LEXOLOGY

Intellectual Property: The Wealth Engine No One is Talking About

Quinn IP Law

USA | October 21 2024

The course that I teach, *Innovation & IP Strategy* at the University of Michigan, brought with it this week a compelling and spirited discussion in context of the current election season.

As we hear and see in the advertisements dominating the media we consume, there arises a common theme that considers whether "the rich" need to "pay their fair share."

Of course, my class and my students examined this topic through the prism of IP, an important nuance that often gets lost in the discussion of wealth.

In fact, the wealth of the richest individuals and the value of companies in the S&P 500 are heavily based on intellectual property (IP)—not just tangible assets or income. Some estimates suggest that 60% to 90% of the market value of S&P 500 companies comes from their IP—patents, trademarks, copyrights, and trade secrets. Ignoring this fails to account for all manners and forms of true wealth in discussions about taxes, public policy, and economic fairness.

Intellectual Property as the Backbone of Wealth

Take a closer look at the giants of the S&P 500, and it becomes clear that IP is the real engine behind their valuations. Apple, for example, is valued at more than $2 trillion—not because of its hardware alone, but because of the patents, copyrights, and trademarks that make its products unique and difficult to rival.

The same is true for many other companies. While physical assets are part of the equation, the bulk of wealth (both for companies and individuals) comes from far less tangible intellectual property.

Are Patents "For the Weak?"

Elon Musk famously told Jay Leno that "patents are for the weak," and that "most patents are B.S." However, Musk's first significant fortune was built on the success of PayPal, a company protected by more than 6,000 patents!

PayPal's strong IP position helped Musk earn $175 million when the company was sold to eBay, which ultimately fueled his subsequent ventures, including Tesla and SpaceX.

Though Musk may have downplayed the role that patents played in his own wealth creation to Leno at the time, his experience actually serves to demonstrate the very importance of intellectual property in modern innovation. His businesses rely on proprietary technology, even if he chooses not to patent all of it.

Warren Buffet: IP in a Bottle

Warren Buffet's investment in Coca-Cola further illustrates the immense value of intellectual property. Coke is, at its core, a flavored "sugar water," yet Buffet turned a $1 billion investment into $21 billion.

The real value of Coca-Cola is in its brand, trademarks, and the secret formula that's been protected for decades. Buffet recognized this when he invested in the company, understanding that intellectual property was at the heart of Coca-Cola's enduring profitability—even more so than the product itself!

Bill Gates and Microsoft's IP Fortress

Bill Gates and Microsoft exemplify the power of intellectual property in the tech world. Microsoft's dominance in the software market wasn't just due to technical superiority but also its aggressive protection of IP through patents and copyrights. This created barriers for competitors and allowed Microsoft to build a fortune on its intellectual property portfolio.

Illuminating the Blind Spot on IP

When politicians discuss whether the rich are "paying their fair share," they rarely consider how much of modern wealth is rooted in intellectual property —in other words, non-liquid and, therefore, generally non-taxable assets. Instead, they focus on traditional assets—real estate, stock, and income—without acknowledging the value of intangible assets like patents, trademarks, and copyrights.

If 60% to 90% of the value of S&P 500 companies comes from IP, failing to factor in IP wealth is a major omission and a miscalculation.

Discussion Points for IP Law Reform

If intellectual property is such a significant driver of wealth, reforming IP laws should be on the table of any legitimate discussion about wealth and taxes. Tweaking some patent laws could both incentivize innovation and ensure that the benefits of IP are more widely shared.

Here are some possible (and definitely controversial!) tweaks to existing patent laws that could achieve these goals:

1. **Shortening the Patent Term**: Currently, patents last for up to 20 years. In fast-moving industries, is this is too long? Shortening patent terms might stimulate more competition and reduce monopolistic control over critical technologies.
2. **Stricter Non-Use Clauses ("Use It or Lose It")**: Patents could be granted with the understanding that they will be put to use. Introducing stricter non-use clauses may prevent companies from sitting on patents without commercializing them, and possibly selling them to trolls. If a patent is not used within a certain time frame, it could be revoked or transferred.
3. **Tiered Patent Duration Based on Revenue**: Patent duration could be tied to the revenue generated by the patented product or technology. Small businesses and startups might receive longer patent protection, while large corporations could see reduced terms, preventing prolonged market dominance.

4. **Limiting Continuations and CIPs**: Continuing applications (CIPs and continuations) can be abused by patent holders to extend the life and scope of their patents by incrementally adding claims or adjusting the scope when a competitor pops up. Limiting the number of continuations, as well as restricting the types of changes allowed in these applications, would reduce anti-competitive patent gamesmanship and encourage faster commercialization.
5. **Limit the Number of Claims and Doctrine of Equivalents Scope**: Restricting the number of claims in patent applications would force applicants to focus on their core innovations, rather than attempting to cast a wide net of overly broad or vague claims. Similarly, narrowing the scope of the doctrine of equivalents could prevent companies from using overly broad interpretations to assert infringement, thus promoting more precise patent filings.
6. **Anti-Patent Trolling Legislation**: Patent trolls—companies that hold patents solely to sue others for infringement without ever intending to use the technology—stifle innovation. Stronger legislation to curb patent trolling would free up resources for genuine innovation and reduce unnecessary legal costs.
7. **Patent Taxation Based on Market Impact**: IP-driven wealth could be more effectively taxed. A system that taxes patents based on their market impact, rather than just the revenues generated, could ensure that companies pay taxes on the intangible value they derive from their innovations.
8. **Greater Scrutiny of Patent Applications**: The U.S. Patent and Trademark Office could adopt stricter criteria for approving patents, especially in fields where incremental improvements are frequently patented without significant innovation. This could reduce the clutter of overly broad patents and promote meaningful innovation.
9. **Broaden Prosecution Laches as a Defense and Curb Patent Flooding**: Patent flooding occurs when companies file numerous patents around a single invention to create a thicket of IP and block competitors, undermining the intent of patent law. Also, delaying the patent prosecution process to extend control over a market could be prevented by broader application of prosecution laches. More rigorous enforcement of anti-flooding measures and penalties for prosecution laches could prevent these tactics and promote fair competition.
10. **Open Innovation Incentives**: Governments could offer tax incentives and grants for companies that engage in open innovation, where they share their patents and technology with others for collaborative development. This might create more robust ecosystems of innovation, particularly in fields like AI, green energy, and medical research.

Tax Incentives for IP Development

One of the most promising areas for reform lies in tax incentives for IP development. Rather than penalizing companies with heavy taxation on IP-derived revenue, policymakers should consider tax breaks or credits that encourage further innovation.

By providing targeted tax incentives, governments could help foster a culture of continuous intellectual property development, which would benefit not only the companies but also society at large.

Tax incentives could be structured in various ways:

- **R&D Tax Credits**: Expand existing research and development tax credits to include specific incentives for companies that file patents, create trademarks, or develop new intellectual assets. This could encourage businesses of all sizes to invest in new technologies and solutions.

- **IP-Driven Tax Deductions**: Companies that create, maintain, and actively use intellectual property could receive additional tax deductions based on the economic impact or societal value of their IP. For example, companies in the pharmaceutical or green energy sectors could be rewarded with more significant tax breaks if their patents lead to life-saving treatments or sustainable technologies.
- **Incentives for Startups and Small Businesses**: Small companies and startups are often the most innovative, yet they lack the resources to fully exploit their ideas. Offering tax incentives specifically for startups engaged in IP creation would lower barriers to entry and promote competition. This could include offering longer patent protection for smaller businesses or tax deferrals for IP-related income until they reach certain revenue thresholds.
- **IP Development Zones**: Similar to “opportunity zones” for real estate development, the government could designate certain industries or geographic regions as “IP development zones.” Companies operating in these areas would receive tax benefits for their investments in intellectual property creation, leading to innovation hubs that boost economic growth.

These tax incentives would broaden participation in IP-driven wealth creation, allowing more businesses to innovate and compete. At the same time, the government would still collect revenue, albeit from a larger pool of IP-generating companies, while supporting technological advancement.

Rethinking IP in the Wealth Equation

The wealth of the modern economy is inextricably linked to intellectual property. Ignoring IP when discussing whether “the rich pay their fair share” misses a vital part of the wealth puzzle. From Elon Musk to Warren Buffet, Bill Gates to Apple, the richest individuals and companies in the world are built on intangible assets protected by IP law.

Reforming the patent system could foster more innovation, distribute the benefits of intellectual property more widely, and ensure that the wealth created by IP contributes to the public good. At the same time, adapting tax policies to provide incentives for IP creation, especially for startups and small businesses, could democratize the benefits of intellectual property and spur continued innovation.

As the debate rages on about ensuring fairness in the tax system (even beyond the next election cycle), it’s time everyone involved started accounting for the hidden wealth of intellectual property.

Quinn IP Law - Christopher W. Quinn