³ The role of the registrar is to provide these services, but the domain name itself is not a service contract.²²⁴ Moreover, NSI, once the exclusive

217. ICANN, *Registrar Accreditation Agreement* § I.II, at <http://www.icann.org/registrars/ra-agreement-17may01.htm> (May 17, 2001).

218. See *Barcelona.com*, 330 F.3d at 623–24 ("To obtain a domain name, a would-be registrant simply makes application to a registrar (there are currently over 160), submits a fee, and agrees to the terms of the domain name registration agreement."); *Thomas v. Network Solutions, Inc.*, 176 F.3d 500, 505 (D.C. Cir. 1999) (noting that the appellants paid NSI, the registrar for the registration fees which were one hundred dollars for the initial registration for a two year period and fifty dollars annually thereafter).

219. See *Network Solutions, Inc.*, 2003 WL 22989688, at *1 (noting the registrants failed to pay for the registration fees of 4,280 domain names and the registrar sued the registrant for breach of the Domain Name Registration Agreement and unjust enrichment). The Fourth Circuit held that the registrant was obligated to pay the registrar seventy dollars for each domain name that the registrar registered. *Id.* at 847.

220. See *Kremen v. Cohen*, 99 F. Supp. 2d 1168, 1173 n.2 (N.D. Cal. 2000) (examining a case concerning domain names and stating that these cases were concerned with the registrar's "role, rather than the proper classification of a domain name").

221. *Id.* (rejecting the characterization of domain names as service contracts).

222. Indeed, when a registrant fails to pay the registration fees, the registrar stops providing the registration services and the domain names themselves are available for others to register. See *Schmidheiny v. Weber*, 285 F. Supp. 2d 613, 628 (E.D. Pa. 2003) (finding that the defendant registered domain names that had lapsed for the purpose of buying and selling domain names for profit). The defendant registered the name "Schmidheiny" and solicited Mr. Schmidheiny, who is among the world's wealthiest individuals according to Forbes, to pay one million dollars for the domain name. *Id.* at 618. The court held that the defendant violated the Anticybersquatting Consumer Protection Act by registering a domain name, to which defendant had no right, with the bad faith intent solely to profit from the name. *Id.* at 627–28.

223. See *Kremen*, 99 F. Supp. 2d at 1173 n.2 (N.D. Cal. 2000) (declining to adopt the unsatisfactory reasoning rendered by the Virginia Court in *Umbro* that domain names are service contracts).

224. *Id.* at 1171–73 (analyzing the domain name registration agreement between NSI and the registrant, the Cooperative Agreement between NSI and NSF, and holding that the domain name itself is not service contract, but a form of intangible property); see also *Jahn v. 1-800-FLOWERS.com, Inc.*, 284 F.3d 807, 810–11 (7th Cir. 2002) ("Consider Internet domain names. These are rented by the year from administrators (one per top domain), yet there is a thriving market in these addresses.").

registrar of domain names and currently the largest, has seemed to concede that domain names are not service contracts, but intangible property.²²⁵

C. DOMAIN NAMES AS PROPERTY

Domain names are intangible property, and are subject to conversion. The Ninth Circuit, in *Kremen v. Cohen*, held this to be true.²²⁶ In *Kremen*, the plaintiff alleged that the defendant had converted the domain name “sex.com.”²²⁷ In reversing the lower court’s decision, the Ninth Circuit first noted that property is a broad concept that includes “every intangible benefit and prerogative that is susceptible to dispossession or disposition.”²²⁸ The court applied a three-part test to determine whether a property right exists in a domain name. First, a domain name must be an interest capable of precise definition.²²⁹ Second, the owner of a domain name must be able to have “exclusive possession or control.”²³⁰ Third, the putative owner of a domain name “must have established a legitimate claim to exclusivity.”²³¹ The court concluded that domain names satisfy all three criteria.²³² Indeed, a domain name is a well-defined interest; a person who registers a domain name generally decides where on the Internet “those who invoke that particular name . . . are sent.”²³³ The court noted that ownership of a domain name is exclusive; the registrant alone decides where to send those who visit its Web site.²³⁴ Also, domain names have been valued and sold, often for

225. See *Kremen v. Cohen*, 337 F.3d 1024, 1029 (9th Cir. 2003) (stating that Network Solutions all but conceded that registrants have property rights in their domain names); *Network Solutions, Inc. v. Clue Computing, Inc.*, 946 F. Supp. 858, 860 (D. Colo. 1996) (stating that Network Solution admits that domain names are intangible personal property); *Network Solutions, Inc. v. Umbro Int’l, Inc.*, 529 S.E.2d 80, 86 (Va. 2000) (“[Network Solutions] acknowledged during oral argument before this Court that the right to use a domain name is a form of intangible personal property.”).

226. *Kremen*, 337 F.3d at 1030.

227. *Id.* at 1027.

228. See *id.*

229. *Id.*

230. *Id.*

231. *Id.*

232. *Id.* (“Domain names satisfy each criterion.”).

233. *Id.* (“Like a share of corporate stock or a plot of land, a domain name is a well-defined interest. Someone who registers a domain name decides where on the Internet those who invoke that particular name—whether by typing it into their web browsers, by following a hyperlink, or by other means—are sent.”).

234. *Id.* (“Ownership is exclusive in that the registrant alone makes that decision.”).

large sums of money.²³⁵ Moreover, a registrant has a legitimate claim of exclusivity in a domain name because the registration provides a right similar to “staking a claim to a plot of land at the title office.”²³⁶ The registration informs others that a domain name is possessed solely by the registrant.²³⁷ The registrant may subsequently invest substantial amounts of time and money developing and promoting Web sites that depend on their domain names.²³⁸ Exclusive ownership ensures that registrants can reap the benefits of their investments.²³⁹ Domain name registration reduces uncertainty and encourages investments that facilitate Internet growth.²⁴⁰ In sum, domain names are intangible property. Furthermore, they are a species of intangible property subject to conversion claims.²⁴¹ Therefore, if a registrar were to allow a third party to fraudulently register a domain name that is the property of another, the registrar would be liable for its decision.²⁴²

Congress mandated that domain names are property when it passed the Anticybersquatting Consumer Protection Act (ACPA).²⁴³ The ACPA provides *in rem* actions against domain names themselves in cases where a trademark owner cannot locate a domain name registrant,²⁴⁴ or when a court has no *in personam* jurisdiction over a foreign registrant.²⁴⁵ In

235. *Id.* (stating that “like other forms of property, domain names are valued, bought and sold, often for millions of dollars . . . and they are now even subject to *in rem* jurisdiction”).

236. *Id.*

237. *Id.*

238. *Id.*

239. *Id.*

240. *Id.*

241. *Id.* at 1033–34 (holding that domain names are intangible property subject to conversion after analyzing the conversion claim under the *Restatement (Second) of Torts* and California law).

242. *Id.* at 1035 (holding that “it would not be unfair to hold” the registrar responsible for its decision to allow the “sex.com” domain to be registered in the name of a third party who owned no property right in the name).

243. See *Porsche Cars N. Am., Inc. v. Porsche.Net*, 302 F.3d 248, 260 (4th Cir. 2002) (“Congress plainly treated domain names as property in the ACPA . . .”). The ACPA *in rem* provision is codified as 15 U.S.C. § 1125(d)(2)(A)(ii)(I). The provision allows litigation against the domain name itself where the domain name is deemed to locate. *Porsche Cars N. Am.*, 302 F.3d at 260 (stating that in “an *in rem* proceeding in which the property itself is the source of the underlying controversy between plaintiff and defendant, . . . due process is satisfied’ by assigning jurisdiction based on the location of the property” (quoting *Rush v. Savchuck*, 444 U.S. 320, 329 (1980))).

244. See *Shri Ram Mission v. Sahajmarg.org*, 139 F. Supp. 2d 721, 723 (E.D. Va. 2001) (The ACPA “requires an affirmative finding by the district court that the mark owner was not able to obtain personal jurisdiction or was not able to locate a would-be defendant.”).

245. See Xuan-Thao Nguyen, *The Digital Trademark Right: A Troubling New Extraterritorial Reach of United States Law*, 81 N.C. L. REV. 483, 510–13 (2003) (analyzing *in rem* jurisdiction availability when there is a lack of *in personam* jurisdiction over foreign registrants).

applying ACPA *in rem* actions and resolving ownership disputes over domain name registrations, courts have consistently held that domain names are property.²⁴⁶

Classifying domain names as valuable intangible “property” does not *ipso facto* determine their federal tax treatment. Section 197, the necessary starting point for determining the tax treatment of intangible rights, does not govern all valuable rights classified as intangible property, but instead governs only those intangible rights within the definition of “section 197 intangibles.”²⁴⁷ The discussion that follows analyzes whether domain names fit within two particular categories of section 197 intangibles: goodwill and trademarks.

I. Domain Names as Goodwill

It could be argued that a domain name purchase should be treated as a goodwill purchase, amortizable over fifteen years under section 197. Purchasing a domain name, as the argument might go, is the same as purchasing a company with a recognized name at a premium to its true asset value.²⁴⁸

Acquired goodwill is included within the definition of a section 197 intangible asset.²⁴⁹ The regulations define goodwill for purposes of section 197 as “the value of a trade or business attributable to the expectancy of continued customer patronage . . . [that] may be due to the name or reputation of a trade or business or any other factor.”²⁵⁰

246. See generally *Caesars World, Inc. v. Caesars-Palace.com*, 112 F. Supp. 2d 502 (E.D. Va. 2000); *Lucent Techs., Inc. v. LucentSucks.com*, 95 F. Supp. 2d 528, 535 (E.D. Va. 2000). The courts held that there is no violation of the Constitution as Congress has the authority to treat a domain name registration as property subject to *in rem* jurisdiction. See *Caesars World*, 112 F. Supp. 2d at 504; *Lucent Techs.*, 95 F. Supp. 2d at 535.

247. I.R.C. § 197(a), (d) (2004).

248. For the tax definition of “goodwill,” see *infra* notes 249–254.

249. *Id.* § 197(d)(1)(A). Acquired “going concern value” is also included in the definition of a section 197 intangible. The regulations under section 197 define going concern value as:

the additional value that attaches to property by reason of its existence as an integral part of an ongoing business activity. Going concern value includes the value attributable to the ability of a trade or business (or a part of a trade or business) to continue functioning or generating income without interruption notwithstanding a change in ownership [Going concern value] also includes the value that is attributable to the immediate use or availability of an acquired trade or business, such as, for example, the use of the revenues or net earnings that otherwise would not be received during any period if the acquired trade or business were not available or operational.

Treas. Reg. § 1.197-2(b)(2) (2000).

250. Treas. Reg. § 1.197-2(b)(1).

Although this definition of goodwill is consistent with the Supreme Court's description of goodwill in *Newark Morning Ledger* as "the expectancy of continued patronage,"²⁵¹ it is nevertheless difficult to apply in practice. The Supreme Court itself noted in *Newark Morning Ledger* that "every intangible asset is related, to a greater or lesser degree, to the expectation that customers will continue their patronage."²⁵² A more workable definition of goodwill can be found in section 1060 of the Code, which provides a residual method of valuing assets in a business acquisition.²⁵³ Under section 1060, the premium paid for a business (the excess of the purchase price over the value of the identifiable tangible and intangible property acquired) is attributable to goodwill. "Under this approach to defining goodwill," as noted by some commentators, "no attempt need be made to label the resulting asset as the expectation of continued customer patronage or to offer any other definition of 'goodwill.'"²⁵⁴ Nevertheless, section 197 is clear in defining goodwill as the value of a trade or business attributable to the expectancy of continued customer patronage due to the name or reputation of a trade or business or any other factor.²⁵⁵

Does the value of a domain name fit section 197's definition of goodwill (i.e., value attributable to expectancy of continued customer patronage)? Purchasing a domain name gives an owner the exclusive right to that name, for no two are identical.²⁵⁶ Most importantly, a domain name allows an owner to direct Internet traffic to its Web site,²⁵⁷ provided

251. 507 U.S. 546, 555-56 (quoting *Boe v. Comm'r*, 307 F.2d 339, 343 (9th Cir. 1962)).

252. *Id.* at 556.

253. If a trade or business is acquired in an "applicable asset acquisition" under section 1060, the total amount paid for the trade or business must be allocated among the various acquired assets in accordance with the rules of section 1060 (i.e., the "residual method" of valuing various acquired assets). I.R.C. § 1060.

254. Postlewaite, *supra* note 155, § 11.01[1], at 11-5 (noting that the "Supreme Court largely adopted the residual approach to the definition of 'goodwill' in its decision in *Newark Morning Ledger*").

255. See *supra* note 250 and accompanying text.

256. See *Brookfield Communications, Inc. v. W. Coast Entm't Corp.*, 174 F.3d 1036, 1044 (9th Cir. 1999) (explaining that each domain name is associated with a Web page and is unique in that there are no identical domain names).

257. See *Carefirst of Md., Inc. v. Carefirst Pregnancy Ctrs., Inc.*, 334 F.3d 390, 394 (4th Cir. 2003) (noting that the plaintiff registered a number of domain names that contain "carefirst" to direct Internet traffic to its Web site); *Nat'l A-1 Adver., Inc. v. Network Solutions, Inc.*, 121 F. Supp. 2d 156, 177 (D.N.H. 2000) (finding that the plaintiff used certain domain names to generate commercial Web traffic to their sites).

the owner has developed a Web site associated with its domain name.²⁵⁸ Internet users search for companies, products, and services by applying two common search methods. Internet users can type a domain name directly into a Web browser,²⁵⁹ or they can type a domain name into a search engine that conducts a search and provides users with choices of Web sites they may want to visit.²⁶⁰ The domain name serves as the link between the owner and users of a Web site.²⁶¹ In addition, the domain name serves as an important signal used to locate resources on the Internet.²⁶²

Bank of America, for example, purchased the domain name “loans.com” for three million dollars because the location received three to four thousand hits per day, even though the domain name was not associated with a developed Web site.²⁶³ Users looking for lending

258. See *Interactive Prods. Corp. v. a2z Mobile Office Solutions, Inc.*, 326 F.3d 687, 691 (6th Cir. 2003) (noting that upon entering a domain name into the Web browser, the corresponding Web site’s “homepage” will appear on the computer screen).

259. See *id.* (“A specific website is most easily located by entering its domain name into the browser.”); see, e.g., *PGMedia, Inc. v. Network Solutions, Inc.*, 51 F. Supp. 2d 389, 408 (S.D.N.Y. 1999) (concluding that a domain name is “simply a routing instruction that helps computers find each other”). The actual networking, however, is done through the Internet Protocol numbers that correspond with domain names for the ease of human users. See *id.* (“[T]here does not appear to be a requirement that a computer user wishing to establish an Internet site have a domain name at all. This is because domain names serve the sole purpose of making it easier for users to navigate the Internet; the real networking is done through the IP numbers.”).

260. If a Web user does not know the domain name, the user may then use an Internet search engine. “When a keyword is entered, the search engine processes it to generate a (sometimes long) list of web pages (ideally relating to the entered keyword).” *Interactive Prods.*, 326 F.3d at 691.

261. This linkage is severed if there is a third party who registered a misspelled version of the domain name. See *Ballistic Prods., Inc. v. Precision Reloading, Inc.*, No. Civ. 03-2950 ADM/AJB, 2003 WL 21754816, at *5 (D. Minn. July 28, 2003) (holding that irreparable harm exists in a case where the defendant registered misspelled domain names and directed Internet traffic from the plaintiff’s Web site to defendant’s Web site). Defendant’s action caused consumer confusion, leading them to falsely believe that the plaintiff does not operate a Web site. *Id.* Thus, the plaintiff “can never know how much traffic was lost, or how much faster the traffic would have grown” absent defendants’ registration of the misspelled domain names. *Id.* (quoting *Shields v. Zucarini*, 89 F. Supp. 2d 634, 641 (E.D. Pa. 2000)).

262. See *Interactive Prods.*, 326 F.3d at 691 (“A website’s domain name (e.g., azzsolutions.com) signifies its source of origin and is, therefore, an important signal to Internet users who are seeking to locate web resources.”). Due to its source identifying capacity, many courts have held that the use of another’s trademark within the domain name of a Web site can constitute a trademark violation. *Id.* See generally *Shields v. Zucarini*, 254 F.3d 476, 483 (3d Cir. 2001) (affirming the district court’s ruling in favor of the trademark owner in a case where the defendant registered domain names that incorporated the protected trademark to divert Internet traffic from the trademark owner’s Web site to the defendant’s Web site, causing irreparable harm to the trademark).

263. See Elise Ackerman, *Low-tech Entrepreneurs Stake Claim to Online Domains*, THE SAN DIEGO UNION-TRIBUNE, Jan. 24, 2000, at C-1 (stating that Bank of America paid three million dollars for

services on the Internet, without knowing of any particular company, often decide to randomly select a name, most likely one that is easily associated with lending services, such as “loans”; they then type “www.loans.com” directly into the Web browser.²⁶⁴ Bank of America understood how traffic reaches a Web site, the role of a memorable domain name in e-commerce, so it purchased “loans.com” for a high price to obtain visitors at its soon-to-be-constructed Web site.²⁶⁵ For the same reason, a number of other memorable domain names command a high price on the secondary market.²⁶⁶

Clearly these memorable, generic domain names possess inherent value based on the number of visitors they attract,²⁶⁷ even though no Web site has been constructed, no business has been created, and no products or services have been offered.²⁶⁸ The inherent value in domain names, however, is not identical to the general concept of “goodwill”; that is, a company’s “expectation of continued patronage,” which requires that the company continue in existence, offering goods or services and building a reputation.²⁶⁹

The concept of “goodwill” is more akin to the value that a domain name accumulates after a company constructs and maintains an

“loans.com,” an undeveloped domain name).

264. See *Costly ‘Loans’ for Bank of America*, COMPUTERS TODAY, May 31, 2000, at 106 (reporting that Bank of America purchased the domain name “loans.com” because “it’s a unique and valuable name, especially in connection with what [Bank of America does] which is make loans to individuals and businesses”), available at 2000 WL 3282695.

265. See Daniel Joelson, *Banks Square Off Over Internet Domain Names*, BANK TECH. NEWS, Nov. 22, 2000, at 1 (stating that the acquisition of the domain name “loans.com” for three million dollars is “less startling when one considers that the site was receiving 3,000 to 4,000 hits per day at the time”), available at 2000 WL 17153605; Patrick Larkin, *Profit.com: P&G sells ‘Net names*, THE CINCINNATI POST, Aug. 30, 2000, at 6B (reporting that Bank of America paid three million dollars for “loans.com,” “a nonexistent site that was getting 3,000 to 4,000 hits a day”), available at 2000 WL 23839188.

266. See generally Larkin, *supra* note 265, at 6B (listing generic domain names sold or being offered for sales at high prices).

267. See Agin, *supra* note 183, at 990 (stating that “a domain name represents goodwill because the traffic generated by a website—the number of people who visit the website and view the content provided there—and consequently the value of that website depend on the domain name” and that “[w]hen the domain name changes, the volume of traffic to the website will drop, as visitors are no longer able to locate the website”).

268. See *Dorer v. Abel*, 60 F. Supp. 2d 558, 561 (E.D. Va. 1999) (acknowledging that there are generic domains that are “extremely valuable to Internet entrepreneurs” because they can be “freely transferred apart from their content”).

269. See generally *Newark Morning Ledger Co. v. United States*, 507 U.S. 546, 555–56 (1993) (“Although the definition of goodwill has taken different forms over the years, the shorthand description of good-will as ‘the expectancy of continued patronage’ provides a useful label with which to identify the total of all the imponderable qualities that attract customers to the business.”).

associated Web site. Indeed, when a Web site is constructed and used in connection with the sale of products or services, value might be added to the domain name.²⁷⁰ Value is measured by the number of visitors to the Web site and could be the result of a combination of factors, such as its online content,²⁷¹ ease of navigation, quality products or services, or extensive and visible advertising.²⁷²

In sum, the inherent value of a generic domain name (value distinct from that added by the registrant or the person who has the right to use the domain name) is not the same as “goodwill” as defined in section 197.²⁷³ However, value added by the registrant after a Web site is constructed and the domain name is used in connection with the site, could be considered “goodwill” within the meaning of section 197 (or “trademark” value as discussed below). In the latter case, the domain name is dependent on the value or goodwill added. Indeed, the domain name could not be transferred without the value or goodwill added.

2. Domain Names as Trademarks

It has been suggested that domain names should be subject to the same tax rules as trademarks. As discussed previously, amounts paid or incurred to acquire a trademark must be capitalized and deducted ratably over fifteen years under section 197, regardless of whether the trademark is acquired separately or with a trade or business.²⁷⁴ For

270. See Mason Miller, Note, *Technoliability: Corporate Websites, Hyperlinks, and Rule 10(b)-5*, 58 WASH & LEE L. REV. 367, 381 (2003) (noting that the number of visitors to a Web site determines the “value” of the Web site).

271. See John E. Cummerford, *Hyperlinking and Framing: Recent Developments and Trends*, 644 PLI/PAT 293, 295 (2001) (“What drives visitors to websites is content—whether it’s sports scores, music downloads or pornography—that’s the thing that makes people show up, stay there, and come back another day.”); Jennifer Gordon, *For Web Success: Content, Content, Content*, 7 MKTG. FOR LAW. 7 (Nov. 2000) (stating that keeping online content fresh will encourage traffic).

272. Ryan L. Blaine, Comment, *Election Law and the Internet: How Should the FEC Manage New Technology?*, 81 N.C. L. REV. 697, 725 (2003) (“Large Internet corporations also use radio and television advertisements to increase the traffic to their Web sites.”); Kristen M. Beystehner, Note, *See Ya Later, Gator: Assessing Whether Placing Pop-Up Advertisements on Another Company’s Website Violates Trademark Law*, 11 J. INTEL. PROP. L. 87, 96–99 (2003) (discussing different types of online advertisements employed by Web sites to increase traffic to their sites); Allison Roarty, Note, *Link Liability: The Argument for Inline Links and Frames as Infringements of the Copyright Display Right*, 68 FORDHAM L. REV. 1011, 1016 (1999) (noting that Web site owners utilize links to increase traffic to their Web sites).

273. See *Dorer*, 60 F. Supp. 2d at 561 (“[I]f the only value that comes from transfer of the domain name is from the value added by the user, it is inappropriate to consider that [the domain name] is an element subject to execution.”).

274. See *supra* notes 126–130 and accompanying text.

purposes of section 197, the term “trademark” “includes any word, name, symbol, or device, or any combination thereof, adopted and used to identify goods or services and distinguish them from those provided by others.”²⁷⁵ Similarly, a trade name is defined as “any name used to identify or designate a particular trade or business or the name or title used by a person or organization engaged in a trade or business.”²⁷⁶ Are these regulatory definitions broad enough to include domain names? Domain names serve a technical function of locating Web sites on the Internet. This technical function is not enough for domain names to fall within section 197’s definition of “trademark” or “trade name.”²⁷⁷ Therefore, the relevant issue becomes whether domain names serve any other function so as to fall within the scope of section 197.

It is well established that certain domain names may be registered as trademarks. The U.S. Patent and Trademark Office (PTO) has issued guidelines on the registration of domain names as trademarks.²⁷⁸ Under the PTO policy, domain names are entitled to the protection afforded to trademarks if they are arbitrary, fanciful, suggestive, or descriptive, with acquired secondary meaning.²⁷⁹ Domain names that are merely descriptive or generic are not entitled to registration in the Principle Register.²⁸⁰ If a domain name contains a descriptive or generic component, its owner will be asked to disclaim that portion of the trademark.²⁸¹ For example, the owner of “Nike_shoes.com” must disclaim an exclusive right to use the word “shoes.” If the descriptive or generic component is part of a unitary²⁸² domain name such as “Nike.shoes.com”

275. Treas. Reg. § 1.197-2(b)(10)(i) (2000).

276. *Id.*

277. The technical function of locating sites on the Internet does not fall within the required definitional function of identifying goods or services and distinguishing them from those provided by others.

278. See *555-1212.com, Inc. v. Communication House Int’l, Inc.*, 157 F. Supp. 2d 1084, 1086 (N.D. Cal. 2001) (mentioning PTO registered domain name); *Image Online Design, Inc. v. Core Ass’n*, 120 F. Supp. 2d 870, 878 (C.D. Cal. 2000) (stating PTO governs trademark registrations for domain names); US DEP’T OF COMMERCE, PATENT AND TRADEMARK OFFICE, EXAMINATION GUIDE NO. 2-99: MARKS COMPOSED, IN WHOLE OR IN PART, OF DOMAIN NAMES [hereinafter PTO EXAMINATION GUIDE NO. 2-99] (explaining PTO policy of registering domain names as trademarks), available at <http://www.uspto.gov/web/offices/tac/notices/guide299.htm> (Sept. 29, 1999).

279. See PTO EXAMINATION GUIDE NO. 2-99, *supra* note 278.

280. See *id.*

281. When an owner disclaims a portion of a trademark, the owner cannot assert that it has any rights to that portion of the trademark. 15 U.S.C. § 1056 (2003).

282. A mark is unitary if it creates “a commercial impression separate and apart from any unregistrable component.” See TRADEMARK MANUAL OF EXAMINING PROCEDURE § 1213.05, at 1200–14

or “Nikeshoes.com,” no disclaimer is required.²⁸³ Regardless of whether a domain name is registered in the “.com,” “.org,” or “.net” TLD, the significant part of the domain name registration is the second-level domain, the portion immediately to the left of the dot.²⁸⁴ Moreover, the PTO policy does not allow registration of domain names that “function as ‘merely an informational indication of the domain name address used to access a website.’”²⁸⁵

Obviously, to be considered as a potential trademark for registration, a domain name must function as a source indicator.²⁸⁶ To qualify as a trademark, the registrant or owner of the domain name must use the domain name at its Web site to distinguish the goods or services offered there and to indicate the source of those goods or services.²⁸⁷ More specifically, the Web site must be an active or interactive site that offers goods or services using the domain name to identify the source of the goods or services at the home page or internal pages, capturing the attention of Internet consumers. The domain name owner must use the domain name in advertisements and sales in connection with the products or services offered at the site.²⁸⁸ Such uses of domain names in on-line commerce facilitate, in the mind of the consumer, an association between the domain name and the source of the products or services offered at the Web site. Courts have consistently held that domain names are not merely addresses, but powerful source indicators on the

(3d ed. 2003).

283. PTO EXAMINATION GUIDE No. 2-99, *supra* note 278.

284. See Christie L. Branson, Comment, *Was \$7.5 Million a Good Deal for Business.com? The Difficulties of Obtaining Trademark Protection and Registration for Generic and Descriptive Domain Names*, 17 SANTA CLARA COMPUTER & HIGH TECH L.J. 285, 305 (2001) (discussing the PTO policy on registering domain names as trademarks).

285. Eric G. Begun, *Even Courts Aren't Sure: Domain Name: Property? Contract?*, N.J. LAW., Sept. 10, 2001, at 7.

286. 1 J. McCARTHY, TRADEMARKS AND UNFAIR COMPETITION § 7:17.1, at 7-25 (4th ed. 1996) (“A domain name can become a trademark if it is used as a trademark.”).

287. See, e.g., *Lockheed Martin Corp. v. Network Solutions, Inc.*, 985 F. Supp. 949, 956 (C.D. Cal. 1997) (noting that when a domain name is used only to indicate an address on the Internet and not to identify the source of specific goods and services, the name is not functioning as a trademark); 6 JEROME GILSON ET AL., TRADEMARK PROTECTION AND PRACTICE § 2-99, at 3 (1999) (distinguishing the technical use from the trademark use of domain names to identify goods and services).

288. Cf. *Data Concepts, Inc. v. Digital Consulting, Inc.*, 150 F.3d 620, 628 (6th Cir. 1998) (Merritt, J., concurring) (noting that Data Concepts failed to establish use of the “dci.com” domain name as a trademark, “[f]or instance, there is no evidence in the record indicating whether Data Concepts disseminated advertisements of its services displaying the “dci.com” address or whether the company’s customers or employees simply passed the “dci.com” address along to potential customers in the same way someone might give out a telephone number”).

Internet.²⁸⁹

A domain name can be a word, phrase, or combination of words and numbers. Whether all domain names are protected under trademark law requires an examination of trademark jurisprudence. Under trademark law, the inquiry of whether a term is entitled to protection begins at the classification of the term within the spectrum of distinctiveness.²⁹⁰ Within the spectrum of distinctiveness, not all words and phrases receive protection under trademark law.²⁹¹ Furthermore, the law does not accord an equal level of protection to all words that qualify as trademarks.²⁹² Determining whether a protected trademark is strong in the marketplace requires an assessment of the recognition value of the mark.²⁹³ A conceptually strong trademark does not necessarily translate into a commercially strong trademark.²⁹⁴

Under trademark law, an arbitrary or fanciful trademark is accorded the highest level of protection because it is deemed to be inherently

289. See, e.g., *Brookfield Communications, Inc. v. W. Coast Entm't Corp.*, 174 F.3d 1036, 1055 (9th Cir. 1999) (recognizing that “[t]he domain name is more than a mere address: like trademarks, second-level domain names communicate information as to source”); *Patmont Motor Werks, Inc. v. Gateway Marine, Inc.*, 1997 WL 811770, at *4 n.6 (N.D. Cal. Dec. 18, 1997) (“Because of the importance of a domain name in identifying the source of a website, many courts have held that the use of a trademark within the domain name of a URL can constitute a trademark violation.”); *Cardservice Int'l v. McGee*, 950 F. Supp. 737, 741 (E.D. Va. 1997), *aff'd*, 1997 WL 716186 (4th Cir. 1997); *Panavision Int'l v. Toeppen*, 945 F. Supp. 1296, 1304 (C.D. Cal. 1996).

290. “A court’s inquiry into whether a term merits trademark protection starts with the classification of that term along the spectrum of ‘distinctiveness.’” *Boston Beer Co. L.P. v. Slesar Bros. Brewing Co.*, 9 F.3d 175, 180 (1st Cir. 1993).

291. *DeGidio v. W. Group Corp.*, 355 F.3d 506, 510 (6th Cir. 2004) (stating that whether a trademark qualifies for “protection is determined by where the mark falls along the established spectrum of distinctiveness”).

292. See *id.* (discussing the distinctiveness spectrum of trademarks and finding that arbitrary, fanciful, and suggestive trademarks are inherently distinctive and automatically entitled to protection, descriptive trademarks are accorded protection only if they acquired a secondary meaning, and generic marks are never distinctive and do not receive protection); *GoTo.com, Inc. v. Walt Disney Co.*, 202 F.3d 1199, 1207 (9th Cir. 2000) (Trademarks “can be conceptually classified along a spectrum of increasing inherent distinctiveness. From weakest to strongest, marks are categorized as generic, descriptive, suggestive, and arbitrary or fanciful.” (citations omitted)).

293. See *King of the Mountain Sports, Inc. v. Chrysler Corp.*, 185 F.3d 1084, 1093 (10th Cir. 1999) (stating that “to assess the relative strength of a mark, one must consider the two aspects of strength: (1) ‘Conceptual Strength: the placement of the mark on the [distinctiveness or fanciful-suggestive-descriptive] spectrum’; and (2) ‘Commercial Strength: the marketplace recognition value of the mark’” (citation omitted)).

294. See *Sunenblick v. Harrell*, 895 F. Supp. 616, 626 (S.D.N.Y. 1995) (“[A] mark may be conceptually strong and yet commercially weak if the mark lacks the requisite ‘origin-indicating’ quality in the eyes of consumers.”).

distinctive.²⁹⁵ A common word that is used in an uncommon, unexpected way to identify a source of goods or services is an arbitrary trademark.²⁹⁶ It has no real connection with its associated goods or services. Examples of arbitrary trademarks include “Apple” for computers and “Camel” for cigarettes.²⁹⁷ A fanciful trademark is an invented, coined, non-dictionary word²⁹⁸ that is applied in “a unique, unfamiliar usage for the express purpose of serving as a trademark to be attached to a particular product, but bearing no identifying trace to the product or source.”²⁹⁹ Some fanciful trademarks include Kodak, Clorox, Polaroid, and Exxon.³⁰⁰

Descending the trademark distinctiveness spectrum, we see suggestive trademarks, which are accorded less protection than arbitrary or fanciful trademarks.³⁰¹ Suggestive trademarks are words that require consumers to use their imagination to connect the trademark with its associated products or services.³⁰² “Citibank,” which connotes an urban or modern bank; “Goliath,” which refers to the large size of its wooden pencils,³⁰³ and “Passion,” which describes the fragrance of its cosmetics,³⁰⁴ are examples of suggestive trademarks.

295. See *Duluth News-Tribune v. Mesabi Publ'g Co.*, 84 F.3d 1093, 1096 (8th Cir. 1996) (stating that “an arbitrary or fanciful trademark is the strongest type of mark and is afforded the highest level of protection” (citing *Cellular Sales, Inc. v. MacKay*, 942 F.2d 483, 485 (8th Cir. 1991))); see also *Eli Lilly & Co. v. Natural Answers, Inc.*, 233 F.3d 456, 462 (7th Cir. 2000) (affirming the finding that “PROZAC®” is a “fanciful word that has no meaning independent of Lilly’s mark” and that “[s]uch marks are entitled to the highest protection”).

296. See generally *Sports Supply Group, Inc. v. Columbia Cas. Co.*, 335 F.3d 453, 460 n.7 (5th Cir. 2003); *Union Nat'l Bank of Tex., Laredo, Texas v. Union Nat'l Bank of Tex., Austin, Texas*, 909 F.2d 839, 845 (5th Cir. 1990).

297. See *BigStar Entm't, Inc. v. Next Big Star, Inc.*, 105 F. Supp. 2d 185, 198 (S.D.N.Y. 2000) (noting that “‘APPLE’ as a brand name for a computer or ‘XEROX’ for a copier are arbitrary and fanciful trademarks, respectively”).

298. See *Transamerica Corp. v. Trans Am. Abstract Serv., Inc.*, 698 F. Supp. 1067, 1071 (E.D.N.Y. 1988) (stating that a fanciful trademark is “a word invented solely for use as a trademark” (quoting *Pan American World Airways, Inc. v. Pan American Sch. of Travel, Inc.*, 648 F. Supp. 1026, 1033 (S.D.N.Y. 1986), *aff'd without opinion*, 810 F.2d 1160 (2d Cir. 1986))).

299. *BigStar Entm't*, 105 F. Supp. 2d at 197; see also *Sport Supply Group*, 335 F.3d at 461 n.7.

300. *Larsen v. Terk Techs. Corp.*, 151 F.3d 140, 148 n.5 (4th Cir. 1998).

301. *Virgin Enters. Ltd. v. Nawab*, 335 F.3d 141, 148 (2d Cir. 2003) (stating that arbitrary or fanciful trademarks “receive broader protection than weak marks, those that are descriptive or suggestive of the products on which they are used”).

302. “A term is suggestive if it requires imagination, thought and perception to reach a conclusion as to the nature of the goods.” *Stix Prods., Inc. v. United Merchs. & Mfrs., Inc.*, 295 F. Supp. 479, 488 (S.D.N.Y. 1968).

303. *Champions Golf Club, Inc. v. The Champions Gold Club, Inc.*, 78 F.3d 1111, 1117 (6th Cir. 1996) (stating that “Citibank” and “Goliath” are suggestive trademarks).

304. See *Elizabeth Taylor Cosmetics Co., Inc. v. Annick Goutal, S.A.R.L.*, 673 F. Supp. 1238, 1244 (S.D.N.Y. 1987) (finding “Passion” a suggestive trademark).

Words that describe the nature, quality, characteristics, or function of products³⁰⁵—such as “King Size” for large men’s clothes,³⁰⁶ “No Spot” for a carwash system,³⁰⁷ and “World Book” for an encyclopedia³⁰⁸—are descriptive trademarks. This type of trademark is not automatically entitled to trademark protection. In order to receive protection for a descriptive trademark, an owner must demonstrate that consumers have come to perceive the trademark as a source identifier.³⁰⁹ Generally, six factors have been identified to help establish secondary meaning. They are (1) advertising expenditures; (2) consumer studies linking the mark to a source; (3) unsolicited media coverage of the product; (4) sales success; (5) third party attempts to plagiarize the mark; and (6) the length and exclusivity of the mark’s use.³¹⁰ The burden of establishing secondary meaning is heavy, and proof “entails vigorous evidentiary requirements.”³¹¹ Essentially, the evidence must establish that the descriptive trademark identifies the producer, not the product.³¹²

On the bottom of the trademark protection spectrum are generic words, which never receive protection.³¹³ Generic trademarks are common words that are names of articles in commerce.³¹⁴ A generic term

305. See *Stix Products*, 295 F. Supp. at 488 (“A term is descriptive if it forthwith conveys an immediate idea of the ingredients, qualities or characteristics of the goods.”)

306. See *King-Size, Inc. v. Frank’s King Size Clothes, Inc.*, 547 F. Supp. 1138, 1156 (S.D. Tex. 1982) (finding “King-Size” a descriptive trademark for large men’s clothes).

307. See *Raco Car Wash Sys., Inc. v. Smith*, 730 F. Supp. 695, 701 (D.S.C. 1989) (finding “No Spot” a descriptive trademark), *appeal dismissed*, 929 F.2d 694 (4th Cir. 1991)).

308. See *Field Enters. Educ. Corp. v. Cove Indus., Inc.*, 297 F. Supp. 989, 992 (E.D.N.Y. 1969).

309. Secondary meaning attaches if “the consuming public primarily associates the term with a particular source.” *Bristol-Myers Squibb Co. v. McNeil-P.P.C., Inc.*, 973 F.2d 1033, 1040 (2d Cir. 1992) (citing *Centaur Communications, Ltd. v. A/S/M Communications, Inc.*, 830 F.2d 1217, 1221 (2d Cir. 1987)).

310. See *Centaur Communications*, 830 F.2d at 1221 (listing the factors for determining whether a descriptive mark has achieved secondary meaning).

311. *20th Century Wear, Inc. v. Sanmark-Stardust Inc.*, 747 F.2d 81, 90 (2d Cir. 1984) (quoting *Ralston Purina Co. v. Thomas J. Lipton, Inc.*, 341 F. Supp. 129, 134 (S.D.N.Y. 1972)), *cert. denied*, 470 U.S. 1052 (1985).

312. See *Two Pesos, Inc. v. Taco Cabana, Inc.*, 505 U.S. 763, 786 (1992) (Thomas, J., concurring) (“[T]he user of a . . . descriptive word or symbol could obtain relief only if he first showed that his trade name did in fact represent not just the product, but a producer . . .”).

313. See *Sport Supply Group, Inc. v. Columbia Cas. Co.*, 335 F.3d 453, 460 n.7 (5th 2003) (noting that a generic trademark, “which refers to an entire class of products (such as ‘airplane’ or ‘computer’), does not distinguish a product at all, and therefore receives no protection under trademark law”); *A&H Sportswear, Inc. v. Victoria’s Secret Stores, Inc.*, 237 F.3d 198, 222 (3d Cir. 2000) (stating that generic marks receive no protection and “they are not ‘trademarks’ at all”).

314. “A generic term is one that is commonly used as the name of a kind of goods. Unlike a trademark, which identifies the source of a product, a generic term merely specifies the genus of which

generally refers to “the genus of which a particular product is a species.”³¹⁵ Examples of generic trademarks are “Apple” for apples and “Computer” for computers.³¹⁶ Essentially, “a mark is generic if, in the mind of the purchasing public it does not distinguish products on the basis of source but rather refers to the type of product.”³¹⁷ Generic trademarks belong to the public.³¹⁸ No person has an exclusive right to use or monopolize a generic word that, in its ordinary or common meaning, names a good or service.³¹⁹

Accordingly, domain names that are arbitrary with respect to the goods or services offered at their associated Web site receive a high level of protection under trademark law. “amazon.com” for an online bookstore³²⁰ and “monster.com” for employment services are examples of arbitrary domain names.³²¹ Similarly, “ebay.com” is a fanciful domain name for an online auction; it is an invented term that has no connection to the goods or services offered at its associated Web site. The domain name “goto.com” is a suggestive trademark for search engine services,³²² because it requires Internet surfers to use their imagination in making the connection between “go to” and Internet searches.³²³ “Goto.com” has been ranked as the twenty-sixth most visited Web site on the Internet.³²⁴

the particular product is a species.” *Liquid Controls Corp. v. Liquid Control Corp.*, 802 F.2d 934, 936 (7th Cir. 1986) (citations omitted).

315. 815 *Tonawanda St. Corp. v. Fay’s Drug Co., Inc.*, 842 F.2d 643, 647 (2d Cir. 1988).

316. See *Sport Supply Group*, 335 F.3d at 460 n.7.

317. *Courtenay Communications Corp. v. Hall*, 334 F.3d 210, 214 n.2 (2d Cir. 2003).

318. See *Interstellar Starship Servs., Ltd. v. Epix, Inc.*, 304 F.3d 936, 944 (9th Cir. 2002) (noting that an apple grower in Washington may use the domain name “www.apple.com” to promote his business and has no fear of infringing the famous “Apple” trademark for computers).

319. See *Am. Cyanamid Corp. v. Connaught Labs., Inc.*, 800 F.2d 306, 308 (2d Cir. 1986) (“A trademark holder cannot appropriate generic . . . terms for its exclusive use, and a trademark infringement finding thus cannot be based on the use of a generic . . . term . . .”).

320. See *Interstellar Starship Servs.*, 304 F.3d at 943 n.6 (9th Cir. 2002) (noting that “Amazon” is an arbitrary trademark).

321. See Mark J. Gundersen, *Want to Be Ruler of Your Own Domain? The Name’s the Thing in E-Business*, 11 BUS. L. TODAY 19, 19 (May/June 2002) (stating that “monsters.com” is an arbitrary domain name and “may require more advertising to create an association between the name and the service or product supplied” at the associated Web site).

322. See *GoTo.com, Inc. v. Walt Disney Co.*, 202 F.3d 1199, 1207 (9th Cir. 2000) (concluding that “GoTo” is a suggestive trademark for search engine services).

323. *Id.*

324. See *id.* at 1208 (noting that the domain name and its associated Web site was ranked as the twenty-sixth most visited Web site; analyzing the trademark, words and logos, and how the trademark is used in the Internet by the trademark owner and others; and concluding that the trademark is not strong).

Also on the distinctiveness spectrum of domain name trademark protection, we have descriptive domain names. “Lawoffices.net” is an example of a descriptive trademark.³²⁵ A descriptive domain name will not be accorded trademark protection unless the name has acquired secondary meaning. Given the vastness of the global network—the existence of more than forty-six million domain names, a billion readable Web pages, and numerous hosts—the owner of a descriptive domain name faces a tremendous task of proving secondary meaning.³²⁶ Moreover, due to the nature of the Internet, users can access a Web site by its descriptive name by typing the term as a keyword into a search engine. This would pose difficult for a domain name holder who attempts to prove that a descriptive domain name has acquired secondary meaning in the minds of Internet users.³²⁷ In addition, courts have rejected evidence proving that the use of a Web site means equal identification with a particular provider,³²⁸ evidence of high placement of

325. *DeGidio v. W. Group Corp.*, 355 F.3d at 506, 511 (6th Cir. 2004) (affirming the district court’s finding that “lawoffices.net” is a descriptive trademark of an “online database of attorneys and the electronic publication via a global network of computers”).

326. *Id.* at 513 (listing a seven-factor test for assessment of secondary meaning); *BigStar Entm’t, Inc. v. Next Big Star, Inc.*, 105 F. Supp. 2d at 185, 202 (S.D.N.Y. 2000) (listing a six-factor test for secondary meaning). Even if a domain name has been used for a good length of time and without interruption of use, the wide use of the descriptive term by other Web sites weighs “against a finding of secondary meaning.” *DeGidio*, 355 F.3d at 513. Further, even if the plaintiff has spent millions of dollars in advertisements, such information alone does not establish that the descriptive domain name has come to identify the source. See *BigStar Entm’t*, 105 F. Supp. 2d at 202 (Although the plaintiff had reportedly spent twelve million dollars in advertising, “the Court is unable to determine supportably the extent to which plaintiff’s advertising efforts have been effective in causing consumers to associate ‘BIGSTAR’ or ‘BIGSTAR.COM’ only with plaintiff.”).

327. See *Thomas v. Network Solutions, Inc.*, 2 F. Supp. 2d 22, 26 (D.D.C. 1998) (noting that a domain name “can be tailored to be easily remembered, and even to convey information about the user—it is often descriptive,” that “the user can access a site by its descriptive name” and that “[i]f the name is properly registered and linked to an IP address, the user will be conveyed to the site he or she seeks”); see also *1-800 Contacts, Inc. v. WhenU.com*, 309 F. Supp. 2d 467 (S.D.N.Y. 2003).

[A] metatag is ‘buried code’ that is not visible to Internet users, which is referenced by domain name search engines or directories to determine whether a website corresponds to descriptive keywords entered into the search engine by a computer user. Those websites with metatags corresponding to the requested keywords appear on the computer screen as the search engine’s response.

1-800 Contacts, Inc., 309 F. Supp. 2d at 492 n.45 (citing *Brookfield Communications, Inc. v. W. Coast Entm’t Corp.*, 174 F.3d 1036, 1061–62 n.23 (9th Cir. 1999)).

328. See *DeGidio*, 355 F.3d at 513 (noting that the plaintiff provided affidavits of three people who visited the “lawoffices.net” site and such evidence failed to “identify the website with a particular source of services” and that “[m]ere use of a website does not equal identification with a particular provider”).

the associated Web site in search engine listings,³²⁹ and evidence providing ranking information based on the number of other sites that link to the associated Web site.³³⁰ Courts often demand consumer survey evidence demonstrating that Internet consumers perceive the domain name as a source identifier, not a description of the products or services at the Web site.³³¹ Descriptive domain names that have not acquired secondary meaning include “bigstar.com,”³³² “hometown.net,”³³³ “homemarket.com,”³³⁴ “lawoffices.net,”³³⁵ and “24hourfitness.com.”³³⁶

329. See *Shade's Landing, Inc. v. Williams*, 76 F. Supp. 2d 983, 989 (D. Minn. 1999).

The high placement of plaintiff's web site in search engine listings shows that plaintiff has gone to great lengths to register it with search engine providers and to use effective metatags so that consumers searching for the key phrase 'Home-Market' can find it easily. It does not show, however, that many consumers have actually found or searched for plaintiff's services using that phrase such that it has become associated with plaintiff's web site in the public mind.

Id. (footnote omitted) (citing *Co-Rect Prods., Inc. v. Marvy! Adver. Photography, Inc.*, 780 F.2d 1324, 1332 (8th Cir. 1985)).

330. See *DeGidio*, 355 F.3d at 513 (noting that the district court correctly rejected “as irrelevant the rankings by *WebsMostLinked.com*, a site that ranks websites based upon the number of other sites that link to them”).

331. See *id.* (noting that the plaintiff did not submit consumer survey evidence for secondary meaning); *BigStar Entm't*, 105 F. Supp. 2d at 203 (noting that the plaintiff did not conduct a consumer survey for secondary meaning).

332. *BigStar Entm't*, 105 F. Supp. 2d at 203 (finding that the domain name “bigstar.com” has not achieved secondary meaning because “the Court is unable to determine supportably the extent to which plaintiff's advertising efforts have been effective in causing consumers to associate ‘BIGSTAR’ or ‘BIGSTAR.COM’ only with plaintiff”).

333. *Eglen v. America Online, Inc.*, No. TH 00-135-C-M/H, 2003 WL 21508343, at *10 (S.D. Ind. June 12, 2003) (finding that “hometown.net” is merely descriptive and that the plaintiff failed to prove that it has secondary meaning).

334. *Shade's Landing*, 76 F. Supp. 2d at 989.

“Home-Market.com” is a descriptive term. Although the precise nature of plaintiff's business is not apparent from this language, it directly and clearly conveys the general nature of the services it identifies. The term “Home” describes services related to homes, “Market” indicates that the services are available to consumers, and “.com” is a well-known top-level domain name indicating that the services are available through the Internet. Because plaintiff's web-site referral network markets services related to homes over the Internet, it can be stated fairly that the mental leap between the words “Home-Market.com” and the general attributes of the service it identifies is almost instantaneous.

Id. (citation omitted).

335. In analyzing whether the domain name “lawoffices.net” has acquired secondary meaning, the court applied a seven-factor test that included (1) direct consumer testimony; (2) consumer surveys; (3) exclusivity, length and manner of use; (4) amount and manner of advertising; (5) amount of sales and number of customers; (6) established place in the market; and (7) proof of intentional copying. *DeGidio*, 355 F.3d at 513. The court held that the evidence submitted by the plaintiff failed to satisfy its heavy burden of proof. *Id.*

336. See *24 Hour Fitness USA, Inc. v. 24/7 Tribeca Fitness, L.L.C.*, 277 F. Supp. 2d 356, 362-63 (S.D.N.Y. 2003) (analyzing the trademark “24 Hour Fitness,” finding that “the evidence that the mark

The definition of “trademark” in section 197 is broad enough to include domain names that are able to be protected as valid trademarks, such as those considered arbitrary, fanciful, suggestive or descriptive with acquired secondary meaning. Therefore, purchase costs allocable to domain names that function as trademarks should be amortized ratably over a fifteen-year period irrespective of the domain name’s remaining registration period and registration renewal options.³³⁷

However, generic domain names such as “fitness.com,” “wireless.com,” “wine.com,” and “register.com” (which provides domain name registration services), are not entitled to protection. For example, a court held that “cds.com” (where the owner asserted that “cds” is in reference to compact disc products and services) is generic and therefore not entitled to trademark protection.³³⁸ Although generic domain names are not entitled to trademark protection, they are greatly sought after by many Internet companies. The trade-off for selecting a generic domain name without trademark protection is that the name needs little promotion to be effective, as it directly communicates to Internet users

24 Hour Fitness has achieved secondary meaning in the minds of consumers to a significant degree as identifying Plaintiff as the particular source of goods and services offered under that rubric is far from compelling,” and concluding that it is a descriptive trademark, and arguably a generic trademark, since there are 1.6 million hits for the word “fitness” alone).

337. I.R.C. § 197(a) (2004); Treas. Reg. § 1.197-2(a)(1) (2004). The fifteen-year period begins on the first day of the month in which the domain name is acquired and held in connection with either a trade or business (within the meaning of section 162) or an activity conducted for profit (within the meaning of section 212). I.R.C. § 197(c)(1)(B); Treas. Reg. § 1.197-2(f)(1)(i)(A). If a domain name that functions as a trademark is acquired as part of the acquisition of an ongoing business, the total amount paid for the business must be allocated among the various assets in order to determine the basis of the domain name. If a business is acquired in an “applicable asset acquisition” under section 1060, the total amount paid for the business must be allocated among the various acquired assets (including the domain name) in accordance with the rules of section 1060 (i.e., the basis of the domain name must be determined under the “residual method”). An applicable asset acquisition is any transfer of a group of assets if the assets constitute a trade or business in the hands of either the purchaser or the seller and the purchaser’s basis in the assets can be determined wholly by reference to the consideration paid. A group of assets constitutes a trade or business either if the use of those assets would qualify as an active trade or business under section 355 or if goodwill or going concern value could attach to those assets under any circumstances. Treas. Reg. § 1.197-2(e)(1); *Id.* § 1.1060-1(b)(2) (2004).

338. This is a case where the owner of the domain name “cds.com” attempted to expand the scope of its original trademark “CDS,” which was the initial trademark of its businesses. The plaintiff sought a declaratory judgment that its domain name “cd.com” does not infringe upon the defendant’s “CDS.” The defendant claimed that “CDS” is for compact disc products and services. The court found that the defendant’s assertion rendered its “CDS” trademark “a term in common usage” and the mark was “invalid as being generic.” *CD Solutions, Inc. v. Tooker*, 15 F. Supp. 2d 986, 989–90 (D. Or. 1998).

the nature of the goods or services offered at the associated Web site.³³⁹ The rationale for not allowing generic domain names to have trademark protection is rooted in the well-established “genericness” doctrine. The genericness doctrine dictates that generic terms cannot be appropriated or monopolized; all may use words that comprise ordinary language. Indeed, no individual or entity may corner the market on a term used in everyday speech to the exclusion of the public and competitors who may seek, “at the risk of potential liability to one who laid claim to words of common currency, to avail themselves of ordinary language to refer to an article by its publicly accepted name.”³⁴⁰ Under the genericness doctrine, there is no trademark protection whatsoever for generic terms, even if the terms have acquired secondary meaning.³⁴¹ This rule applies regardless of how long a term has been used in marketing a particular product or service, or how closely the term has come to be associated with a particular source.³⁴² Moreover, as the Supreme Court emphatically announced sixty-six years ago, goodwill in a generic term is shared by all, and its free exercise is in the interest of the public.³⁴³

The question then arises whether the costs of purchasing generic domain names are amortizable under section 197 like the costs of purchasing domain names protected under trademark law. Some commentators have suggested that generic domain names might

339. See Gundersen, *supra* note 321, at 20–21.

The first step, then, is to consider choosing a common or descriptive name versus choosing an arbitrary or fanciful one. The usual trade-off exists between a descriptive name that needs little promotion to be effective, but is harder to register and defend—versus an arbitrary or fanciful name that needs more promotion, but is more defensible. Each approach represents a valid Internet business model, but each has different legal consequences—especially on the Internet.

Id.

340. See *BigStar Entm't, Inc. v. Next Big Star, Inc.*, 105 F. Supp. 2d 185, 195 (S.D.N.Y. 2000); see also *Am. Cyanamid Corp. v. Connaught Labs., Inc.*, 800 F.2d 306, 306 (2d Cir. 1986).

341. See *generally* *Surgicenters of Am., Inc. v. Med. Dental Surgeries, Co.*, 601 F.2d 1011, 1016 (9th Cir. 1979) (“[A] ‘generic word’ cannot be validly registered as a trademark even if there is proof of secondary meaning.”).

342. See *generally* *Keebler Co. v. Rovira Biscuit Corp.*, 624 F.2d 366, 374 (1st Cir. 1980) (“No amount of purported proof that a generic term has acquired secondary meaning associating it with a particular producer can transform that term into a registrable trademark.”); *CES Publ'g Corp. v. St. Regis Publ'ns Inc.*, 531 F.2d 11, 13 (2d Cir. 1975) (rejecting the district court’s finding that a generic term may become a trademark if it acquires secondary meaning, and reiterating the rule that generic terms cannot attain trademark status in any circumstance).

343. See *Kellogg Co. v. Nat'l Biscuit Co.*, 305 U.S. 111, 122 (1938) (stating that “[s]haring in the goodwill of an article unprotected by . . . trade-mark is the exercise of a right possessed by all—and in the free exercise which the consuming public is deeply interested”).

constitute a trademark or trade name *for tax purposes* even if they do not for intellectual property law purposes.³⁴⁴ In other words, generic domain names may be included in the broad definition of a trademark or trade name under section 197, even though they cannot be trademarked because they are common names. To better understand this argument, a closer look at the tax definitions of trademark and trade name is in order.

The regulations under section 197 define a trademark as “any word, name, symbol, or device, or any combination thereof, adopted and used to identify goods or services and distinguish them from those provided by others.”³⁴⁵ Similarly, a trade name is defined as “any name used to identify or designate a particular trade or business or the name or title used by a person or organization engaged in a trade or business.”³⁴⁶ More importantly, according to some commentators, the regulations state that “[a] trademark or trade name includes any trademark or trade name arising under statute or applicable common law, and *any similar right granted by contract*.”³⁴⁷ Relying on this regulatory definition, one commentator has suggested that generic domain names, even though not able to be protected under trademark law, “can still serve to identify a certain company (or mascot) on the web and are registered rights,” and thus are a “‘similar right’ granted by contract.”³⁴⁸ Another commentator has similarly suggested that a generic domain name might be a similar right granted by contract:

[A] domain name is adopted to identify a web site and to distinguish that web site from web sites provided by others. If a web site itself could be deemed a ‘service’ then all domain names would constitute ‘a similar right granted by contract’ even though the domain name would not be a trademark under the Lanham Act. . . . Although we might expect the definition of a trademark or trade name for tax purposes to follow that of applicable IP law, the regulations are clearly not so limited. The fact that the regulations refer to ‘a similar right granted by contract’ means that the definition of a trademark or trade name for tax purposes is broader than that under IP law.³⁴⁹

344. See *infra* text accompanying notes 348–349.

345. Treas. Reg. § 1.197-2(b)(10)(i) (2004).

346. *Id.*

347. *Id.* (emphasis added).

348. Annette Nellen, *Domain Names and Other Intangibles for Internet Business*, 14 J. TAX’N F. INST. 31, 34 (2001).

349. E-mail from David L. Cameron, Associate Director, Tax Program, and Senior Lecturer, Northwestern University School of Law to Jeffrey A. Maine, Professor of Law, University of Maine

Contrary to the arguments above, the definition of “trademark” under tax law is similar to the definition of trademark provided under the federal trademark statute, the Lanham Act. As noted above, regulations under section 197 define a trademark as “any word, name, symbol, or device, or any combination thereof, adopted and used to identify goods or services and distinguish them from those provided by others.”³⁵⁰ Similarly, the Lanham Act provides that a trademark is a “word, name, symbol, or device, or any combination thereof used by a person . . . to identify and distinguish his or her goods . . . from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown.”³⁵¹ This strongly suggests that, like the Lanham Act, section 197 excludes generic domain names that do not function as trademarks because such names fail to identify and distinguish the associated goods or products from those provided by others.³⁵² Identifying and distinguishing goods or services are the cornerstone functions of a trademark; a domain name that is unable to do so is therefore not a trademark under either section 197 or the Lanham Act.³⁵³

Moreover, the regulations for section 197 indicating that “[a] trademark or trade name includes any trademark or trade name arising under statute or applicable common law, and any similar right granted by

School of Law, (Jan. 23, 2004) (on file with author). Professor Cameron notes that “[t]he same argument could be made to bring a domain name within the category of a right similar to a trade name.” *Id.*

350. Treas. Reg. § 1.197-2(b)(10).

351. 15 U.S.C. § 1127 (2004).

352. See *BellSouth Corp. v. DataNational Corp.*, 60 F.3d 1565, 1569 (Fed. Cir. 1995) (“A generic term cannot function as an indication of source,” i.e., “cannot inform the public that the product has a particular source.”); *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 828 F.2d 1567, 1569–70 (Fed. Cir. 1987) (stating that generic marks are incapable of indicating a particular source of goods or services, and cannot be registered as trademarks; doing so “would grant the owner of the mark a monopoly, since a competitor could not describe his goods as what they are” (citing *CES Publ’g Corp. v. St. Regis Publ’ns Inc.*, 531 F.2d 11, 13 (2d Cir. 1975))). Even the fact that the public may associate a generic term with a particular source will not necessarily preclude a finding of “genericness.” See, e.g., *E. Air Lines, Inc. v. N.Y. Air Lines, Inc.*, 559 F. Supp. 1270, 1275 (S.D.N.Y. 1983).

353. The primary function of a trademark is to identify and distinguish the goods or services of one source from those sold by all others, although this may be accomplished anonymously. 1 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 12.01[1], at 12-4 (4th ed. 2003); *Merrill Lynch*, 828 F.2d at 1569 (“Generic terms, by definition incapable of indicating source, are the antithesis of trademarks, and can never attain trademark status.”). The Lanham Act precludes registration on the principal register of a mark that “when used on or in connection with the goods of the applicant is merely descriptive or deceptively misdescriptive of them.” 15 U.S.C. § 1052(e)(1). A generic term falls within this prohibition because “[t]he generic name of a thing is in fact the ultimate in descriptiveness.” *H. Marvin Ginn Corp. v. Int’l Ass’n of Fire Chiefs, Inc.*, 782 F.2d 987, 989 (Fed. Cir. 1986).

contract,” must be interpreted consistently with the definition of trademark provided in the plain language of section 197.³⁵⁴ That means that “any similar right granted by contract” cannot be expanded to include a name that is not capable of identifying and distinguishing goods or services of one source from those of another. Furthermore, statutory interpretation canons³⁵⁵ dictate that “any similar right granted by contract” must be parallel to and cannot be in conflict with a right “arising under statute or applicable common law.”³⁵⁶ Otherwise, the regulations defining trademarks and trade names could also include non-trademarks in their scope, which would be an anomalous result.³⁵⁷

The interpretation of section 197 and its regulations advocated by those who believe generic domain names are capable of identifying the Internet company behind associated Web sites is contrary to established law stating that generic words are incapable of identifying a producer, maker, or source. Generic words by their own nature identify products. To say that generic domain names are capable of identifying their owners would turn years of precedent on its head. Interpreting tax law at the detriment of well-established trademark law is hardly fulfilling the intent of the drafters, carrying out tax policy, or serving the public good.

In addition, such interpretations fall into a line of reasoning similar to the argument that domain names are rights under service contracts. Recent court decisions have squarely rejected the argument that domain names are service contracts.³⁵⁸ Courts have observed that this argument is

354. Treas. Reg. § 1.197-2(b)(10)(i).

355. “Under the principle of *eiusdem generis*, when a general term follows a specific one, the general term should be understood as a reference to subjects akin to the one with specific enumeration.” *Norfolk & W. Ry. Co. v. Am. Train Dispatchers’ Ass’n*, 499 U.S. 117, 129 (1991).

356. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 106 (2001), is illustrative of the maxim *eiusdem generis*. There, the Court interpreted that “any other class of workers engaged in . . . commerce” constitutes a residual phrase, following, in the same sentence, explicit reference to ‘seamen’ and ‘railroad employees.’ The wording thus calls for application of the maxim *eiusdem generis*, under which the residual clause should be read to give effect to the terms ‘seamen’ and ‘railroad employees,’ and should be controlled and defined by reference to those terms.” *Id.* (citation omitted).

357. See, e.g., *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 575 (1995) (warns against attributing to a generic term “a meaning so broad that it is inconsistent with its accompanying words, thus giving ‘unintended breadth to the Acts of Congress’” (quoting *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961))).

358. See generally *Kremen v. Cohen*, 99 F. Supp. 2d 1168, 1173 n.2 (N.D. Cal. 2000), *aff’d*, 337 F.3d 1024 (9th Cir. 2003). The correct characterization of domain names is as property, not rights under service contracts. *Id.*; see also *Kremen v. Cohen*, 337 F.3d 1024, 1030 (9th Cir. 2003) (holding that domain names are characterized as property).

focused on the role of the registrar (i.e., performing registration services), not the actual characterization of domain names.³⁵⁹ The largest domain name registrar, NSI, has also consistently taken the position that domain names are not service contracts, but a form of property—some of which are trademarks.³⁶⁰

Finally, to support the conclusion that generic domain names should be excluded from the definition of trademark or trade name under section 197, it is helpful to look at where generic domain names derive their value. Some domain names derive their value from their relationship to a product, service, or the goodwill and reputation of the business with which they are associated.³⁶¹ The owner of a domain name can cultivate its value through extensive use of the name in association with the goods and services sold at the Web site, through years of marketing and advertising the name in connection with those goods and services, and through media coverage of the name in the industry.³⁶² These names are not valuable if they do not have the attached goodwill.³⁶³ In fact, an assignment of words, phrases, symbols, or combination thereof without the associated goodwill has long been established as a naked, invalid assignment.³⁶⁴

In contrast to domain names that derive value from their association with a product, service, or business (i.e., domain names that function as trademarks), generic domain names are inherently valuable.³⁶⁵ They can be freely sold, assigned, or transferred without associated Web sites.³⁶⁶

359. See *Kremen*, 99 F. Supp. 2d at 1173 n.2.

360. See generally *Kremen*, 337 F.3d at 1029; *Network Solutions, Inc. v. Clue Computing, Inc.*, 946 F. Supp. 858, 860 (D. Colo. 1996); *Network Solutions, Inc. v. Umbro Int'l, Inc.*, 529 S.E.2d 80, 86 (Va. 2000).

361. See *Dorer v. Arel*, 60 F. Supp. 2d 558, 561 (E.D. Va. 1999) (stating that the value of a domain name depends on how it is used by the registrant).

362. *Island Insteel Sys., Inc. v. Waters*, 296 F.3d 200, 209 (3d Cir. 2002) (noting that a trademark owner spends “energy, time, and money” to obtain the goodwill associated with a trademark (quoting *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844, 854 n.14 (1982))).

363. See *Creative Arts by Calloway, L.L.C. v. Brooks*, No. 02-7050, 2002 WL 31303241, at *2 (2d Cir. Oct. 11, 2002) (“A trademark is merely a symbol of goodwill and cannot be sold or assigned apart from the goodwill it symbolizes.”).

364. See *Marshak v. Green*, 746 F.2d 927, 929 (2d Cir. 1984) (“There are no rights in a trademark apart from the business with which the mark has been associated; they are inseparable.”).

365. Hardesty, *supra* note 162, at 369.

366. Many domain names are sold at auction sites without associated Web sites. See, e.g., Lauren Weber, *Electronic Commerce: Bidders Lose Itch for Generic Names on Web Domains*, 166 AM. BANKER 18, 18 (2001) (stating that “mortgage.com” was sold for \$1.8 million), available at 2001 WL 3912527; Sarah Andrews, *The Cyber Space*, THE N. ECHO 5 (2000) (reporting that

They do not need associated Web sites, or any value added by the owners.³⁶⁷ They still command high price tags in the secondary domain name market because they can attract visitors due to the nature of the Internet and the ways in which Internet surfers search for Web sites.³⁶⁸

This distinction between (1) domain names that derive value from their association with a specific product, service, or business, and (2) generic domain names that have inherent value is relevant only if a similar distinction also exists in section 197 with respect to other intellectual property rights. As outlined above, section 197 applies to the following acquired intellectual property rights: (1) patents acquired as part of the acquisition of a trade or business; (2) copyrights acquired as part of the acquisition of a trade or business; (3) trademarks and trade names regardless of whether acquired separately or as part of the acquisition of a trade or business; and (4) trade secrets and know-how regardless of whether acquired separately or as part of the acquisition of a trade or business.³⁶⁹ All of these intellectual property rights subject to section 197 have one thing in common: they either constitute a portion of a business (the first and second included intangibles) or have value only in their association with a business (the third and fourth included intangibles).³⁷⁰ With respect to trademarks, for example, one court recognized that "trademarks are not separate property rights. They are integral and inseparable elements of the goodwill of the business or services to which they pertain."³⁷¹ Section 197's tax treatment of trademarks and trade names is in accordance with this idea. In fact, the regulations under section 197 provide that the single asset acquisition of a trademark or trade name is construed as the acquisition of a trade or business or substantial portion thereof, thus requiring application of section 197 to the trademark or trade name and removing it from the

"diamondseternally.com" is worth £3,175,000), available at 2000 WL 29569307.

367. See *Dorer v. Arel*, 60 F. Supp. 2d 558, 561 (E.D. Va. 1999).

368. See *supra* Part I.A.

369. See *supra* notes 125-143 and accompanying text.

370. Hardesty, *supra* note 162, at 372.

371. *Visa, U.S.A., Inc. v. Birmingham Trust Nat'l Bank*, 696 F.2d 1371, 1375 (Fed. Cir. 1982). Courts have consistently held that a valid assignment of a trademark requires the transfer of the goodwill associated with the mark. See, e.g., *Sands, Taylor & Wood Co. v. Quaker Oats Co.*, 978 F.2d 947, 956 (7th Cir. 1992) ("[T]he transfer of a trademark apart from the goodwill of the business which it represents is an invalid 'naked' or 'in gross' assignment, which passes no rights to the assignee." (citation and quotations omitted)); *Berni v. Int'l Gourmet Rests. of Am., Inc.*, 838 F.2d 642, 646 (2d Cir. 1988).

scope of any exception for intangibles acquired separately.³⁷²

Intellectual property rights specifically excluded from section 197, such as separately acquired patents and separately acquired copyrights, have something completely different in common: they are not linked to a particular business but instead have inherent value. Like separately acquired patents and copyrights, which are not subject to section 197, generic domain names are not linked to any particular business, have inherent value, and can be legally transferred without any goodwill of a business.³⁷³ Due to the nature of the Internet, the search methods often employed by Internet users, and the unique nature of the domain name assigning system, generic domain names possess inherent value and are valuable in the secondary market.³⁷⁴ To carry out the clear congressional intent to exclude from section 197 all those intangibles with inherent value, it would seem that generic domain names should be excluded from section 197.

3. *Domain Names as Non-Trademarks*

This article has concluded thus far that domain names should not be treated for tax purposes as government licenses or contracts for services, but instead should be treated as valuable intangible property. The article has further concluded that domain names that function as source indicators are amortizable under section 197, but those that do not (i.e., generic domain names) fall outside the scope of section 197, except for any “goodwill” or “trademark” value accumulated after a Web site is constructed and the domain name is used at the Web site. The next issue is whether the costs of a generic domain name are amortizable over any other Internal Revenue Code provision or administrative pronouncement.

As a general rule, if section 197 does not apply to acquired intellectual property rights, amortization continues to be governed by pre-section 197 law. Prior to the enactment of section 197, section 167 permitted a taxpayer to amortize the capitalized costs of acquiring certain intangible property. To be eligible to amortize the capitalized costs of acquiring intangible property under section 167, the acquired asset must have an ascertainable useful life. In other words, intangible property not covered by section 197 may nevertheless be subject to an

372. H.R. REP. NO. 103-213, at 678 (1993), *reprinted in* 1993 U.S.C.C.A.N. 1088, 1367.

373. *See supra* notes 136–138 and accompanying text.

374. *See supra* Part I.A.

amortization allowance under section 167 if the intangible property is “known from experience or other factors to be of use in the trade or business or in the production of income for only a limited period, the length of which may be estimated with reasonable accuracy.”³⁷⁵ Intangible property with no ascertainable useful life is not subject to the allowance for amortization.³⁷⁶

Does a generic domain name have a determinable useful life so as to be eligible for amortization under section 167? The regulations under section 167 provide that the useful life of an asset is not necessarily the statutory legal life of the asset, but rather is the “period over which the asset may reasonably be expected to be useful to the taxpayer in his or her trade or business or in the production of income.”³⁷⁷ It might be argued that the useful life of a domain name is the initial registration period. After all, there is an initial domain name registration period for a generic domain name (e.g., 1, 2, 5 or 10 years) depending on the agreement with the domain name registrar, and a domain name might be lost if the registrant does not renew it.

Despite the suggestion that a generic domain name “can still be considered an asset that can be amortized,”³⁷⁸ amortization of a generic domain name under section 167 is improper and inconsistent with the general, pre-section 197 treatment of intangibles. To permit generic domain name acquisition costs to be written off over the domain name’s initial registration period makes little sense. The initial period is often short and would allow purchasers to recover substantial acquisition costs over a very short recovery period. More importantly, purchasers often plan to use domain names for periods extending well beyond the initial registration period. The cost to renew a generic domain name is minimal, and for most purchasers, continued registration is expected.

To permit generic domain name purchasers to pick an amortization period over which they expect the generic domain names to be useful in their business is troublesome. Generic domain names are unlike other amortizable intangible assets with inherent value, such as separately acquired patents and copyrights, that are readily susceptible to such

375. Treas. Reg. § 1.167(a)-3 (2004).

376. *Id.*

377. Treas. Reg. § 1.167(a)-1(b).

378. CCH Tax and Accounting, *Domain Names—What You Must Know About Their Tax Treatment*, E-COMMERCE TAX ALERT 1, ¶10 (Dec. 2000) (citation omitted), at <http://tax.cchgroup.com/ecom/archive/2000/1200/200.htm>.

estimates. For example, a taxpayer can typically establish the useful life of a patent or copyright for amortization purposes based on his own experiences with similar property.³⁷⁹ If such experiences are inadequate, a taxpayer can establish the useful life of a patent or copyright based on general industry standards.³⁸⁰ The same is not true for generic domain names. The useful life of a patent or copyright (and hence the recovery period over which deductions will be allowed) is typically tied to the period over which the patent or copyright will most likely generate income for the taxpayer.³⁸¹ Indeed, the goal behind permitting taxpayers depreciation or amortization deductions is to achieve a fair allocation of the costs of acquiring an asset to the period in which the taxpayer realizes income from the asset.³⁸² The economic usefulness of a generic domain name cannot be measured by the domain name's condition or by the passage of time, suggesting that generic domain names should not be subject to amortization under section 167.³⁸³

379. Treas. Reg. § 1.167(a)-1(b) (stating that a taxpayer may establish the useful life of eligible property for depreciation purposes based upon his own experiences with similar property).

380. *Id.* (stating that if a taxpayer's experience is inadequate, the taxpayer may establish useful life based on general industry standards).

381. The regulations provide that the useful life of intellectual property is not necessarily the statutory legal life of the asset, but rather is the period over which the asset may reasonably be expected to be useful to the taxpayer in his or her trade or business or in the production of income. *Id.* § 1.167(a)-1(b).

382. See, e.g., *Comm'r v. Idaho Power Co.*, 418 U.S. 1, 11-12 (1974) (explaining the purpose of the cost recovery system).

383. It should be noted that there are different methods of amortizing the capitalized costs of eligible intangible property under section 167. The regulations under section 167 contemplate use of the straight-line method of amortization, under which capitalized costs of acquiring eligible property (less salvage value) are deducted ratably over the property's estimated useful life. Treas. Reg. § 1.167(b)-1(a). Recognizing that straight-line amortization might result in the mismatching of income and expenses to the extent intangible property generates an uneven flow of income, the regulations under section 167 permit a taxpayer to amortize eligible intangible property using a method other than the straight-line method if the alternative method provides a more reasonable allowance. Treas. Reg. § 1.167(b)-1(a) (requiring use of straight-line method unless a different acceptable method with respect to such property is adopted); see, e.g., *Citizens & S. Corp. v. Comm'r*, 91 T.C. 463, 512 (1988), *aff'd per curiam*, 919 F.2d 1492 (11th Cir. 1990); *Liquid Paper Corp. v. United States*, 2 Cl. Ct. 284, 293 (1983); *Computing & Software, Inc. v. Comm'r*, 64 T.C. 223, 232 (1975), *acq.*, 1976-2 C.B. 1. A common, alternative method for eligible intangible property acquisition costs is the income-forecast method, under which costs of acquiring eligible intangible property are recovered as income is actually earned from exploitation of the property. See Rev. Rul. 60-358, 1960-2 C.B. 68, *amended by* Rev. Rul. 64-273, 1964-2 C.B. 62, *amended by* Rev. Rul. 79-285, 1979-2 C.B. 91. The Code limits the types of property for which the income forecast method may be used. Eligible property includes interests in (1) motion picture films, videotapes, and sound recordings; (2) copyrights; (3) books; (4) patents; (5) theatrical productions; and (6) other property as designated in published guidance by the IRS. I.R.C. § 167(g)(6) (2004). Domain names are not specifically mentioned as being eligible, perhaps lending

In short, the useful life of a generic domain name is unascertainable. The owner of a generic domain name today cannot be the owner tomorrow if he forgets to renew the domain name registration. Yet, the owner of a generic domain name can bring a conversion action against the registrar who assigns the domain name to others without the original owner's permission, given that the domain name registration at the time of the assignment or transfer was valid. Although a generic domain name can be acquired separately for its inherent value, the name itself does not have an ascertainable useful life. Indeed, a generic domain name can last forever, as long as the owner pays the registration fees.

In January 2004, the IRS issued final regulations under section 167 that provide a fifteen-year safe harbor amortization period for certain intangible assets that do not have readily ascertainable useful lives.³⁸⁴ Under the safe harbor, amortization is determined using a straight-line method with no salvage value, consistent with amortization under section 197.³⁸⁵ Does this safe harbor amortization apply to generic domain names when amortization is not authorized under sections 197 or 167 of the Code?

The new regulations provide that "a taxpayer may treat an intangible asset as having a useful life equal to 15 years *unless* . . . [t]he intangible asset is *described in* 1.263(a)-4(c) (relating to intangibles acquired from another person)."³⁸⁶ Treasury Regulation section 1.263(a)-4(c) states: "A taxpayer must capitalize amounts paid to another party *to acquire any intangible from that party in a purchase* or similar transaction."³⁸⁷ That regulation then provides that intangibles within the scope of section 1.263(a)-4(c) "*include, but are not limited to*" fifteen specific types of intangibles provided they are "acquired from another

further support to the argument that generic domain names are not subject to amortization under section 167.

384. Treas. Reg. § 1.167(a)-3(b).

385. *Id.* § 1.167(a)-3(b)(3) (providing that the basis of the intangible asset, without regard to salvage value, is amortized ratably over the fifteen-year amortization period beginning on the first day of the month in which the intangible asset is placed in service by the taxpayer).

386. *Id.* § 1.167(a)-3(b)(1)(ii) (emphasis added). Also excluded from the safe harbor amortization are (1) intangible assets, the amortization period or useful life for which is already specifically prescribed or prohibited by the Code, the regulations thereunder, or other published guidance from the Service; (2) intangible assets that have a useful life the length of which can be reasonably estimated; and (3) certain intangible benefits arising from the provision, production, or improvement of real property. *Id.* § 1.167(a)-3(b)(1)(i), (iii), (iv).

387. *Id.* § 1.263(a)-4(c)(1) (emphasis added).

party in a purchase or similar transaction.”³⁸⁸ An interesting issue is whether only those fifteen types of acquired intangibles listed in section 1.263(a)-4(c)(1)(i)-(xv) are excepted from the safe harbor amortization under section 1.167(a)-3(b)(1)(ii) as intangibles “described in” section 1.263(a)-4(c), or, instead, whether all intangibles acquired from another party are excluded from the safe harbor amortization. If the former is true, acquired generic domain names would be eligible for the safe harbor amortization since generic domain names are not among the fifteen listed intangibles. If, however, the latter is true, acquired generic domain names would not be eligible.

It would seem that if an acquired intangible would have to be capitalized under section 1.263(a)-4(c) (as an acquired generic domain name would), then it would fall automatically within the exception of section 1.167(a)-3(b)(1)(ii) and hence not be eligible for the safe harbor amortization. One might try to argue that the safe harbor provision of section 1.167(a)-3(b) should still apply even though capitalization of the costs of an acquired intangible is required under section 1.263(a)-4(c). In other words, perhaps there is a difference between an acquired intangible that must be capitalized under the “include, but are not limited to” language of section 1.263(a)-4(c) and an acquired intangible “described” in section 1.263(a)-4(c) as provided under section 1.167(a)-3(b)(1)(ii).

This interpretation is inconsistent with the explanation of the safe harbor provision provided in the Preambles to both the proposed and final regulations. In the Preamble to the proposed regulations, the Service states: “The safe harbor amortization period does not apply to intangibles acquired from another party”³⁸⁹ The Preamble also states that the safe harbor provision is intended to apply to “amounts paid to obtain certain memberships or privileges of indefinite duration,” assets that are self-created and not acquired under section 1.263(a)-4(d)(4). The Preamble to the final regulations clarify that the nonexclusive list of intangibles for which capitalization is required is “illustrative.”³⁹⁰ Importantly, the final regulations modify the introductory language to specifically state that the list contains “examples” of intangibles within the scope of section 1.263(a)-4(c). Moreover, the final regulations make

388. *Id.* § 1.263(a)-4(c)(1)(i)-(xiv) (emphasis added).

389. Safe Harbor Amortization, 67 Fed. Reg. 77709 (Dec. 19, 2002) (to be codified at 26 C.F.R. pt. 1).

390. Preamble, 69 Fed. Reg. 436, 437 (Jan. 5, 2004).

clear that the fifteen-year safe harbor amortization “applies to intangibles *created* on or after December 31, 2003.”³⁹¹

The safe harbor regulations have apparently created a distinction between self-created generic domain names and purchased generic domain names. The capitalized costs of creating (registering with a domain name registrar) a generic domain name are eligible for the fifteen-year safe harbor amortization. In contrast, the capitalized costs of acquiring from another party (in a purchase or similar transaction) a generic domain name are not be eligible for the safe harbor amortization. The distinction raises some important questions. Why would the Treasury Department permit the amortization of a self-created generic domain name that has no determinable useful life, but not an acquired generic domain name that has no determinable useful life? Should not there be consistency in the tax treatment of self-created and acquired generic domain names?

The Treasury was aware of the inconsistency it created. It made clear in the Preamble to the proposed regulations that the safe harbor amortization period applies to self-created intangibles with no ascertainable useful life, but not to acquired intangibles with no ascertainable useful life.³⁹² The Treasury was not trying to ensure that all intangible assets have some amortization period (exempting acquiring intangibles assuming that they already fall within either section 197 or another applicable amortization provision, such as section 167). In fact, the government warned taxpayers in the Preamble that acquired intangibles excluded from the safe harbor amortization rule may not be amortizable at all: “These intangibles *are generally not amortizable*, are amortizable under section 197, or are amortizable over a period prescribed by other provisions of the Code or regulations.”³⁹³ While it is clear that the distinction was deliberate, the issue remains whether the tax system should treat self-created generic domain names (i.e., costs of registering and securing a generic domain name) differently from acquired generic domain names (i.e., costs of purchasing a generic domain name from another party). In other words, is the distinction justified, or has the government made a mistake?

Current tax law treats many intellectual property creation costs

391. Treas. Reg. § 1.167(a)-3(b)(4) (emphasis added) (providing effective date).

392. 67 Fed. Reg. 77701, 77709 (Dec. 19, 2002).

393. Safe Harbor Amortization, 67 Fed. Reg. at 77709.

differently from intellectual property acquisition costs. First, most patent development costs are deductible when incurred,³⁹⁴ whereas patent acquisition costs are deductible either over an arbitrary fifteen-year period (if the patent was purchased as part of the acquisition of a trade or business) or over the useful life of the patent (if the patent was purchased separately).³⁹⁵ Second, most trade secret creation costs are deductible when paid or incurred,³⁹⁶ whereas trade secret acquisition costs are always deductible over fifteen years regardless of whether acquired separately or with a trade or business.³⁹⁷ Third, copyright creation costs are immediately deductible for many creators,³⁹⁸ while copyright acquisition costs are deductible either over fifteen years (if the copyright was purchased as part of the acquisition of a trade or business) or over the useful life of the copyright (if the copyright was purchased

394. Section 174 permits an immediate deduction for costs qualifying as "research and experimental expenditures." I.R.C. § 174 (2004). Research and experimental expenditures typically include costs paid or incurred in developing patentable inventions. In fact, the regulations under section 174 specifically provide that research and experimental expenditures include the costs of obtaining a patent. Treas. Reg. § 1.174-2(a)(1). Such costs include not only expenses incurred in the development of patented inventions, but also attorneys' fees and costs associated with the prosecution of patents. *Id.*

395. For the treatment of patent acquisition costs, see *supra* Part II.B.1.

396. Section 174 applies to costs qualifying as "research and experimental expenditures." I.R.C. § 174. Research and experimental expenditures typically include costs paid or incurred in connection with developing trade secrets and know-how. The regulations under section 174 define research and experimental expenditures as "all reasonable costs incident to the development of a product, including any pilot, model, process, formula, invention, technique, or similar property." Treas. Reg. § 1.174-2(a)(1); see *Cactus Wren Jojoba, Ltd. v. Comm'r*, 74 T.C.M. (CCH) 1133, 1144 (1997) (disallowing section 174 deductions because there was no evidence that the taxpayer's activities would lead to patentable technology or even know-how).

397. For the tax treatment of trade secret acquisition costs, see *supra* Part II.B.1.

398. Internal Revenue Code section 263A requires a taxpayer to capitalize all direct and indirect expenditures incurred to produce tangible personal property as part of a trade or business or activity conducted for profit. I.R.C. § 263A. Although section 263A mentions "tangible personal property," the phrase actually applies to several types of intangible property. The phrase "tangible property" is defined under the Code to include "a film, sound recording, video tape, book, or similar property that embodies the words, ideas, concepts, images, or sounds by the creator thereof." *Id.* § 263A(b). As can be seen, section 263A applies to numerous forms of intellectual property for which copyright protection is available. Section 263A(h), however, provides an important exemption from the capitalization requirements of section 263A in the case of certain writers, photographers, and artists. *Id.* § 263A(h). Section 263A(h), which was added to the Code in 1988, provides that "qualified creative expenses" are not required to be capitalized. *Id.* A qualified creative expense is defined as any expense paid or incurred by an individual in the trade or business of being a "writer," "photographer," or "artist," which, except for the uniform capitalization rules of section 263A, would otherwise be deductible for the taxable year. *Id.* § 263A(h)(2). If the exemption applies, qualified creative expenses are usually deductible when paid or incurred. *Id.* § 162(a).

separately).³⁹⁹ Finally, the costs of building the goodwill in a trademark or trade name (i.e., advertising costs) are immediately deductible,⁴⁰⁰ whereas the costs of acquiring a trademark or trade name must be amortized over fifteen years.⁴⁰¹ In each case, the creation costs receive the preferable tax treatment via a current deduction.⁴⁰²

Whenever the tax system treats intellectual property creation costs differently from intellectual property acquisition costs, there is usually a good reason for it. For example, Congress permits the immediate deduction of most patent and trade secret creation costs that would otherwise have to be capitalized in order to encourage research and development.⁴⁰³ Furthermore, Congress permits most writers, photographers, and artists to immediately deduct their copyright creation costs in order to relieve them from the burdens of the capitalization rules, especially when their activities may not generate income for years.⁴⁰⁴ While sound policy reasons exist for treating self-created patents, trade secrets, and copyrights differently from acquired intellectual property, is there any good reason for treating self-created generic domain names differently from acquired generic domain names? Is there some societal benefit of encouraging taxpayers to register their own generic domain names rather than purchasing them? One would have to stretch to answer these in the affirmative.

The safe harbor amortization regulations did achieve something

399. For the tax treatment of copyright creation costs, see *supra* Part II.B.1.

400. There are certain expenses associated with trademarks and trade names that are not required to be capitalized and amortized over fifteen years. There is authority holding that advertising expenditures may be deducted in full in the year paid or incurred. In Revenue Ruling 92-80, the Service ruled that most advertising expenditures are immediately deductible under section 162 of the Code notwithstanding the fact that advertising expenses often give rise to benefits that last well beyond the current year. Rev. Rul. 92-80, 1992-2 C.B. 57. This is a significant ruling since advertising costs are often incurred in developing the goodwill of trademarks and trade names (i.e., incurred in gaining customer acceptance and identification of trademarks and trade names). Such expenses are currently deductible. See *supra* note 134.

401. For the tax treatment of trademark acquisition and trade name acquisition costs, see *supra* Part II.B.1.

402. For more information on the tax treatment of intellectual property creation costs, see MAINE & NGUYEN, *supra* note 7, at 102-73.

403. See, e.g., *Snow v. Comm'r*, 416 U.S. 503-04 (1974) (stating that section 174, which permits a current deduction for certain research and experimental expenditures, "will greatly stimulate the search for new products and new inventions upon which the future economic and military strength of our Nation depends. . . . [and] will be particularly valuable to small and growing businesses" (citing 100 CONG. REC. 3425 (1954) (statement of Rep. Reed))).

404. See H.R.CONF. REP. NO. 100-1104, at 145 (1988), reprinted in 1988 U.S.C.A.N. 5048, 5205.

worthy. They brought any capitalized costs of creating trade secrets and know-how within the fifteen-year safe harbor amortization period so as to be in line with the tax treatment of capitalized costs of acquiring trade secrets and know-how. Under current tax rules, if patent development costs are not eligible to be deducted immediately, such costs are amortizable over the patent's useful life (similar to the treatment of patent purchase costs).⁴⁰⁵ Similarly, if copyright creation costs are not eligible to be deducted currently, such costs are amortizable over the copyright's useful life (similar to the treatment of copyright purchase costs).⁴⁰⁶ In each case, any development costs that are not eligible for current deduction are amortized over the developed property's useful life, just as if the property were acquired separately.⁴⁰⁷

Prior to the promulgation of the safe harbor amortization regulations, however, if trade secret development costs were not eligible to be deducted immediately, such costs were not amortizable at all.⁴⁰⁸ Amortization was not available under section 197 since self-created trade secrets and know-how are not included within the definition of section 197 intangible.⁴⁰⁹ Amortization was not available under section 167 because trade secrets and know-how possess an indeterminable useful life (they are generally entitled to protection as long as the owner maintains their secrecy).⁴¹⁰ Non-amortization of otherwise capitalized trade secret creation costs was inconsistent with the fact that acquired trade secrets are subject to fifteen-year amortization under section 197 regardless of whether they were acquired separately or with a trade or business.⁴¹¹ This disparate treatment has been remedied with the safe harbor regulations. Under section 1.167(a)-3(b), capitalized costs to create trade secrets are eligible for the fifteen-year amortization since trade secrets possess indeterminable useful lives.⁴¹² Now, trade secret creation costs, which are not otherwise deductible, are treated the same

405. Treas. Reg. § 1.167(a)-3.

406. *Id.*

407. See MAINE & NGUYEN, *supra* note 7, at 159-72, for the proper treatment of intellectual property creation costs that are not immediately deductible.

408. *Id.* at 181-84.

409. See *id.* at 183.

410. See *id.* at 28, 183-84.

411. See *id.* at 266-69.

412. Treas. Reg. § 1-167(a)-3 (2004).

for tax purposes as trade secret acquisition costs.⁴¹³

While the safe harbor amortization regulations reconciled the treatment of self-created trade secrets and acquired trade secrets, it had the opposite effect on generic domain names. Prior to their adoption, the costs associated with both self-created and acquired generic domain names were not amortizable. Now, under the regulations, the capitalized costs of registering a generic domain name are subject to fifteen-year amortization, whereas the costs of purchasing a generic domain name are not amortizable at all.⁴¹⁴

IV. NEW RULES NEEDED GOVERNING NEW INTELLECTUAL PROPERTY RIGHTS

While the costs of registering or purchasing a domain name almost certainly must be capitalized, uncertainties remain over whether such capitalized costs can be amortized. This Article has suggested, after analyzing the legal nature of domain names and the current tax rules governing traditional intangible property rights, that amortization depends on several factors. The costs of both registering and purchasing a domain name that functions as a trademark are amortizable over fifteen years under section 197. The costs of registering a generic domain name are also amortizable over fifteen years pursuant to recent regulatory authority and not pursuant to any Code provision. The costs of purchasing a generic domain name, in contrast, are not amortizable at all unless it can be shown that a portion of the cost is attributable to "goodwill" or "trademark" value.

Applying current tax rules, which deal only with traditional intellectual property and intangible rights, to domain names has yielded problematic results. For example, acquired generic domain names are not amortizable at all. This is troubling in light of the fact that most intangible property with significant value is amortizable over some period, either the arbitrary fifteen-year recovery period under section 197 or the intangible property's useful life under section 167. If valuable

413. Treasury Regulation section 1.167(a)-3(b) now provides for a fifteen-year period for amortization of capitalized trade secret creation costs, whereas section 197 provides for a fifteen-year period for amortization of capitalized trade secret acquisition costs. It is uncertain why Congress did not merely amend section 197.

414. Presumably, the registration costs would be treated as "creation" costs falling within the safe harbor amortization rule of section 1.167(a)-3(b). Purchasing costs, on the other hand, clearly would not.

intangible business assets such as goodwill, going concern value, trademarks, and trade names are amortizable, why are acquired generic domain names not amortizable? Is it because generic domain names do not fit the characteristics of goodwill or trademarks under non-tax law? It seems that the approach of trying to classify domain names as one or more variations of existing intellectual or intangible property rights, and then looking for the appropriate current tax rules dealing with those variations, has produced an unsatisfactory tax regime for domain names.

For example, there is a distinction under current tax law between domain names that function as trademarks and those that do not. What happens if a portion of the value of a generic domain name derives from its association with a particular business? Should the generic domain name now be considered two assets, one with inherent value (not amortizable) and the other with either goodwill or trademark value (amortizable)? Consider the following example:

“Car.com” is a domain name where “car” is a generic word such as vitamins, wireless, and loans. The name is owned and used by a Web site that at first was not an active business. Subsequently, the Web site receives repeated unique hits and develops a large and loyal customer base. The Web site owner then decides to sell the business, including the domain name, which now has a market value of \$5.5 million.⁴¹⁵

According to one commentator:

A portion of the value of the name derives from its association with the business. So to some extent, the name should be treated as having trademark value. The remaining value is the name’s inherent value. The inherent and trademark values in this transaction are separate assets, and their values have different sources. One derives from the inherent value of the exclusive use of a generic term, and the other derives from the goodwill of the business.⁴¹⁶

It would follow then, under existing tax rules, that a portion of the cost of a generic domain name would be eligible for amortization, and the other portion of the cost would not be eligible for amortization.

This approach would result in much litigation concerning the identification of and valuation of generic domain names. Because no amortization would be allowed for the inherent value of a generic domain name, taxpayers would try to distinguish trademark value from inherent value in a single domain name, and the Service would

415. For a similar example, see Hardesty, *supra* note 162, at 370.

416. *Id.*

undoubtedly challenge their determinations. Taxpayers who have the resources to litigate over the identification and valuation of generic domain names would be better off than those taxpayers who lack such resources. Needless to say, fitting generic domain names within existing tax rules would produce much litigation and uncertainty.

This article has illustrated the inadequacies of current tax law in dealing with Internet domain names. These inadequacies and uncertainties are becoming more apparent with the emergence of new forms of intellectual property rights. As with domain names, no special tax rules exist specifically governing the tax treatment of Web site creation and acquisition costs. Taxpayers and advisors are left with questions such as: Should the costs related to the development of a Web site be treated the same as software development costs? How should the costs of creating or purchasing content for Web sites be treated? Does it make a difference if some Web site content is copyrightable or noncopyrightable?

If Web sites are considered variations of existing intellectual or intangible property rights to which existing tax law can be adopted, then the tax treatment of Web sites may depend on the Web site's components (e.g., software, copyrightable content, noncopyrightable content). This result could produce varying rules not easily applied in practice. For example, if the Service agrees that the basic structure of a Web site (the permanent portion of the site) should be treated as "software," a Web developer would be able to immediately deduct the costs of building the basic structure of the site under Revenue Procedure 2000-50.⁴¹⁷ If a taxpayer incurred costs to develop copyrightable content such as literary text, music, photographic images, art works, graphics, and sound, such costs would either be currently deductible or amortized over the useful life of the copyright.⁴¹⁸ If a taxpayer incurred costs to develop

417. Revenue Procedure 2000-50 defines software as

any program or routine (that is, any sequence of machine-readable code) that is designed to cause a computer to perform a desired function or set of functions Computer software does not include any data or information based . . . (for example, data files, customer lists, or client files) unless the data base or item is in the public domain and is incidental to a computer program.

Rev. Proc. 2000-50, 2000-2 C.B. 601. Under such a definition, designing a Web site with HTML language is creating "software." The costs in developing such software should be treated similarly under Revenue Procedure 2000-50.

418. For possible tax treatment of Web site expenditures, see MAINE & NGUYEN, *supra* note 7, at 201-07.

noncopyrightable content, such costs might not have to be capitalized.⁴¹⁹ If the costs of developing noncopyrightable content must be capitalized, they would only be amortizable if a useful life could be established.⁴²⁰

Again, current and historical tax concepts (section 197 and pre-section 197 law) do not translate smoothly with respect to the expansion of existing rights for certain intangible assets or, more importantly, the emergence of new intellectual property and intangible rights such as domain names. An unfortunate trend that is developing is an ad hoc response by administrative bodies to fill in the gaps. For example, the Service issued an administrative pronouncement, Revenue Procedure 2000-50, to clarify the uncertain tax treatment of software development costs in light of the fact that software now may be protected under patent, copyright, and trade secret law.⁴²¹ More recently, the Service adopted new regulations under section 167, Treasury Regulation section 1.167(a)-3(b), to provide a fifteen-year safe harbor amortization period for created intangibles that do not have an ascertainable useful life.

Each time the Service responds to inadequacies in the current tax law, new issues are raised and additional uncertainties are created. An interesting issue, for example, is whether the Treasury had legal authority to create a fifteen-year safe harbor amortization period under section 167 when intangible assets that are not subject to section 197 (and do not have ascertainable useful lives) have not previously been amortizable. Several arguments can be made against the validity of the safe-harbor amortization regulations. First, because the section 167 regulations were in effect for almost fifty years, Congress tacitly approved the old system, which permitted amortization only if a useful life could be established. Second, because the statutory authority of section 197 was necessary to allow the amortization of a variety of types of intangible assets that did not have ascertainable useful lives, Congress reserves the power to modify it. Finally, the Treasury may have exceeded its authority to interpret a statute since its action was so overly expansive

⁴¹⁹ *Id.*

⁴²⁰ *Id.*

⁴²¹ The tax treatment of software costs is beyond the scope of this article. However, an interesting issue with respect to software is whether there should be three different tax treatments depending on the protection sought (patent, copyright, trade secret). Recognizing potential uncertainties, the Service issued Revenue Procedure 2000-50 providing that software development costs may be deducted currently regardless of whether the software is patented or copyrighted or trade secret protected. Rev. Proc. 2000-50, 2002-2 C.B. 601.

as to determine tax policy.

A better approach would be for Congress to revisit section 197's treatment of intangible assets. Section 197 has received little legislative attention since its enactment over ten years ago. With the arrival of global electronic commerce transactions on the Internet, the nature of cyberspace will undoubtedly require new tax rules.

CONCLUSION

What should you advise your CEO with respect to the possible tax treatment for his acquisition of the domain name "men.com"? The easy answer would be to say that there is no current tax rule specifically dealing with such new intellectual property acquisition costs. The more complex answer would require you to characterize the new intellectual property right in the context of current tax rules on various forms of intangibles acquisitions. You may conclude that fitting the new intellectual property right into existing law is like pressing a round ball through a smaller square hole. Perhaps it is time for a complete overhaul of the current intangible tax regime and a better model for the taxation of intellectual property.