TAXATION OF COPYRIGHT INCOME UNDER THE 1954 INTERNAL REVENUE CODE*

In 1954, Congress enacted the present Internal Revenue Code, designed to simplify and re-arrange the law, and in some cases to grant tax relief or close loopholes.[1] In many instances new code sections proved inappropriate or incomplete and were repealed[2] or amended.[3] The bulk of the sections remain; but it is not necessarily because of their appropriateness or completeness.

When considering the relatively narrow area of taxing copyright income, some very good arguments could be made to demonstrate that the new code is neither appropriate nor complete. For example, the basic policy which permits patent holders to get preferential tax treatment as compared to copyright holders seems open to considerable criticism. The most striking example of preference given to patents is that capital gains rates are available upon sale of patents, whereas most copyrights are specifically excluded from the definition of capital asset. Section 1221 provides that a capital asset does not include:

> (3) a copyright, a literary, musical, or artistic composition, or similar property held by—
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> (A) a taxpayer whose personal efforts created such property, or
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> (B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property.

In addition to the disparate capital gains treatment, income from patents may be spread over a longer period than income from copyrights.[4] One would have to concede that patents were in some way different or more worthy of encouragement than are copyrights, before the 1954 Code treatment could properly be termed appropriate. Regarding completeness, the 1954 Code's provisions expressly cover

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1. See, e.g., Freter, Business Income, Expenses, and Accounting Methods, 1955 U. Ill. L.F. 357.

2. E.g., Int. Rev. Code of 1954, ch. 736, § 452, 68A Stat. 152, which permitted spreading of prepaid income if certain conditions were met.

3. E.g., Int. Rev. Code of 1954, § 341(e), 72 Stat. 1615 (1958), which exempts transactions otherwise covered by "collapsible corporation" provisions.

4. Int. Rev. Code of 1954, § 1302.

situations which had been left to the courts, but even in the situations covered, a great deal more could have been done.

This note will consider the sections of the 1954 Code which relate to the taxation of income from copyrights, indicate important changes from prior law, discuss situations not now covered by statute, and examine possible courses open to authors and others holding copyrighted works. The so-called Eisenhower amendment[5] passed in 1950, which denied capital gains treatment to sales of copyrights by amateurs, will be considered as an innovation of the 1954 Code, inasmuch as Congress, by embracing the 1950 changes, indicated it intended to break sharply with the prior case law.

Because of the potential size of the tax bite, owners of copyrights, like all taxpayers, are constantly trying to avoid upper income brackets, either by somehow getting capital gains treatment, or by spreading income over a greater period of time. Most copyright holders cannot avoid being taxed at ordinary income rates, because of the 1954 Code's express denial of capital gain treatment to an author of a copyrighted work, and to a taxpayer whose basis is determined by reference to the basis of the copyright's creator.[6] This latter provision apparently applies only to donees of gifts and beneficiaries of trusts set up by the creator of the copyrights. Therefore, many of the real question marks regarding the taxing of income from copyrights concern persons not explicitly covered by statute, as are creators, their donees or the beneficiaries of a copyright trust set up by a creator. One who is not explicitly covered *may* be able to get capital gains treatment. Whether or not he does get such treatment depends upon his status as determined by reference to the general requirements for capital gain. In fixing one's position under the general requirements, reference to the pre-1954 law affords indications of the possibility for success in escaping taxation at ordinary income rates.

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5. Int. Rev. Code of 1939, § 117(a), as amended, ch. 994, 64 Stat. 932 (1950). Prior to this amendment, it was possible for one who did not deal in copyrights as part of his trade or business, e.g., a non-professional writer, to obtain capital gains treatment on a sale. The name of the amendment was derived because one of the world's most famous "amateur" authors realized a capital gain on the sale of the book *Crusade in Europe.*

6. Int. Rev. Code of 1954, § 1221(3) denies capital asset status to a copyright held by "a taxpayer whose personal efforts created such property, or . . . a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property." Under § 1015 the basis of property acquired by gift or by a transfer in trust is the same as that of the donor or transferor.

CAPITAL GAINS PROBLEMS OF COPYRIGHT HOLDERS NOT EXPRESSLY COVERED BY SECTION 1221

Precisely what is necessary before one not explicitly covered by the code may expect to obtain capital gain treatment upon sale of a copyright? First, there must be a "sale" or "exchange"[7] and second, the asset must be a capital asset, and not be held primarily for sale in the ordinary course of the taxpayer's business,[8] Both these requirements may be formidable barriers for a copyright holder seeking to avoid being taxed at ordinary income rates—but both requirements must be met before a profitable sale can count as a capital gain.

Seemingly the sale requirement would be easily met. Certainly in the everyday sense of the word, a sale is not unusual or difficult to effect. Unfortunately for the taxpayer, the ordinary sense of the word is disregarded by the courts when considering problems arising upon disposition of copyrights. The biggest stumbling block to accomplishing a sale in the copyright sense of the word has been the so-called "indivisibility rule."[9] This rule treats the transfer of less than all rights which the transferor has under section one of the Copyright Act[10] as "license." Only if *all* rights are transferred is there said to be a "sale."[11]

The "indivisibility rule" arose from judicial doctrine originally applied to patent law cases,[12] and was often criticized for failing to consider that the various rights given under section one of the Copyright Act are basically different. The basis of the indivisibility rule bore no relation to taxes, but was instead formulated to prevent a copyright infringer from being sued twice for the same infringement—once by the proprietor and once by the licensee of the copyright.[13] That such double suit is likely seems doubtful, since the licensee must compel the proprietor as trustee to join as plaintiff in a suit.[14] More-

7. Int. Rev. Code of 1954, § 1222.

8. Int. Rev. Code of 1954 § 1221(2).

9. For a complete discussion of this rule, and problems it caused under the 1939 Code, see Fulda, Copyright Assignments and the Capital Gains Tax, 58 Yale L.J. 245, 247 (1948). The rule is also referred to as the "one package rule." Ibid.

10. 17 U.S.C. § 1 (1958). Numerous rights are enumerated in this section, such as the right to print, reprint, publish, copy, vend, translate, dramatize, transcribe, and many others.

11. Fulda, supra note 9, at 246, citing cases. See also Cory v. Commissioner, 230 F.2d 941 (2d Cir.), cert. denied, 352 U.S. 828 (1956); Gershwin v. United States, 138 Ct. Cl. 205, 153 F. Supp. 477 (1957).

12. Wolff, Copyright Law and Patent Law: A Comparison, 27 Iowa L. Rev. 250 (1942).

13. See, e.g., Machaty v. Astra Pictures, Inc., 197 F.2d 138, 144 (2d Cir. 1952); New Fiction Publishing Co. v. Star Co., 220 Fed. 994 (S.D.N.Y. 1915).

14. E.g., Buck v. Elm Lodge, Inc., 83 F.2d 201 (2d Cir. 1936); Buck v. Russo, 25 F. Supp. 317 (D. Mass. 1938).

over, res judicata will apply to a suit involving the same cause of action.[15] Even conceding some procedural validity to the rule, it is not appropriate for an index of whether or not the disposition of a given right is a capital gain.

To illustrate the inherent divisibility of a copyright, one should consider that several section one rights are generally disposed of separately.[16] Thus, the right to print a work is generally sold to someone other than the purchaser of the right to dramatize.[17] These rights may quite easily be valued separately. Furthermore, one of the section one rights individually may be used as basis for getting new copyrights that are distinct from the original.[18] The copyright owner of a novel may dramatize it and may also write a separate scenario for a movie based on the novel and copyright the scenario.

In spite of criticism of the rule, it remained a factor for which the 1954 Code made no provision. However, notwithstanding the inadequacy of the Code, the rule was laid to rest by the Treasury's publication, in 1954, of Revenue Ruling 54-409.[19] This ruling provided:

> When the proprietor of a copyright grants the exclusive right to exploit the copyrighted work throughout the life of the copyright in a medium of publication or expression for a consideration which is not measured by a percentage of receipts from the sale, performance, exhibition, or publication of the copyrighted work, is not measured by the number of copies sold, performances given or exhibitions made of the copyrighted work, and is not payable periodically over a period generally coterminous with the grantee's use of the copyrighted work, the consideration is to be treated as the proceeds of a sale of property and not as rentals or royalties.

As a result of this rule, the first requirement, that of a sale, may be met much more easily and in many more situations which reasonably may arise—provided the measure of consideration is not tied in some way to the productivity of the copyrighted work, in the manner of a royalty.

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15. Commissioner v. Sunnen, 333 U.S. 591 (1948); Estate of Egan v. Commissioner, 260 F.2d 779 (8th Cir. 1958).

16. See Fulda, supra note 9, at 253. See also Herwig v. United States, 105 F. Supp. 384 (Ct. Cl. 1952).

17. Thus, a famous man would be likely to sell the right to print his memoirs to a national magazine and sell the right to dramatize them to a theatrical producer.

18. "A man having general statutory dramatic rights . . . might make a play and perform it under his common-law rights without publication, or he might copyright the play, and he would still not have copyrighted . . . . his moving picture rights . . . he could get a separate copyright upon that." Photo Drama Motion Picture Co. v. Social Uplift Film Corp., 213 Fed. 374, 377 (S.D.N.Y. 1914). For the separate classifications an application for copyright may specify, see 17 U.S.C. § 5 (1958).

19. 1954-2 Cum. Bull. 174.

The question of whether the asset is used in trade or business raises separate problems. In *Goldsmith v. Commissioner*,[20] it was held that a copyright in the hands of a playwright was held for sale in the ordinary course of business and that income derived from the sale was ordinary income. Under the 1954 Code, a play's author would be excluded from capital gains treatment by section 1231, but to exclude one who dealt in scripts or scenarios authored by others, the rationale would have to be of the type found in the *Goldsmith* case. This case apparently retains its force under the 1954 Code, although it has more limited scope.

Therefore, one who does not generally deal in copyrighted words, and who is not the creator or one using his basis—and only one fitting this description—gets capital gains treatment upon selling a copyrighted work. The heirs of a deceased author, it should be noted, qualify for possible capital gains treatment, since they take a basis not related to that of the decedent.[21]

Since the courts have held that one may hold an asset for more than one purpose,[22] the taxpayer should always be able to prove that he under no circumstances deals in sale of copyrighted works in the ordinary course of his activities. In cases involving sales of literary property arising under section 1221, whether the taxpayer usually acted as a dealer of literary rights has been a crucial factor.[23] Thus, in *Anatole Litvak*,[24] a case involving the sale of motion picture rights by a director who did not generally deal in such rights, the income was taxed at capital gains rates. The case followed the rule laid down in *Fred MacMurray*,[25] where a famous actor who also had been a producer-director, got capital gains treatment on his sale of a story to a movie studio, which immediately thereafter filmed the story, starring MacMurray. On the other hand, in *Z. Wayne Griffin*,[26] the income on the sale by a producer of a purchased story to a producing corporation was held to be ordinary income, since the producer's practice had been to deal in stories only in connection with his activities as producer.

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20. 143 F.2d 466 (2d Cir.), cert. denied, 323 U.S. 774 (1944).

21. Int. Rev. Code of 1954, § 1014.

22. Philber Equipment Corp., 25 T.C. 88, rev'd, 237 F.2d 129 (3d Cir. 1956).

23. See, e.g., Anatole Litvak, 23 T.C. 441 (1954); Fred MacMurray, 21 T.C. 15 (1953). The Commissioner does not acquiesce in these decisions. 1958-2 Cum. Bull. 9. The Commissioner previously had acquiesced in the latter case. 1954-1 Cum. Bull. 5. His position is based on the theory that there need be only a few transactions before one is "in the business." Cf. Julius H. (Groucho) Marx, 29 T.C. 88 (1957) (sale of partnership interest); Jack Benny, 25 T.C. 197 (1955) (sale of corporation stock). Both Marx and Benny got capital gain treatment.

24. 23 T.C. 441 (1954).

25. 21 T.C. 15 (1953).

26. 33 T.C. No. 68 (Dec. 31, 1959).

CAPITAL GAINS PROBLEMS OF NON-RESIDENT ALIEN COPYRIGHT HOLDERS

Section 872 of the 1954 Code provides that gross income of a non-resident alien includes only that from sources within the United States. Section 861(a) (4) states that royalties for the use of a copyright in the United States are treated in the same manner as income from sources within the United States—thus they are taxable. Unfortunately for the copyright holder, what may be a "sale" for one not a non-resident, may be called a license for a non-resident and taxed at ordinary income rates.[27] This inconsistency is not a problem caused by the 1954 Code, but is another example of the Code's failure to provide a fair solution to a serious inequity which had existed in the earlier law.

The presence of a double-standard for non-resident cases stems largely from but two cases. The first of these, *Rohmer v. Commissioner*,[28] a case with much the same fact situation as the *Goldsmith* case was decided only three years later, by the same circuit court of appeals. The court, by using a diametrically opposite standard, distinguished *Goldsmith* by giving to the word "sale" different meanings, depending upon the code section in which it was used. The other case was *Commissioner v. Wodehouse*.[29] There, a British subject not residing in this country sold exclusive serial and book rights within the United States to certain of his works which were copyrighted. On the basis of statutory interpretation and legislative history of the non-resident alien provision, the Supreme Court of the United States concluded the lump sum payments Wodehouse received were really taxable royalties and not income from the sale of the property interest in the copyright.

As a result, the non-resident alien cases are no guide to prediction of cases involving other types of taxpayers. Furthermore, the Treasury, in the very regulation[30] which corrected much of the problem caused by the "indivisibility rule" insofar as its application generally is concerned, expressly stated that "the taxability of the income of a non-resident alien derived from a copyrighted work is also distinct from the question dealt with here." Thus, the problem was recognized, and then deftly sidestepped.

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27. Rohmer v. Commissioner, 153 F.2d 61 (2d Cir. 1946).

28. 153 F.2d 61 (2d Cir. 1946). See also Sabatini v. Commissioner, 98 F.2d 753 (2d Cir. 1938).

29. 337 U.S. 369 (1949).

30. Rev. Rul. 54-409, 1954-2 Cum. Bull. 174, 176.

PROBLEMS OF SPREADING INCOME FROM COPYRIGHTS

A copyrighted work which has taken several years to create may within one taxable year yield a large return—which will of course be ordinary income to the creator.[31] If all the income is taxed in the year it is actually received, he will be in a much higher bracket than would be the case were he able to allocate the money over all the years he spent on the work. To prevent severe hardship which might be caused by taxing the one "feast" year occurring at the end of the "famine" period, the 1954 Code permits certain devices which spread the income over several years.

This provision is found in section 1302 of the code which provides:

> If—
> (1) an individual includes in gross income amounts in respect of a particular . . . artistic work created by the individual; and
> (2) the work on the . . . artistic work covered a period of 24 months or more . . . and
> (3) the amounts in respect of the . . . artistic work includible in gross income for the taxable year are not less than 80 percent of the gross income in respect of such . . . artistic work in the taxable year plus the gross income therefrom in previous taxable years and the 12 months immediately succeeding the close of the taxable year, then the tax atributable to the part of such gross income of the taxable year . . . shall not be greater than the aggregate of the taxes attributable to such part had it been received ratably over . . . in the case of an artistic work, that part of the period preceding the close of the taxable year but not more than 36 months.

Section 1302(b)[32] expressly includes copyrights in the definition of artistic work. There is also in the section an express provision prohibiting income spreading if the income is a capital gain, but it should be noted that in the case of copyrights this is not needed, since anyone who could qualify under section 1302 could not qualify for capital gains treatment under section 1221.[33]

The essential requirements to be eligible for income spreading as may be seen from the above statutory quote are: (1) The taxpayer must be the creator of the copyrighted work; (2) The time spent authoring the copyrighted work must have been at least twenty-four months; and (3) The amounts includible in the author's gross income received in the taxable year must be at least 80% of the total received from the copyright in the taxable year all prior years, and the twelve

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31. Such income is denied capital gain treatment by § 1221 (3).

32. "The term 'artistic work' means a literary, musical, or artistic composition or a copyright covering a literary, musical, or artistic composition."

33. Section 1302 covers only creators of copyrights. Section 1221(3) (A) specifically excludes "a taxpayer whose personal efforts created such property."

months following the end of the taxable year. The future twelve months' income must necessarily be estimated.

If these requirements are met, the tax allocable to the income of the copyrighted work in the present taxable year is determined by finding the difference between the tax if the copyright receipts are included in gross income and the tax if such receipts are excluded. The copyright income is then spread ratably over a period not exceeding the thirty-six calendar months preceding the close of the taxable year. The amount of the tax attributable to the income of the copyrighted work, for each of the taxable years in the thirty-six calendar month period is found in the same manner as was the present year's tax. The tax of each year during the thirty-six calendar month period is totaled. The tax then imposed is the lesser of this total or the tax payable for the present year if all receipts are taxed in that year. Except in unusual cases, the tax arrived at by spreading the income will be lower.[34]

For example, suppose X is the author of a copyrighted work and reports on a cash basis of accounting. He received on July 1, 1959, a $72,000 royalty payment for income from a copyrighted work. He had received nothing from the copyright earlier and expects to receive only $8,000 during 1960. Since a total of $80,000 will be received in all years through and including 1959 and 1960, and 90% of this was received in 1959, X meets the 80% requirement. X had started on this work on January 1, 1954, and did not complete it until October 1, 1957—a forty-five month period. Allocations, however, may be made only to the last thirty-six calendar months included within the part of the period of work which preceded the close of the 1959 taxable year, the year of receipt. Therefore $2,000 ($72,000 divided by 36) is allocated to each of the thirty-six calendar months preceding January 1, 1960. $24,000 is allocated to 1959, 1958, and 1957. The tax on all these years is recomputed with the $24,000 addition figured in. The tax paid or payable without the inclusion of the $24,000 is subtracted from the tax with the $24,000 included in income. The difference is attributable to the copyright income. The differences in taxes of the three year period are then totaled. The difference in the 1959 tax with and without inclusion of the $72,000 is figured, and this difference is compared with the total of the differences of the three years. The lower figure is the tax.

In some cases, the estimated copyright income for the ensuing twelve calendar months after the end of the taxable year (in the above example the $8,000 anticipated in 1960) may prove to be too low. Thus, if X should in 1960 receive $28,000 rather than $8,000, only

34. If the taxpayer had substantial income in the two preceding taxable years, and little or none in the current taxable year, the current year's tax would be less than one based on spread income.

72% of his copyright income would have been received in 1959 and he will not meet the the 80% requirement. He would, in such a case, be required to file an amended return for 1959 and pay taxes without benefit of any income spreading.

The present code section on income spreading is patterned after the one found in the 1939 Code.[35] A significant change was made, however, in the length of time the work must be in preparation—this was shortened from thirty-six to twenty-four months.

A copyright holder who does not, or cannot, spread his income must under section 451[36] include all income of his taxable year. Conversely, one who does *not* receive income does not have to pay a tax when he receives nothing—but this obvious truth may obscure a tax liability to a taxpayer who receives no *cash* and equates no cash with no income. Income may be received in forms other than cash.

A taxpayer wishing to avoid having income taxed even though no cash is received must contend with the judicially conceived doctrines of "cash equivalency" and "constructive receipt." Under the "cash equivalency" doctrine an unconditional executed contract of a sale of a copyright may have a fair market value and could be treated as a cash equivalent, even though the taxpayer receives nothing but the contractual right.[37] The doctrine of constructive receipt applies when income is available to the taxpayer at his demand although he actually does not receive it.[38] Since the constructive receipt doctrine applies only if the income is presently available, its application can be avoided if care is exercised in drafting of the contractual right to demand given to the taxpayer.[39] The taxpayer should have no present contractual claim and no special fund should be set aside.[40]

In *Howard Veit*,[41] the taxpayer was to have been paid his share of the 1940 profits during 1942. In a new employment contract executed late in 1941 he agreed to take the profit in five equal annual installments beginning in 1943, rather than receive the entire payment in 1942. The taxpayer prevailed in his contention that the entire sum

35. Int. Rev. Code of 1939, § 107(b).

36. Section 451 provides that "the amount of any item of gross income shall be included in the gross income for the taxable year. . . ." An exception is permitted for a taxpayer not on the cash basis, who may properly record the income in another period.

37. 2 Mertens, Law of Federal Income Taxation § 11.06 (1955).

38. Treas. Reg. § 1.451-2 (1957).

39. Thus in James Cozzens, 19 T.C. 663 (1953), the taxpayer, an author, was held not to have received constructively over $5,000 in 1942 even though the publisher was willing to advance the money, since taxpayer had no contractual right to receive it in 1942.

40. By setting aside a fund, the taxpayer-obligee might be benefited upon insolvency of the obligor.

41. 18 P-H Tax Ct. Mem. 811 (1949).

was not taxable in 1942. A similar holding [42] upheld the taxpayer in permitting a change in an agreement so that insurance renewal commission payments would not be bunched in one year. This case concerned payments to be made after retirement and the new agreement was reached only three days before retirement. Thus, from the cases it would appear that the taxpayer will not be taxed for a privilege to income unless he has the privilege presently in his possession. Even if it is indicated that the taxpayer may receive the entire sum in advance, there will be no constructive receipt unless the chance for early payment is contractual rather than factual.[43] Of course, if the taxpayer at his own option may draw income, he will be taxed in the year in which he receives the option right.[44]

CAPITAL EXPENDITURES

Section 263 and its supporting regulation[45] make it clear that no deduction is allowed a taxpayer for securing a copyright and plates which remain the property of the person making the payments. Such a payment is considered a capital expenditure and not an expense of trade or business.

DEPRECIATION

Regulation § 1.167 (a)-3 (1958) states:

> 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. Examples are patents and copyrights.

Another regulation provides that the cost or other basis of a copyright should be depreciated over its remaining useful life. Remaining useful life should be estimated realistically. If the remaining life for some reason can not be estimated, it would seem permissible to amortize the copyright over its twenty-eight year statutory life.[46] Since the copyright may be renewed for an additional twenty-eight years at the end of its life,[47] it would seem that the commissioner's viewpoint on renewable leases would apply[48]—that is, unless the facts indicate the copyright is likely to be renewed, the right of renewal is not to be considered.

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42. Commissioner v. Oates, 207 F.2d 711 (7th Cir. 1953).
43. James Cozzens, 19 T.C. 663 (1953).
44. "Income . . . is constructively received . . . [when the taxpayer] may draw upon it at any time." Treas. Reg. § 1.451-2 (a) (1958).
45. Treas. Reg. § 1.263(a)-2 (b) (1959).
46. 17 U.S.C. § 24 (1958).
47. Ibid.
48. 2 CCH 1960 Stand. Fed. Tax Rep. ¶ 1723.

If the author pays all the expenses of publication and sells the work himself, no depreciation is allowed, since the cost goes into what is in effect the author's inventory. If all the books are sold profitably, he gets all his investment back.

Other Expenses

Section 174[49] allows certain taxpayers to deduct research and experimental expenditures they incur which are not chargeable to capital. They may, if they wish, treat the payments as deferred expenses which are allowed as a deduction ratably over at least a sixty month period. This option might be of particular value to a professional author of copyrighted works who has had considerable research expense, since it could permit the recognition of the expense over the same period when income from the copyrighted work may be high and the deduction of more value.

By analogy to patent law, expense of defending infringement suits could be deductible as a business expense.[50]

Possible Ways Open to Copyright Holders to Minimize Taxation

Because the two most obvious ways of minimizing tax—getting capital asset treatment and spreading income—are hemmed in by severe restrictions, the average copyright holder, particularly the creator of the copyright, must seek another way to accomplish tax reduction. One possible method is to do indirectly what is forbidden directly —that is, get capital asset treatment by selling not the copyright, but its equivalent, the stock of a corporation owning the copyright, or spread income by means of the corporate entity. Such an approach is not peculiar to owners of copyrights, but is attempted with varying degrees of success by many who seek to turn ordinary income into capital gain, or spread income so as to remain in the lower brackets. Many hurdles, both judicial and statutory, must be cleared before the taxpayer following this approach can hope to succeed.[51]

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49. "Amateur" authors do not qualify for this deduction. The research expense must be "in connection with . . . trade or business."

50. See Jack Rosenzweig, 1 T.C. 24 (1942) where it was held that an amount paid by one brother to another for defending an infringement suit was a legal deduction under Section 23(a) of the 1939 Code.

51. Still other approaches may be imagined. For example, one authority feels that it is now possible to shift income from copyrights by making an irrevocable gift of the royalty contract. Pilpel, Tax Law Affecting Copyrights, 35 Taxes, 76 (1957). The position is based upon Commissioner v. Reece, 233 F.2d 30 (1st Cir. 1956), a case which held income received on patent royalties, after an irrevocable gift, was taxable to the donee. Pilpel also suggests that one may be able to sell

Under section 351, one may transfer property to a corporation controlled by the transferor in exchange for stock, without incurring any tax. Thus, in forming the corporation, there is no real tax problem. However, once the corporation is in existence, problems arise. The Code taxes an earning accumulation in excess of $60,000 of any corporation formed or availed of for the purpose of avoiding the tax on dividends to shareholders which permits such an accumulation beyond the reasonable needs of the business.[52] Another code section[53] places a high tax upon "personal holding companies." Here, there is not an "intent" test as is the case under the accumulated earnings section. Five or less persons must own directly or indirectly 50% of the corporation stock and 80% of the corporation's income must be personal holding company income as defined by the statute. Royalties are defined as personal holding company income and Regulation § 1.543-1(3) provides that the term royalties includes amounts received for the privilege of using copyrights. Both the accumulated earnings and the personal holding company problem have been considered in depth elsewhere,[54] and it is here intended only that the copyright holder should be alerted to their dangers. Both these sections contain many complexities and one should not seek to circumvent them without a considerable amount of prior research.

One who forms a corporation and then seeks to sell the stock of the corporation to get capital gains treatment is faced with the "collapsible corporation" section, section 341. This section has been described as "complex and uncertain of application" and a section which "fails to meet the problems adequately, and throws a cloak of uncertainty over a large segment of legitimate business activity."[55] Such a situation naturally makes prediction of result in any given collapsible corporation case quite hazardous. A collapsible corporation is one which is

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the royalty contract as a capital asset. Query if either proposition affords much hope to copyright holders.

In Wodehouse v. Commissioner, 178 F.2d 987 (4th Cir. 1949), the taxpayer assigned a half interest in certain stories before they were copyrighted, but taxpayer did not notify the publisher of the assignment. The court held all the income was taxable to the taxpayer. (This holding was on a point unrelated to taxpayer's non-resident status, which is discussed supra, note 29.)

52. Int. Rev. Code of 1954, § 535.

53. Int. Rev. Code of 1954, § 541.

54. E.g., Greenfield, Personal Holding Company Dangers and How to Meet Them, N.Y.U. 13th Inst. on Fed. Tax 823 (1955); Holzman, The Accumulated Earnings Tax, 32 Taxes 823 (1954); Kopperud, The Burden of Proof in Accumulated Surplus Cases, 35 Taxes 827 (1957); Maloney, What Is a Personal Holding Company?, N.Y.U. 9th Inst. on Fed. Tax 745 (1951); Stone, Financial Institutions and Personal Holding Company Law, 37 Taxes 803 (1959).

55. Axelrad, Tax Advantages and Pitfalls in Collapsible Corporations and Partnerships, 34 Taxes 841 (1956).

formed or availed of to purchase property principally with a view to the sale or exchange of stock before the realization by the corporation of a substantial part of the taxable income of the property. This definition, which is a paraphrase of the pertinent part of the statute[56] as it might apply to copyrights, is deceptively simple. Briefly, it is enough to note that one cannot tell in advance whether such a corporation will be held to have been started or used "principally" to sell stock; one cannot tell in advance whether such a corporation will be held to have a view unconditionally to sell such stock or whether a recognized possibility will suffice; and one can only speculate as to what point the corporation has realized a substantial part of the taxable income from the copyright. There are several statutory exceptions, and numerous complexities, but it should be noted that one clearcut exception is given to gain realized after the expiration of three years following the corporation's acquisition of the copyright from the taxpayer[57]—so perhaps by not disposing of the corporate stock until three years after the corporation acquires the copyright, the taxpayer may break through the maze of regulations and rules.

SUMMARY

The 1954 Code failed in the area of copyright income to give consistent and clear indication of the tax liabilities of copyright holders. Although section 1221 does cover specifically many owners of copyrights, too much is left not covered, and what is worse, the serious inequities in the treatment of copyrights generally serve only to drive copyright owners to questionable tax devices which bring into play some of the Code's more complex and admittedly inadequate sections. In short, the policy of the Code is subject to question, but even conceding the soundness of the policy, its implementation has been unsatisfactory.

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56. Int. Rev. Code of 1954, § 341(b).

57. Int. Rev. Code of 1954, § 341(d) (3).