Not All Copyright Infringers Are Created Equal: Why Federal Income Tax is a Proper Deductible Expense for Non-Willful Copyright Infringers

I. BACKGROUND

A. Tax and its Role in Legal Actions
B. A Rule of Non-Deductibility Applies to Willful Copyright Infringers
C. The Circuit Split
D. The Scholarly Debate Begins

II. ANALYSIS

A. An Overview of Copyright Law and Copyright Infringement
C. An Overview of Trademark Law and Trademark Infringement
D. There Should Be One Deductibility Rule for Copyrights, Patents, and Trademarks
E. In the Context of Copyrights, the Willful / Non-Willful Distinction is Meaningful
F. A Rule of Deductibility Should Apply to Non-Willful Copyright Infringers
G. A Rule of Non-Deductibility Should Not Apply to Non-Willful Copyright Infringers
H. Variations on a General Rule of Deductibility

III. CONCLUSION

The framers of the United States Constitution protected copyrights by including a provision that grants Congress the power “[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries . . . .” Today, the scope of federal copyright protection is determined by the Copyright Act of 1976 and, to some extent, by case precedent. A copyright holder has exclusive

rights and when those rights are infringed upon, the copyright holder may bring a copyright infringement action against the infringer.

If a copyright holder is successful in such an action, she is entitled to statutorily-provided remedies, which may include temporary and permanent injunctions and the impounding or destruction of infringing copies. Additionally, the copyright holder may elect to receive either statutory or actual damages. Actual damages are determined by subtracting deductible expenses from the infringer’s gross infringing revenue. However, “[n]either the Act nor the Committee Reports specify which expenses will be regarded as deductible costs” and therefore, one must turn to case law for the answer.

Although the Supreme Court has ruled that the federal income tax paid by a willful trademark infringer on gross infringing revenue is not a proper deductible expense when calculating actual damages, the circuits are split on the issue of tax deductibility for non-willful infringers. The Second and Ninth Circuits have held that tax is a proper deductible expense where copyright infringement is non-willful. Although there is no opposing copyright case law, the Sixth Circuit stated in a design patent infringement case that tax was not a proper deductible expense in any infringement scenario.

There are four possible solutions to the issue of whether tax is a proper deductible expense in cases of non-willful copyright infringement. The first view is that set forth by the Second and Ninth

3. Id. § 501.
4. Id. § 502(a).
5. Id. § 503(a)-(b).
6. Id. § 504.
7. See id. § 504(b). For purposes of this note, the phrase “gross infringing revenue” will refer to the portion of an infringer's gross revenue that is attributable to their infringement.
9. L.P. Larson, Jr., Co. v. WM. Wrigley, Jr., Co., 277 U.S. 97, 100 (1928).
10. For purposes of this note, the term “tax” will refer to the federal income tax that an infringer has paid on his or her gross infringing revenue.
Circuits—namely that tax is a proper deductible expense for non-willful copyright infringers.\textsuperscript{13} The second view, extrapolated from the Sixth Circuit’s design patent infringement case, is that tax is not a proper deductible expense in any copyright infringement scenario.\textsuperscript{14} The third view, derived from a patent infringement case decided in the Third Circuit, is that tax is a proper deductible expense in cases of non-willful copyright infringement but the infringer remains liable for any tax benefit that they later receive as a result of including the damage award as a tax deduction on a subsequent tax return.\textsuperscript{15} The final view, taken from a patent infringement case decided in the Seventh Circuit, is that tax is a proper deductible expense in cases of non-willful copyright infringement but the amount of the deduction is the amount the copyright holder would have paid had he or she received the infringing revenue in the first instance.\textsuperscript{16}

Case law is sparse on the issue of tax deductibility for non-willful infringers and, as such, cases representing copyright, patent, and trademark infringement have been used interchangeably in an attempt to develop a rule. It is necessary to point out, however, that there are different standards for obtaining and protecting these three different types of intellectual property. As such, this Note will first analyze the remedies available for copyrights, patents, and trademarks to determine whether different standards should apply regarding the deductibility of taxes from gross infringing revenue when determining actual damage awards. Next, this Note analyzes arguments that have been presented in favor of each of the possible solutions to the issue of tax deductibility. Finally, this Note advocates the adoption of the Second and Ninth Circuits’ view that tax is a proper deductible expense for non-willful copyright infringers.

I. BACKGROUND

A. Tax and its Role in Legal Actions

It is no secret that the determination of tax liability is an intricate process. The tax rate applicable to individuals varies greatly, depending on variables such as gross income, tax status (such as

\textsuperscript{13} Three Boys Music, 212 F.3d at 488; In Design, 13 F.3d at 567.

\textsuperscript{14} See Schnadig, 620 F.2d at 1171.

\textsuperscript{15} See Macbeth-Evans Glass Co. v. L.E. Smith Glass Co., 23 F.2d 459, 463-64 (3d Cir. 1927).

\textsuperscript{16} See L.P. Larson, Jr., Co. v. WM. Wrigley, Jr., Co., 20 F.2d 830, 834 (7th Cir. 1927), rev’d, 277 U.S. 97, 100 (1928).
married or unmarried), and allowable deductions. Moreover, an entirely separate set of rules applies to corporations.

One commonality between individual and corporate tax law is that “gross income means all income from whatever source derived,” which includes damage payments received by a patent holder as a result of a victory in an infringement lawsuit. In United States v. Safety Car Heating & Lighting Co., the Supreme Court held that profits owed to a patent holder from a patent infringer are income within the meaning of the Internal Revenue Code. Because “copyrights are so closely analogous to patents [] the principals gleaned from cases dealing with the tax treatment of patent litigation recoveries are applicable and can be relied on for the tax treatment of copyright litigation recoveries.” Therefore, when a copyright holder receives a damage award from a copyright infringer, the award is taxable income for the copyright holder. Furthermore, the copyright infringer may include the paid damage award as a tax deduction on a subsequent tax return.

B. A Rule of Non-Deductibility Applies to Willful Copyright Infringers

The Supreme Court has held that in cases of willful trademark infringement, tax is not a proper deductible expense when calculating actual damages suffered by the trademark holder. In Larson, William Wrigley, Jr., Company (“Wrigley”) brought a trademark infringement suit against L.P. Larson, Jr., Company (“Larson”) alleging that Larson had marketed its “Peptomint” gum in packaging that was a “flagrant and fraudulent imitation” of Wrigley’s “Spearmint” gum packaging. Wrigley obtained a temporary injunction against Larson, which remained in force until the case was dismissed.

21. 297 U.S. at 93.
22. MARVIN PETRY, TAXATION OF INTELLECTUAL PROPERTY § 8.09 (2005).
24. L.P. Larson, Jr., Co. v. WM. Wrigley, Jr., Co., 277 U.S. 97, 100 (1928).
26. Id.
While the injunction was in force, Wrigley brought another trademark infringement suit against Larson.\(^{27}\) In this second suit, Wrigley claimed that Larson’s “Wintermint” packaging infringed on Wrigley’s “Doublemint” packaging.\(^{28}\) In a twist of fate, the Seventh Circuit determined that Larson’s Wintermint packaging had come onto the market first.\(^{29}\) As a result, the court granted Larson a perpetual and universal injunction,\(^ {30}\) and awarded Larson nearly $1.4 million in damages.\(^ {31}\) In determining the amount of the damage award, the court allowed Wrigley to deduct the amount of tax that Larson would have paid had Larson received the infringing revenue in the first instance.\(^ {32}\)

On the issue of tax deductibility, the Supreme Court granted certiorari and reversed the Seventh Circuit. The Court explained that the determination as to whether tax was a proper deductible expense turned in part on the facts of the particular case, which included “the knowledge and the conduct of the party charged.”\(^ {33}\) Couching its argument by stating that there were undoubtedly “cases in which such a deduction would be proper,”\(^ {34}\) the Court held:

> It would be unjust to charge an infringer with the gross amount of his sales without allowing him for the materials and labor that were necessary to produce the things sold, but it does not follow that he should be allowed what he paid for the chance to do what he knew that he had no right to do . . . . Even if the only relief that the Wrigley Company can get is a deduction from gross income when the amount of its liability is finally determined, the Larson Company will have to pay a tax on the Wrigley profits when it receives them, and in a case of what has been found to have been one of conscious and deliberate wrongdoing, we think it just that the further deduction should not be allowed.\(^ {35}\)

**C. The Circuit Split**

Currently, there is an inter-circuit split on the issue of tax deductibility in intellectual property infringement cases. Four circuits, the Second, Third, Seventh, and Ninth, have held that tax is a proper

---

\(^{27}\) Id.

\(^{28}\) Id.

\(^{29}\) Id. at 734.

\(^{30}\) In re L.P. Larson, Jr., Co., 275 F. 535, 538 (7th Cir. 1921).

\(^{31}\) L.P. Larson, Jr., Co. v. WM. Wrigley, Jr., Co., 20 F.2d 830, 831 (7th Cir. 1927) rev’d, 277 U.S. 97, 100 (1928).

\(^{32}\) Id. at 834.

\(^{33}\) Id. at 834.

\(^{34}\) Id. at 99.

\(^{35}\) Id. at 100.
deductible expense for non-willful infringers.\textsuperscript{36} The Sixth Circuit, however, has held that tax is not a proper deductible expense in any infringement scenario.\textsuperscript{37}

In \textit{Stromberg Motor Devices Co. v. Zenith Carburetor Co.}, the plaintiff held valid patents on four carburetors for internal-combustion engines.\textsuperscript{38} The court found that the defendant infringed on all four patents.\textsuperscript{39} In a connected case, the Seventh Circuit held that the infringement was non-willful and therefore, that the defendant was entitled to “deduct from profits the amount of its federal taxes during the infringing period . . . .”\textsuperscript{40}

The court’s decision to allow the deduction rested primarily on the limiting language in \textit{Larson}.\textsuperscript{41} The court noted:

\begin{quote}
We infer from the [\textit{Larson}] opinion that the denial [of a tax deduction] was predicated largely, if not entirely, upon the conclusion that the accounting party was doing “what he knew that he had no right to do.” The court said: “No doubt there are cases in which such a deduction would be proper. * * * Circumstances will affect the conclusion, including in them the knowledge and the conduct of the party charged.” If from this language it may be concluded that where the accounting party had been acting in good faith, and with his infringement there was no admixture of deliberation or willfulness, “such a deduction would be proper.” If not in such a case, we fail to comprehend the significance of what was so said [in \textit{Larson}].\textsuperscript{42}
\end{quote}

In \textit{Duplate Corp. v. Triplex Safety Glass Co.}, the plaintiff held a valid patent for the manufacture of laminated glass.\textsuperscript{43} After finding that the defendants infringed upon the patent, the Third Circuit held “that the defendants were innocent infringers”\textsuperscript{44} and that, therefore, tax was a proper deductible expense.\textsuperscript{45} In coming to its conclusion, the court relied on the limiting language in \textit{Larson} as well as precedent from the Second and Third Circuits.\textsuperscript{46} The court stated: “We do not

\begin{itemize}
\item \textsuperscript{36} Three Boys Music Corp. v. Bolton, 212 F.3d 477, 488 (9th Cir. 2000) (holding that tax is a proper deductible expense for non-willful copyright infringers); In Design v. K-Mart Apparel Corp., 13 F.3d 559, 562 (2d Cir. 1994) (holding same); Duplate Corp. v. Triplex Safety Glass Co., 81 F.2d 352, 356 (3d Cir. 1935), modified by 298 U.S. 448 (1936) (holding that tax is a proper deductible expense for non-willful patent infringers); Stromberg Motor Devices Co. v. Detroit Trust Co., 44 F.2d 958, 965 (7th Cir. 1930) (holding same). These opinions are analyzed above in the order in which they were decided.
\item \textsuperscript{37} Schnadig Corp. v. Gaines Mfg. Co., 620 F.2d 1166, 1171 (6th Cir. 1980) (holding that tax is not a proper deductible expense for any design patent infringer).
\item \textsuperscript{38} 254 F. 68, 69 (7th Cir. 1918).
\item \textsuperscript{39} \textit{Id}.
\item \textsuperscript{40} \textit{Detroit Trust}, 44 F.2d at 965.
\item \textsuperscript{41} \textit{Id.;} see L.P. Larson, Jr., Co. v. WM. Wrigley, Jr., Co., 277 U.S. 97, 100 (1928).
\item \textsuperscript{42} \textit{Detroit Trust}, 44 F.2d at 965 (citing Larson, 277 U.S. at 99-100).
\item \textsuperscript{43} 81 F.2d 352, 353 (3d Cir. 1934), modified by 298 U.S. 448 (1936).
\item \textsuperscript{44} \textit{Id}.
\item \textsuperscript{45} \textit{Id.} at 356.
\item \textsuperscript{46} \textit{Id}.
\end{itemize}
think that [Larson] is determinative, for whereas the defendant in that case was found guilty of a conscious and deliberate infringement, the defendants in the instant case infringed in good faith.”47 The court also cited the Second Circuit’s opinion in Stromberg Motor Devices Co. v. Zenith Detroit Corp.,48 and the Third Circuit’s opinion in Macbeth-Evans Glass Co. v. L.E. Smith Glass Co.,49 concluding that those cases “have held that federal income taxes actually paid may be deducted as a proper item of expense in a patent accounting.”50

In In Design v. K-Mart Apparel Corp., the plaintiff held a valid copyright in a design and sold sweaters bearing the copyrighted design.51 After the plaintiff stopped selling their sweaters, they learned that the defendant was preparing to sell sweaters bearing the same design and subsequently notified the defendant of the alleged infringement.52 After investigating the matter, the defendant determined that their sweaters did not infringe on the plaintiff’s copyrighted design and as such, they went ahead and put their product on the market.53 The trial court determined that the defendant’s sweaters did in fact infringe on the plaintiff’s copyright.54 The trial court also held, however, that the defendant had justifiably relied on carefully prepared legal advice regarding the alleged infringement and was therefore, a non-willful copyright infringer.55

Reversing the trial court’s decision regarding the deductibility of tax, the Second Circuit held that tax was a proper deductible expense.56 As had the Third and Seventh Circuits before it, the Second Circuit based its conclusion on case precedent. First, the court acknowledged the holding in Larson, stating that “[i]t is settled law that the income tax paid on profits is not deductible where infringement was conscious and deliberate.”57 Next, the court explained that the Supreme Court “carefully limited the breadth of its...

47. Id.
48. 23 F.2d 62 (2d Cir. 1934).
49. 23 F.2d 459 (3d Cir. 1927).
50. Duplate, 81 F.2d at 356. The court did not enforce and therefore implicitly overruled the Macbeth-Evans rule that when tax is a proper deductible expense, the infringer remains liable to the patent holder for any tax benefit the infringer later receives as a result of including the damage award as a deduction on a subsequent tax return. See id.
51. 13 F.3d 559, 562 (2d Cir. 1994).
52. Id.
53. Id.
54. Id.
55. Id.
56. Id. at 567.
57. Id. at 566.
holding recognizing that there could be cases where the circumstances of the infringer’s conduct dictated that such a tax deduction would be proper.58 The court then cited both Stromberg Motor Devices Co. v. Detroit Trust Co.,59 and Stromberg Motor Devices Co. v. Zenith-Detroit Corp.60 for the proposition that tax was a proper deductible expense for non-willful patent infringers, and thereby extended that rule to cases of non-willful copyright infringement.61

Next, the court cited two copyright infringement cases where it had held that tax was not a proper deductible expense for willful copyright infringers.62 In both cases, however, the court stated in dicta that tax was a proper deductible expense in cases of non-willful copyright infringement.63

Closing up its precedent-based arguments, the Second Circuit explained that the district court, in determining that an income tax deduction was not proper, had improperly relied on Love v. Kwitny, 772 F.Supp. 1367 (S.D.N.Y. 1991).64 Love was a copyright infringement case in which the district court held that tax was not a proper deductible expense in any case of copyright infringement.65 The Second Circuit affirmed the decision in Love without opinion, which meant that the opinion was not binding precedent.66 Whatever door the court may have opened in affirming Love, it closed with its ruling in In Design.

Finally, the court considered and rejected the reasoning articulated in the Sixth Circuit’s opinion in Schnadig Corp. v. Gaines Mfg. Co., 620 F.2d 1166 (6th Cir. 1980).67 First, the court opined: “We think that when a claim is made for infringing profits, ‘this means profits actually made. A book profit of one dollar is not a profit actually made when from the dollar the government takes twenty cents as the price for the right to make any profit at all.’ ”68 Then the
court criticized the Sixth Circuit’s tax discussions, explaining that “[h]ypothetical discussions of possible indirect tax ramifications do not change this basic fact.”

Approximately six years after In Design was decided, the Ninth Circuit confirmed the Second Circuit’s holding in the context of copyright infringement. In Three Boys Music v. Bolton, the plaintiff had a copyright in its song, “Love is a Wonderful Thing.” The defendant, Michael Bolton, was found to have non-willfully infringed on the plaintiff’s copyright. The court held that because the defendant was a non-willful infringer, tax was a proper deductible expense.

Before ruling, the court carefully considered its options. The court explained that a rule allowing the deduction gives the infringer a potential windfall because she pays a smaller damage award and she may claim the damage award as a tax deduction on a subsequent tax return. On the other hand, the court explained, a rule disallowing the deduction gives the copyright holder a potential windfall because he receives a larger pre-tax award. Without further discussion, the court held that a rule allowing the deduction was appropriate in cases of non-willful copyright infringement.

The Sixth Circuit is the only circuit to have decided a case which could be interpreted as holding that tax is not a proper deductible expense in any copyright infringement case. In Schnadig, the plaintiff held a valid design patent on a three-piece Spanish motif sectional sofa suite. The Sixth Circuit affirmed the district court’s finding that the defendant infringed on the design patent. Although the district court did not explicitly determine whether the infringement was willful, the Sixth Circuit explained that the record supported a finding that the defendant’s copying “was intentional and

---

69. Id.; see infra text accompanying notes 77-86.
70. Three Boys Music Corp. v. Bolton, 212 F.3d 477, 487-88 (9th Cir. 2000).
71. Id. at 480.
72. See id. at 488.
73. Id.
74. Id. at 487.
75. Id. at 488.
76. Id.
78. Schnadig, 620 F.2d at 1167. The remedies available to design patent holders are generally the same as those available to traditional patent holders. See 35 U.S.C. § 171 (2000).
79. Schnadig, 620 F.2d at 1167.
‘in willful disregard of plaintiff’s rights.’” 80 Nevertheless, the court held that tax was not a proper deductible expense in any case of design patent infringement, explicitly disregarding the issue of willfulness. 81

The court’s holding rested primarily on the premise that infringers who pay a damage award may include the award as a tax deduction on a subsequent tax return. 82 The court acknowledged that an award of pre-tax profits may seem harsh because it requires an infringer to pay more in damages than he or she gained were able to gain from the infringement. 83 However, the court reasoned, a pre-tax award is not so harsh because the infringer may be reimbursed for some or all of the taxes paid on the infringing revenue if he or she were to include the award as a tax deduction on a subsequent tax return. 84 The court admitted that “the actual dollar impact of a damage award on the taxes of either party will naturally depend on the party’s overall tax situation [because] . . . [t]ax rates will vary, and offsetting losses could conceivably bar use of the deduction or negate any tax effect of the award.” 85 Nonetheless, the court concluded that because a taxpayer has several years in which to utilize a tax deduction, “the vast majority of infringers should be able to utilize it.” 86

D. The Scholarly Debate Begins

In 1997, a law review article examined the reasoning employed by the Second Circuit in In Design and by the Sixth Circuit in Schnadig. 87 The authors recommend that courts adopt a rule of non-deductibility in all copyright infringement cases. 88 In their article, the authors praise the Sixth Circuit’s analysis and posit that a rule of non-deductibility 89 in all copyright infringement scenarios has three

---

80. Id. at 1171.
81. Id.
82. Id. at 1169.
83. Id.
84. Id.
85. Id. at 1169-70.
86. Id. at 1170.
88. Id. at 72.
89. A rule of non-deductibility means that tax is not a proper deductible expense while a rule of deductibility means that tax is a proper deductible expense.
primary benefits. First, it prevents a copyright infringer from yielding any economic gain. Second, it provides a copyright holder with all of the profits attributable to the infringement. And, finally, the infringer is potentially able to recover the tax paid on infringing revenue on a subsequent tax return. Even if the infringer is not able to recover all taxes paid, the authors argue, the infringer is the proper party to bear the loss.

Plausible arguments have been set forth on both sides of the tax deductibility issue. While there is currently more precedential support for a rule allowing deductibility in the case of non-willful copyright infringement, a majority of circuits have yet to decide a case involving this issue. Without guidance from either Congress or the Supreme Court, the remaining circuit courts will be left to develop their own solutions.

II. ANALYSIS

A. An Overview of Copyright Law and Copyright Infringement

Copyright protection is guaranteed by the United States Constitution, which states that Congress has the power “[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries . . . .” To understand who “authors” are, what “writings” means, and how much protection “authors” get for their “writings,” one must turn to the Copyright Act of 1976 and case precedent.

The Supreme Court has defined an author as “he to whom anything owes its origin; originator; maker; one who completes a work of science or literature.” The idea that an author must create something original to obtain copyright protection has carried over into

---

90. Id. at 84-86.
91. Id.
92. Id.
93. See id.
94. Id. at 87-88 (“Since the plaintiff has no control over an infringers' behavior, it is unable to force the infringer to seek recourse to the appropriate deduction, and cannot itself act to utilize the equitable result such a deduction creates. As a result, the infringer is the only entity that can utilize the deduction and protect its financial position, and should therefore bear any loss its inaction procures. This is certainly the fairest outcome, placing the loss on the infringer as the party that can act with the least effort to prevent the harm at issue.”).
the current version of the Copyright Act, which states: “Copyright protection subsists . . . in original works of authorship fixed in any tangible medium of expression . . .”97

Unlike the term “author,” the term “writings” is defined primarily by the current Copyright Act. The first Congress defined writings to encompass only maps, charts, and books.98 The current Copyright Act, however, expanded the definition to include: literary works; musical works; dramatic works; pantomimes and choreographic works; pictorial, graphic, and sculptural works; motion pictures and other audiovisual works; sound recordings; and architectural works.99 In sum, when a person creates an original work that fits into one of the eight available categories, the creator may secure copyright protection for that work.

Once copyright protection has been secured, the Copyright Act grants certain exclusive rights to the copyright holder. A copyright holder generally has the exclusive right to reproduce the work, prepare derivative works, and distribute copies to the public.100 Furthermore, for certain types of works, a copyright holder has the exclusive right to perform and display the work publicly.101 With few exceptions, “[a]nyone who violates any of the exclusive rights of the copyright owner . . . is an infringer of the copyright”102 and the copyright holder may bring an action against them for copyright infringement.103

If a copyright holder is successful in an action against the infringer, the copyright holder has several available remedies. First, a court may “grant temporary and final injunctions . . . to prevent or restrain infringement of a copyright.”104 Second, a court may order either the impounding of all copies claimed to have been made or used or the destruction of all copies found to have been made or used “in violation of the copyright owner’s exclusive rights.”105 Third, a copyright holder is entitled to collect statutory damages, which are set at not less than $750 and not more than $30,000.106

98. See Burrow-Giles, 111 U.S. at 56-57.
100. Id. § 106(1)-(3).
101. Id. § 106(4)-(5).
102. Id. § 501(a).
103. Id. § 501(b).
104. Id. § 502(a).
105. Id. § 503 (a)-(b).
106. Id. § 504(c)(1). If the infringement was committed non-willfully, a court may reduce the award to not less than $200 and if the infringement was committed willfully, a court may increase the award to not more than $150,000. Id. § 504(c)(2).
In lieu of accepting statutory damages, a copyright holder may elect to recover actual damages.\textsuperscript{107} The Copyright Act paints a deceptively simple picture as to how actual damages are computed. The Act lays out only the burdens of proof that each party to a copyright infringement action must bear.\textsuperscript{108} The copyright holder has the burden of proving gross infringing revenue.\textsuperscript{109} “[T]he infringer is required to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.”\textsuperscript{110} In reality, however, “the calculation of attributable profits is factually intense and can be very complex.”\textsuperscript{111} Furthermore, “[n]either the [Copyright] Act nor the Committee Reports specify which expenses will be regarded as deductible costs” and therefore, case law must be referred to for guidance.\textsuperscript{112} It is important to note that copyright law differs, remarkably in some aspects, from both trademark and patent law. These other types of intellectual property are analyzed in the following two sections.

\textbf{B. An Overview of Patent Law and Patent Infringement}

Patents are protected under the same Constitutional clause as copyrights.\textsuperscript{113} While for copyrights, protection is given to authors for their writings for limited times, in the case of patents, protection is given to inventors for their discoveries for limited times.\textsuperscript{114} Similar to copyrights, the scope of patent protection is primarily laid out in statutes.\textsuperscript{115} Generally speaking, patent protection is given to “[w]hoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof”\textsuperscript{116} where “new” means not yet known\textsuperscript{117} and not obvious from an existing invention.\textsuperscript{118}

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{107}] Id. § 504(b).
\item[\textsuperscript{108}] See id.
\item[\textsuperscript{109}] Id.
\item[\textsuperscript{110}] Id.
\item[\textsuperscript{111}] McNicholas & McNicholas, supra note 87, at 72.
\item[\textsuperscript{112}] Nimmer, supra note 8.
\item[\textsuperscript{113}] See U.S. Const. art. I, § 8, cl. 8.
\item[\textsuperscript{114}] See id.
\item[\textsuperscript{115}] See 35 U.S.C. §§ 1-376 (2000).
\item[\textsuperscript{116}] See id. § 101.
\item[\textsuperscript{117}] See id. § 102(a).
\item[\textsuperscript{118}] Id. § 103(a).
\end{itemize}
\end{footnotesize}
Unlike copyrights, a patent is not valid until it is registered with the Patent and Trademark Office. Furthermore, in most instances a patented invention must be marked to recover damages. If an invention is not properly marked, “no damages shall be recovered by the patentee in any action for infringement, except on proof that the infringer was notified of the infringement and continued to infringe thereafter, in which event damages may be recovered only for infringement occurring after such notice.”

Following in the footsteps of copyrights, patent holders have certain exclusive rights that when infringed upon give a patent holder the right to bring a civil action against the infringer. These exclusive rights include the right to make, use, offer to sell, and sell the invention. When patent infringement is found, the patent holder is entitled to “damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interests and costs as fixed by the court.”

Although an explicit distinction is not made between willful and non-willful infringers in the patent statutes, there is a provision that allows courts to award increased “damages up to three times the amount found or assessed.” “A finding of willfulness . . . does not mandate enhanced damages,” but a finding of willfulness often leads a court to award increased damages. Furthermore, there is a provision in the patent statutes that allows a court to award reasonable attorney fees to the prevailing party. One of the common scenarios in which attorney fees are awarded is in cases of willful patent infringement. Therefore, although the patent statutes do not explicitly call for a distinction to be made between willful and non-
willful infringers, a finding of willfulness may lead a court to require the infringer to pay increased damages and attorney fees.

C. An Overview of Trademark Law and Trademark Infringement

Trademarks, which are marks “by which the goods of the applicant may be distinguished from the goods of others,” receive Federal protection primarily by statute. In addition to traditional trademarks, product names and logotypes, including trade dress, titles, characters, trade names, service marks, and internet domain names are all protected.

Unlike copyrights, trademarks only become effective after certain registration requirements are met. Furthermore, the duration of trademark protection differs from the duration of copyright protection. For example, while copyright protection is available only for “limited times,” the duration of trademark protection is indefinite. Although trademarks are initially covered for only a ten-year period, “each registration may be renewed for periods of 10 years at the end of each successive 10-year period following the date of registration . . . .”

Copyrights and trademarks do, however, have some similar features. For example, both copyright and trademark holders have certain exclusive rights. The trademark holder has exclusive rights to use the mark in connection with the sale, offering for sale, distribution, or advertising of any goods and services associated with the mark. As is the case with copyrights, when any of the exclusive trademark rights are violated, the trademark holder may bring a civil action against the infringer.

When a trademark holder is successful in a civil action, various remedies are available. First, a court may grant an injunction to

---

131. See id. § 1051-1141.
135. See 15 U.S.C. § 1059(a). After the Copyright Term Extension Act, 17 U.S.C. § 302, was enacted, some argued that copyright protection was effectively infinite as well. Eldred v. Ashcroft, 537 U.S. 186 (2003). This view, however, has been rejected by the Supreme Court. Id.
139. Id.
prevent the violation of any of the trademark holder's exclusive
rights. Second, a court may order the destruction of all items
bearing the infringing mark and "all plates, molds, matrices, and
other means of making" the mark. Finally, a trademark holder is
generally entitled to recover the infringer's profits, any damages
sustained by the plaintiff, and the costs of the action. Similar to the
framework in copyright infringement actions, the trademark holder
has the burden of proving the infringer's sales. The infringer is
responsible for proving all elements of cost or reduction.

Whether trademark infringement is willful or non-willful does
not play as large of a role in trademark law as it does in copyright law.
Nevertheless, the distinction is sometimes meaningful, especially
where counterfeit marks are involved. For example, when an infringer
is found to have "intentionally us[ed] "a mark or designation, knowing
such mark or designation is a counterfeit mark," treble profits or
treble damages, whichever is greater, together with reasonable
attorney's fees are the measure unless the court finds extenuating
circumstances. Also, where counterfeit marks are involved, a
trademark holder may elect statutory damages instead of actual
damages. In cases of non-willful infringement involving counterfeit
marks, statutory damages must be not less than $500 and not more
than $100,000. The ceiling increases to not more than $1,000,000
when infringement is willful. In sum, although the remedies
available to a trademark holder are generally the same regardless of
whether the infringement was willful or non-willful, there are some
circumstances, such as where counterfeit marks are involved, in which
the distinction is critical.

D. There Should Be One Deductibility Rule for Copyrights, Patents,
and Trademarks

As explained above, willfulness plays a role in copyright,
patent, and trademark infringement cases. In all copyright and patent

140. Id. § 1116(a).
141. Id. § 1118.
142. Id. § 1117(a).
143. Id.
144. Id.
145. Id. § 1117(b).
146. Id. § 1117(c).
147. Id. § 1117(c)(1).
148. Id. § 1117(c)(2).
When allocating damages in a copyright infringement suit, the distinction between willful and non-willful infringement is meaningful. In nearly all copyright infringement suits where infringement is found, a copyright holder may elect to receive statutory damages from the infringer. This election may be made at any time up until final judgment. The fact that a court may award as little as $200 in statutory damages in cases of non-willful infringement but as much as $150,000 in statutory damages in cases of willful infringement shows that Congress, in creating the Copyright Act, intended to distinguish between willful and non-willful infringers.

Moreover, although Larson was a trademark infringement case, the Supreme Court made it fairly clear that the issue of willfulness is meaningful when determining whether tax is a proper deductible expense from gross infringing trademark revenue. The Larson opinion was a mere two paragraphs long but within those two paragraphs the Court made at least three references to the willful conduct of the trademark infringer.

First, the Court stated that “[c]ircumstances will affect the conclusion [of whether a deduction would be proper], including in
them the knowledge and the conduct of the party charged.” Next, the court explained:

It would be unjust to charge an infringer with the gross amount of his sales without allowing him for the materials and labor that were necessary to produce the things sold, but it does not follow that he should be allowed what he paid for the chance to do what he knew that he had no right to do. Finally, the Court concluded: “in a case of what has been found to have been one of conscious and deliberate wrongdoing, we think it just that the deduction should not be allowed.” The Court’s focus on the issue of willfulness in *Larson* is strong circumstantial evidence that the Court would consider the same issue in a copyright context.

**F. A Rule of Deductibility Should Apply to Non-Willful Copyright Infringers**

Tax should be a proper deductible expense from gross infringing revenue when copyright infringement is non-willful. *Larson*, which holds that tax is not a proper deductible expense in willful trademark infringement cases, carefully limited the breadth of its holding to cases of willful infringement. The Supreme Court opined:

No doubt there are cases in which such a deduction would be proper . . . . Circumstances will affect the conclusion, including in them the knowledge and the conduct of the party charged . . . . [I]n a case of what has been found to have been one of conscious and deliberate wrongdoing, we think it just that the further deduction should not be allowed.

The Seventh Circuit, in determining that non-willful patent infringers should be allowed the deduction, reasoned:

If from this language it may be concluded that where the accounting party had been acting in good faith, and with his infringement there was no admixture of deliberation or willfulness, “such a deduction would be proper.” If not in such a case, we fail to comprehend the significance of what was so said in *Larson*.

Because the willful / non-willful distinction is more prevalent in copyright law than in trademark law, the limiting language in *Larson*
should be applied to cases dealing with copyright infringement as well.

There is also strong precedential support for the Seventh Circuit’s interpretation of the limiting language in Larson and the conclusion that a rule of deductibility is proper for non-willful copyright infringers. In two copyright infringement cases, Three Boys Music and In Design, the court found in favor of a rule of deductibility for non-willful copyright infringers. The only other circuit court cases to have dealt with the issue of deductibility for non-willful infringers are patent cases. Even in the patent context, two of the three circuits to have considered the deductibility issue, the Third and the Seventh, found in favor of a rule of deductibility for non-willful infringers. Because there is overwhelming precedential support for a rule of deductibility for non-willful infringers and very little support for the opposite proposition, all circuits should adopt the former rule.

Furthermore, hypothetical discussions of possible indirect tax ramifications, such as those proposed by the Sixth Circuit in Schnadig, should have no bearing on whether a rule of deductibility or non-deductibility is selected. As one district court stated:

Deductions allowed defendant in computing its federal income tax concern only the Government and the defendant taxpayer, and are of no concern to plaintiff. The tax situation of each party is entirely separate and independent. Plaintiff has no more interest in whether a deduction of the amount of the judgment resulted in a tax saving to defendant, than defendant has in the taxes which plaintiff may have to pay on the amount of income it received pursuant to the decree in the patent infringement accounting.

Finally, distinguishing willful and non-willful copyright infringers comports with notions of equity. Willful infringers knowingly use another’s intellectual property for their own benefit. Non-willful infringers, on the other hand, either do not know or do not think that they are infringing. From an equitable point of view, these two classes of persons should be treated differently.

162. See, e.g., Three Boys Music Corp. v. Bolton, 212 F.3d 477, 488 (9th Cir. 2000) (holding that tax is a proper deductible expense for non-willful copyright infringers); In Design v. K-Mart Apparel Corp., 13 F.3d 559, 567 (2d Cir. 1994) (holding same); Duplate Corp. v. Triplex Safety Glass Co., 81 F.2d 352, 356 (3d Cir. 1935), modified by 298 U.S. 448 (1936) (holding that tax is a proper deductible expense for non-willful patent infringers); Contra Schnadig Corp. v. Gaines Mfg. Co., 620 F.2d 1166, 1171 (6th Cir. 1980) (holding that tax is not a proper deductible expense for any design patent infringer).

163. Three Boys Music, 212 F.3d at 488; In Design, 13 F.3d at 567.

164. Duplate, 81 F.2d at 356; Detroit Trust, 44 F.2d at 965.

165. Schnadig, 620 F.2d at 1169.

G. A Rule of Non-Deductibility Should Not Apply to Non-Willful Copyright Infringers

The Sixth Circuit is the lone circuit to decide a case which could be extended to argue that tax should never be a deductible expense in the copyright infringement context.167 The premise of the court’s argument in Schnadig is that if an infringer is required to pay a pre-tax damage award, he will likely be reimbursed for the tax paid after including the damage award as a tax deduction on a subsequent tax return.168 The hypothetical that the court used to illustrate this possible tax ramification is worth repeating here. The court stated:

[If a company earned a net pre-tax profit of $100 by infringing, paid $50 in tax, and paid the remaining $50 as damages to the patentee, the infringer would have no remaining cash, but would have a $50 tax deduction available to him. At our fictional 50% tax rate, this deduction would be worth $25 to the infringer, and if the deduction is fully utilized it would represent a $25 net overall gain on the infringement. The reciprocal of the infringer’s deduction of the award is the patentee’s inclusion of the award in his gross income. Retaining our fictional 50% tax rate, the patentee will keep only $25 of the $50 award, paying the other $25 in tax. In that hypothetical, but very realistic, possibility, the infringer nets as much as his victim, and perhaps even more if the dynamics of the money market are considered.169

The court explained that “[a]lthough the above illustration is true in theory, the actual dollar impact of a damage award on the taxes of either party will naturally depend upon the party’s overall tax situation.”170 The court admitted that “[t]ax rates will vary, and “offsetting losses could conceivably bar use of the deduction or negate any tax effect of the award.”171 The court goes on to conclude, however, that “the “vast majority of infringers should be able to utilize the deduction.”172

When closely examined, however, the Sixth Circuit’s decision is not controlling on the issue of tax deductibility in the copyright context. First, the court specifically limited the breadth of its holding to cases of design patent infringement.173 Moreover, the court noted in dicta that the district court’s “findings indicate[d] conscious and deliberate infringement” by the defendant.174 Therefore, while this case would certainly not be controlling in a case dealing with

167. See Schnadig, 620 F.2d at 1171 (deciding a patent infringement claim).
168. See id. at 1169-70.
169. Id. at 1169 (citation omitted).
170. Id.
171. Id. at 1169-70.
172. Id. at 1170.
173. See id. at 1171.
174. Id. at 1171 n.11.
In their law review article, the McNicholas praise the Sixth Circuit’s analysis and advocate for a rule of non-deductibility in all copyright infringement cases. The McNicholas argue that a per se rule of non-deductibility for all copyright infringers has many benefits and places any loss on the infringer.

The authors’ attack on a rule of deductibility for non-willful copyright infringers is really an attack on the current tax scheme. The In Design court held: “We think that when a claim is made for infringing profits, ‘this means profits actually made. A book profit of a dollar is not a profit actually made when from the dollar the government takes twenty cents as the price for the right to make any profit at all.’ ” It is true that a copyright infringer may net an overall gain after including a post-tax damage award as a tax deduction on a subsequent tax return. Furthermore, it is true that a copyright holder will not recover the full amount of his or her lost profits because he or she will be required to include the damage award as taxable income on a subsequent tax return. This, however, is the tax scheme as laid out by Congress and in laying out this scheme, Congress has implicitly rejected the proposition that the defendant is the proper party to bear a tax loss.

H. Variations on a General Rule of Deductibility

Two variations on a general rule of deductibility for non-willful copyright infringers can be extracted from cases decided before the Supreme Court’s ruling in Larson. First, in Macbeth-Evans Glass Co. v. L.E. Smith Glass Co., a patent infringement case, the Third Circuit held that the infringer may properly deduct tax paid on gross infringing revenue before paying a damage award to the patent holder. The court went further, however, holding that if the infringer received a tax refund for including the damage award as a

---

175. McNicholas & McNicholas, supra note 87, at 72-73.
176. See supra notes 89-93 and accompanying text.
177. 13 F.3d 559, 567 (2d Cir. 1994) (quoting Macbeth-Evans Glass Co. v. L.E. Smith Glass Co., 23 F.2d 459, 463 (3d Cir. 1927)).
180. 23 F.2d 459, 463 (2d Cir. 1927). No determination as to the willfulness of the defendant’s infringement was made in this case.
tax deduction on a subsequent tax return, the infringer would be required to pay that amount to the patent holder.\textsuperscript{181} This rule would prevent the infringer from realizing any net gain from their infringement.

Although this rule may seem compelling, it cuts against the current federal tax scheme. In any case for the recovery of lost profits, the tax scheme requires the plaintiff to include a damage award as taxable income\textsuperscript{182} and allows the defendant to include the damage award as a tax deduction on a subsequent tax return.\textsuperscript{183} No exception to this tax scheme is carved out for copyright infringement or for any other intellectual property infringement. Furthermore, the court's rule may be impractical because it will often require the infringer to compensate the copyright holder long after the conclusion of an infringement suit. Because this rule upsets the tax scheme and because implementation of it may be impractical, it should not be adopted.

Another variation on the general rule of deductibility for non-willful copyright infringers can be extracted from the Seventh Circuit trademark infringement opinion that was overruled by the Supreme Court in \textit{Larson}. The Seventh Circuit advocated for a rule which allowed a tax deduction but required the amount of the deduction to be the amount that the trademark holder would have paid (and not the amount the infringer actually paid) had the trademark holder received the infringing profits in the first instance.\textsuperscript{184} The court reasoned that it would be unfair for the infringer to pay either a higher or lower tax rate than the trademark holder would have paid.\textsuperscript{185}

This rule, however, is not compatible with the plain language of the Copyright Act. The Act states:

\begin{quote}
\textbf{The copyright owner is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages. In establishing the infringer's profits, the copyright owner is required to present proof only of the infringer's gross revenue, and the infringer is required to prove his or her deductible expenses and the elements of profit attributable to factors other than the copyrighted work.}\textsuperscript{186}
\end{quote}

\begin{tabular}{ll}
\textsuperscript{181} & See\textit{id.} at 463-64. \\
\textsuperscript{182} & \textit{Safety Car}, 297 U.S. at 92-93. \\
\textsuperscript{183} & See\textit{generally} \textit{I.R.C. § 162; Treas. Reg. § 1.162-21(c); Schnadig}, 620 F.2d at 1169. \\
\textsuperscript{184} & L.P. Larson, Jr., Co. v. WM. Wrigley, Jr., Co., 20 F.2d 830, 834 (7th Cir. 1927). \\
\textsuperscript{185} & Id. \\
\textsuperscript{186} & 17 U.S.C. § 504(b) (2000). \\
\end{tabular}
Because the Copyright Act is concerned with the infringer’s gross revenue and the infringer’s deductible expenses, the proper tax deduction would be the amount of taxes the infringer paid. Although this rule seems equitable, it does not comport with the plain language of the Copyright Act and should not be adopted.

III. CONCLUSION

Copyrights are protected by the Constitution and by the Copyright Act of 1976. The holder of a copyright has certain exclusive rights and when those rights are infringed upon, the copyright holder has a civil cause of action against the infringer. Once infringement is found, a copyright holder may elect to receive actual damages, which are computed by subtracting deductible expenses from the portion of the infringer’s gross revenue that is attributable to the infringement. One potential deductible expense is the tax paid by the infringer on the infringing profits.

While the Supreme Court held in Larson that a willful trademark infringer is not entitled to such a deduction, it left open the possibility that a non-willful infringer would be allowed the deduction. There is compelling precedential support for the proposition that a deduction should be allowed in cases of non-willful copyright infringement. Two cases dealing with copyright infringement, Three Boys Music and In Design, both held that a non-willful copyright infringer is allowed the deduction. Furthermore, two cases dealing with patent infringement, Detroit Trust and Duplate, have declared a similar rule in the patent context. Only one case, Schnadig, has, arguably in dicta, declared a rule of non-deductibility for both willful and non-willful infringers. That case, however, was explicitly limited to cases of design patent infringement.

189. Id. § 106
190. Id. § 501.
191. See id. § 504(b).
and may even be dicta with regards to non-willful design patent infringers.\textsuperscript{196}

In addition to strong precedential support for a rule of deductibility for non-willful copyright infringers, the Copyright Act supports a rule that distinguishes between willful and non-willful infringers. The Act's provision regarding statutory damages, which may be awarded in nearly every copyright infringement case, allows a court to award a much larger statutory damages award in cases of willful infringement than it may award in cases of non-willful infringement.\textsuperscript{197} Moreover, the Act's increased punishment of willful infringers comports with notions of equity.

In sum, a rule of deductibility in cases of non-willful copyright infringement is warranted for three reasons. First, the Supreme Court's limited its non-deductibility language in Larson to cases of willful trademark infringement. And, because the Copyright Act makes a meaningful distinction between willful and non-willful copyright infringers, the limiting language in Larson should apply to copyrights in the same way it applied in that case to trademarks. Second, there is strong precedential support in favor of a rule of deductibility for non-willful copyright infringers and little support in favor of the opposite rule. Finally, a rule of deductibility comports with notions of equity. Therefore, in the absence of guidance from either Congress or the Supreme Court, circuit courts should choose to adopt a rule of deductibility for cases of non-willful copyright infringement.

\textit{Christine Ballard}\textsuperscript{*}

\begin{footnotesize}
\begin{itemize}
\item[196.] \textit{Id.} at 1171.
\item[197.] 17 U.S.C. \textsection{} 504(c)(1), (2) (2000).
\item[\textsuperscript{*}] Christine Ballard, J.D. Candidate, Vanderbilt University Law School, 2007. The author wishes to thank the following people: her family, especially her husband, Dylan, for providing endless love and support; her friends, for their words of encouragement throughout the writing process; and the editors and cite-checkers, especially Steve, for perfecting this note.
\end{itemize}
\end{footnotesize}