ROCK OF AGES AND MUSIC ESTATES

By: Ken Abdo and Sarah Wentz

I wouldn't recommend sex, drugs, or insanity for everyone, but they have always worked for me.
- Hunter S. Thompson

The young baby boomers' lifestyle mantra, "sex, drugs, rock & roll," has matured to, "occasional sex, prescription drugs, and what's left of rock & roll."
- Ken Abdo

Death, Taxes and other Certainties:

From the announcement on New Year's Day 2016 that Natalie Cole had died up through the Fall of 2017, iconic music artists have passed on including George Michael, Tom Petty, Prince, David Bowe, Glenn Frey, Leon Russell, Maurice White, Sharon Jones, Otis Clay, Leonard Cohen, Walter Becker, Glen Campbell, Chuck Berry, Tom Petty, Gregg Allman, Don Williams, Fats Domino and others. Though each left a musical and financial legacy, not all planned how to protect, manage and distribute their estate assets. Music creators and IP owners who die with an estate plan have the ability to manage their legacy and to reduce the tax bite that may consume over half of the estate's value without planning.

While most people do not have to worry about valuing their own intellectual property or the value of their image or likeness, these assets may constitute the bulk of artists' estates. A wealthy person who dies without an estate plan supported by the requisite instruments is inviting financial waste, confusion and strained family relationships, but with artists, the risk is both magnified and played out in public. Unlike the death of a real estate tycoon, the intestate death of an artist may severely compromise the viability of the artist's creative legacy. At best, an estate may be left in the hands of legal heirs who have no idea what the artist wanted to happen with their creative works. At worst, an artist's creative legacy may be left to virtual strangers, motivated by short-term greed, who do not share or value the artist's vision or legacy.

Celebrity Estate Law- Not a Narrow Field:

Probate and estate law, similar to entertainment law, is not a narrow field. It intersects with **f**amily**, t**ax**, l**itigation, corporate, finance, real estate, and intellectual property law. For estates of artists, the work required of intellectual property and entertainment lawyers (related to identifying, protecting, and valuing copyrights, trademarks, the right of publicity, and rights of privacy) can far outweigh the expertise needed by the probate and estate lawyers. Intellectual property and entertainment lawyers also need to know the law governing the particular estate assets such as music, film, TV, and other media, and state laws with respect to specific intellectual property concepts. State law controls probate proceedings with respect to the disposition of property. In the event of intestate death, the state law governing intestate succession, in effect, provides a will. Note California Probate Code Section: 6400-64 and Minnesota Statutes: 524.2-101 (the State in which the authors reside).

Estate Plan Basics

Though this article addresses legal issues that have a particular impact on celebrity estates, every estate should consider the following estate planning basics:

Living will: A health care directive (living will) should be discussed and documented, as desired by a client, and as required under state law. A copy should be placed on file at the client's hospital and with the person or persons named by the client to make healthcare decisions. Living wills are a good idea for everyone, but especially for celebrities, as without a living will an artist in failing health could end up being declared incompetent in very public court proceedings.

Financial powers of attorney: In the event of disability, an individual may empower another (or others) as attorney-in-fact with certain designated authority or plenary powers to assist with conducting personal and business affairs. As with living wills, this may be particularly well advised for artists and other celebrities who would not want financial matters to be displayed in public records through a conservatorship should they become incompetent to handle their own legal affairs.

Will and trusts:
The disposition of the assets and other directives upon disability or death is a particularly creative and potentially complicated matter when dealing with celebrity estates. Above all else, beneficiary designation is critical, because the beneficiaries will ultimately influence and control many of the decisions about how the estate is managed both before and after the assets are distributed. As with all estates, one must make sure that the ownership and beneficiary designations of all assets are consistently structured to accomplish the goals incorporated into the estate planning documents. Each state has its own statutes for achieving non-probate transfers with common techniques including payable on death designations for bank accounts, transfer on death designations for securities and brokerage accounts, various types of deeds for real estate, assignment documents for tangible and intangible personal property, and entity documents for business interests. It is also helpful to include a statement about the artist's own vision for how his or her legacy will be managed. While such a vision statement may not be enforceable upon the heirs under state law, it can help to direct heirs who wish to preserve their loved one's legacy in a manner consistent with their wishes.

Asset Inventory:
The first step is to determine the client's financial position, family and financial priorities, and legacy goals. Determining a client's overall assets is growing increasingly more complex. While it is easy to assess a client's real estate, bank accounts and interests in various investments and companies, clients rarely have a complete inventory of intellectual property, copyrights, trademarks, rights to publicity and derivative works both domestic and international. Once you have a complete picture of a client's overall assets inventory that is when the complicated task of putting a value on those assets begins. The assets, liabilities, and rough value of the assets must be determined to identify the overall net worth of the client. Valuation can be a major challenge for creative works or unique items owned by the creator. Copyright and trademark valuation is particularly tricky. If the estate is in excess of the federal estate tax exemption ($11.2 million in 2018) or the state exemption (as low as $1 million in states that have a separate estate tax), there should be transfer tax discussions and planning included in the overall plan. The estate exemption is the amount a client can transfer from the estate tax-free to individuals and in an unlimited amount to a surviving spouse or qualified charities. Steps should be taken to assure the estate tax exemption is fully utilized at the first death and that the survivor's estate is not unduly burdened with additional wealth taxed upon the survivor's death. In order to avoid a costly fight with the IRS on the value of an estate, an artist may want employ gifting techniques to remove these assets from their taxable

estate. Many times the value of these assets increases after death so there can be significant advantages to removing them while the artist is still alive. Further discussion of transfer tax planning is important but beyond the scope of this article.

Administration:
A technique for disposition is the establishment of a private foundation. The foundation typically receives its major funding from one donor but must benefit the public in order to receive tax-exempt status. A foundation may be funded with the property itself or by the proceeds of the sale. To avoid probate, many plans are structured with a revocable living trust, which is recognized in all 50 states. Property can be transferred into the trust during one's lifetime and if the individual becomes incapacitated or dies, the trustee can sell or donate the property to benefit the intended beneficiaries. With intellectual property, it is important to appoint a personal representative (executor) or other agent who is knowledgeable about the client's talent, expertise, and work product. It is important for a personal representative to recognize that he or she serves in a fiduciary capacity and must protect the beneficiary's interests. To be helpful, the owner/artist might approach organizations ahead of time about accepting his or her work. An artist may wish to discard any work the artist does not want to be made public. Without guidance from the artist, it can be very difficult for personal representatives, families, or beneficiaries to make those decisions.

Intestacy:
Passing intestate can lead to unintended beneficiaries, limited ability to direct charitable goals, and substantial estate tax liability. The transfer methods, documents, and planning involved in a basic estate plan are the primary cost-saving methods to reduce estate tax liability. With those options unavailable post-mortem, the personal representative may attempt to reduce the estate tax through the available deductions provided for estates, especially the charitable deduction, which permits a deduction up to the full value of the estate.

Estate Valuation and Taxes

Generally, the estate tax return, IRS Form 706, is due nine months after the date of death. A six-month extension is available if requested prior to the due date and the estimated amount of tax is paid before the initial due date. There is no option to pay taxes after the income is earned and collected. Federal and state income taxes paid from earnings while individuals (or their loan-out entities) are alive can be calculated retroactively based on income accrued during the prior year. Estate taxes calculated on IP held in an artist's estate require the estate administrator to determine its value at the time of death. This valuation is an estimate as it contemplates the unknown actual value of future income streams from IP exploitations. There are no tax refunds if the actual revenues and costs of managing and administering such IP proves incorrect. For estate tax purposes, based on a fair market value standard, the valuation occurs, by election, either on the date of death or six months afterward. Fair market value is the price at which the property would change hands between a willing buyer and a willing seller.

Prince estate example:
The music artist Prince unfortunately and famously died intestate in April of 2016 as a resident of Minnesota. His known works are important music treasures. He is also known for his unreleased "vault" recordings. He fought his recording and publishing companies to achieve independence. Consequently, he owned and/or controlled many of his own compositions and recordings from his vast catalog of music and videos. Though the inventory has not been reported, it is possible the majority of these recordings were never released to the public during his lifetime. While it is difficult enough to predict the future royalty revenue from known recordings like

"Little Red Corvette," to estimate the value of royalties for songs that neither have been heard nor generated revenue, requires very broad assumptions.

Because Prince died intestate, his estate is exposed to maximum estate taxes. With an estate worth up to an estimated $300,000,000 (the maximum estimated value reported by the press) taxes are certain to consume the majority of the estate, with the government essentially becoming his biggest heir. State estate taxes are estimated, paid and deducted from the value of the estate prior to calculating the federal level estate tax. Under this value assumption and calculation, Minnesota would receive approximately $47.5M in estate tax. The IRS allows a federal exclusion of up to $5,540,000 from the remaining estate. This would leave a federally taxable estate value of approximately $247,000,000. After applying the 40% federal estate tax rate, which would approximate $99,000,000, the combined federal and state estate taxes alone would be more than $146,000,000 or almost half of the $300MM estate. In addition, the estate would be obligated to pay legal fees, accounting fees, management costs, administration costs and ongoing operating expenses required to maintain the business of the estate. These costs are necessary to enable the estate to generate the income on which the estimated estate tax is based. Furthermore, ongoing applicable state and federal capital gain and income taxes will be owed by the estate and/or heirs on royalties and other income earned on the estate's assets. Combined, the estate taxes, income taxes, fees, professional services, and related expenses will easily consume the majority, or potentially the vast majority, of the value of the estate on the date of death.

Termination of Copyright Transfers and Estates

Termination rights under the U.S. Copyright Act:

Termination rights have created a method to recapture valuable copyrights in musical compositions (songwriting) and sound recordings (recordings of performances of compositions). This right can be a part of an inter vivos or post mortem estate. Many music artists are using the termination right as a method of estate planning as they relocate the administration of copyrights or renegotiate their contractual relationship with their recording and publishing companies. The U.S. Copyright Act (the "Act"), 17 U.S.C. §§ 203 and 304, permits authors or if the authors have passed, their surviving spouses, children or grandchildren (or their executors, administrators, personal representatives or trustees) to terminate the exclusive or non-exclusive grant of a transfer or license of copyright (including both music composition and sound recording copyrights). Termination only affects U.S. copyrights. As a result, the right to collect and administer foreign income shall continue as provided under existing agreements.

Grants executed on or after January 1, 1978:

In the case of an exclusive or non-exclusive grant of a transfer or license of any right under copyright executed by the author on or after January 1, 1978, Section 203 of the Copyright Act provides that notices of termination may be served no earlier than 25 years after the execution of the grant or, if the grant covers the right of publication, no earlier than 30 years after the execution of the grant or 25 years after publication under the grant, whichever comes first. However, termination of a grant cannot be effective until 35 years after the execution of the grant or, if the grant covers the right of publication, no earlier than 40 years after the execution of the grant or 35 years after publication under the grant, whichever comes first. The notice of termination under Section 203 must state the effective date of termination, which shall fall within the five-year period specified above, and the notice shall be served not less than two or more than ten years before the effective date of termination. A copy of the notice must be recorded in the copyright office before the effective date of

termination as a condition to its taking effect. Termination of the transfer may be affected notwithstanding any agreement to the contrary, including an agreement to make a will or a future grant.

Because of the foregoing, the effective date of the termination of a transfer of copyright executed, for example, on January 1, 1979 is January 1, 2014. The window in which an author (or his surviving spouse and/or children) may serve a notice of termination of this transfer of copyright is January 1, 2004 (or 10 years before the effective date of termination) and January 1, 2012 (or 2 years before the effective date of termination). The five-year cure period would allow a termination to be served and filed in September 2015, but the effective date of termination would not occur until September 2017.

Grants executed prior to January 1, 1978:

In the case of an exclusive or non-exclusive grant of a transfer or license of any right under copyright that is in its first or renewal term prior to January 1, 1978 and which was executed by the author prior to January 1, 1978, Section 304 of the Copyright Act provides that notices of termination may be effected at any time during a period of five years beginning at the end of fifty-six years from the date the copyright was originally secured, or beginning on January 1, 1978, whichever is later. The termination shall be effected by serving an advance notice in writing upon the grantee or the grantee's successor in title. The notice must state the effective date of the termination which will fall within the five-year period specified above or, in the case of copyrights which have expired on or before the effective date of the Sonny Bono Copyright Term Extension Act, within the five-year period specified in that amendment with the notice served not less than or more than ten years before the effective date of termination under that amendment. A copy of the notice must be recorded in the copyright office before the effective date of termination as a condition to its taking effect. Termination of the transfer may be effected notwithstanding any agreement to the contrary, including an agreement to make a will or a future grant.

Because of the foregoing, the effective date of the termination of a transfer of copyright originally secured, for example, on January 1, 1960, is January 1, 2016. Notice for such a transfer should have been served on or before January 1, 2014 to take advantage of the 56-year reversion term. The five-year cure period would allow a termination to be served and filed in September 2015, but the effective date of termination would not occur until September 2017.

Estates and control of the right to terminate:

The person or entity that controls the termination right under both Section 203 and Section 304 of the Act depends on whether the author survives to termination vesting. If the author survives to the vesting of the termination right, the author has the right to the reversion of the granted interest. The termination right vests upon the service of a termination notice on the transferee of the interest in the work. This means that if the author serves a notice of termination, but dies before effective date termination occurs, the author's estate, and not his or her statutory successors, takes the reversion.

However, if the author fails to exercise the termination right during his lifetime (i.e. does not serve a notice of termination), the author has no ability to change the statutory structure under which a surviving spouse and/or descendants own and control the termination right. For example, if the author merely survives to a date at which he or she could serve a termination notice, but dies without serving one, the statutory successors, and not the author's estate, gain the right to serve such a notice and to enjoy the interests that subsequently revert by reason of such notice. Similarly, if the author dies before the rights subject to termination have been vested in

him or her by such termination, the author's termination interest passes to the statutory successors, and not the author's estate, under the statutory provisions, which govern who control the termination rights at issue. See Lloyd J. Jassin, Copyright Termination is an Author Right: Use it or Lose it, COPYLAW.ORG (Mar. 28, 2010), http://www.copylaw.org/2010/03/copyright-alert-notice-of-termination.html (Because Miles Davis died before serving a termination notice, copyright reversion vested in children who were not included in Davis' will.)

The impact on successors:

Where the statutory successor provision applies, a surviving spouse owns the entire termination interest if the author has left no surviving children or grandchildren. If the author has left surviving children or grandchildren, the surviving spouse owns one-half of the termination interest and the surviving children or grandchildren own one-half of the termination interest, with that one-half interest equally divided among the children. If there is no surviving spouse, the children own the entire termination interest to be equally divided among them pursuant to 17 U.S.C. §§ 203(a)(2)(C). Although the rights of the termination do not revert until the termination date specified in the notice of termination, the rights of those who are recipients of the terminated rights vests upon the date the notice of termination is served. Therefore, the class of those who may claim as recipients of the terminated rights is determined as of the date the termination notice is served. See, 3 Nimmer on Copyright, Statutory Termination of Transfers and Non-Exclusive Licenses: Who Has The Right To Terminate? § 11.03 (Rel. 8/2005) for a thorough discussion.

Descending Rights of Publicity

Regarding a descending right of publicity (the right to control and monetize an artist's name and likeness), it matters where clients live and die. State rules regarding an inheritable right of publicity can also be particularly difficult to value. The majority of states recognize some right of publicity and a descendible (inheritable) right. For example, California offers protections for both during life and after death. The valuation of the publicity rights has become a major fight for the Michael Jackson and other California-based artist's estates. Michael Jackson's administrators pegged the value of his name and likeness at $2,015. The IRS challenged that number, instead valuing it at $434.26 million. Though Michael died in 2010, the valuation is still being litigated.

Some states have laws that protect a descending right of publicity for beneficiaries or heirs that enable heirs to release new recordings, use an artist's likeness and exploit other intellectual property. However, the IRS is ready to tax the unknown value of recordings. In California, a descending right of publicity is set forth in the State's Civil Code. Section 3344.1 offers a remedy for those beneficiaries or heirs of a person's estate for when a person's "name, voice signature, photograph, or likeness, in any manner," is used in connection with advertising, selling or soliciting any products or services. The injured party has the right to profits from any sale that took place, which requires only that the injured party present proof of gross revenue attributable to the use of the deceased's likeness, etc. The defendant is tasked with proving her deductible expenses. Importantly, punitive damages may be awarded to the injured party. Some states have no such descendible right of publicity, including New York, while other state courts or legislatures have yet to consider the question. Following Prince's death, a bill formally recognizing a descending right of publicity was introduced in the Minnesota legislature but did not pass. Clearly, the passing of such an act would create additional and taxable value to Prince's estate. See Milton H. Greene Archives, Inc. v. CMG Worldwide, Inc., 568 F.Supp. 2d 1152 (C.D. Cal. 2008) (doctrine of judicial estoppel bars claim by beneficiary of the Estate of Marilyn Monroe that Monroe was domiciled in California on the date of her death where Monroe's tax representatives had claimed residence in New York, as opposed to California, for tax purposes.)

Right of publicity valuation:

In Estate of Andrews, 850 F. Supp. 1279 (E.D. Va. 1994) dealt with the right of publicity for federal estate tax purposes, the court agreed with the IRS position that "name and likeness" was an asset that can be valued for estate tax purposes but disagreed with the IRS position on how to value the asset. In this case involving the estate of a well-known author, the valuation issue focused on the rights of the estate to hire a ghostwriter to write the books that the author had agreed to produce but had not completed prior to death. A ghostwriter was hired who wrote several successful books, and the IRS argued that the estate tax valuation should be based on the actual value of all of the books written after the taxpayer's death. The court instead determined that the value should be based on facts known at the date of death, which was what a willing buyer and a seller would have negotiated based on the possibilities for success or failure of the first book. There have been no reported cases since then, although there continues to be a risk that the IRS would assess an estate tax value for the right of publicity of prominent clients.

Holographic resurrection of artists:

New ideas test the boundaries of the descending right to publicity as technology develops and new methods of creating art expand. In 2014, Michael Jackson "appeared" and "performed" at the 2014 Billboard Music Awards™ in Las Vegas, Nevada as a hologram, and discussions and plans seem to be in the mix for a world tour featuring Michael Jackson's hologram. Tupac, Patsy Cline, and Whitney Houston are other musicians who were or will be introduced as holograms in shows developed and managed by HologramUSA. Holograms then influenced how artists and studios contract and interact with one another, and now, CGI and digitally resurrecting deceased actors in film are on the table. In Rogue One: A Star Wars Story™, Peter Cushing returned to film with more than a handful of lines through digital resurrection – utilizing his image and voice to create a realistic presence and performance. It is doubtful that when Peter Cushing first entered into an agreement that the idea of digital resurrection was a topic of negotiation. In this new expanse, attorneys and artistic clients will need to look further into the future to protect the rights of their descendants to use their image and likeness into unknown technological areas.

Conclusion

The aging Baby Boom generation of music artists has created legacies indelibly etched into the lexicon of rock and roll and other genres. Great artists will unfortunately continue to pass on. However, their creative works will survive for the duration of copyright and trademark protection and beyond. These unique intellectual property assets must be understood as a part of estate planning and protecting an artist's assets, finances and legacy. Planning must contemplate unconventional intellectual property assets, valuation and tax consequences. The impact of termination of transfers of copyright and rights of publicity, if any, must also be considered when estate planning. Estate valuation and tax minimization strategy can greatly affect the viability of a creative estate. Intestacy should be proactively avoided.

Ken Abdo ,**Sarah Wentz** are partners with Fox Rothschild, LLP's Minneapolis office, whose experience includes working with a large variety of musicians, actors and other artists (living and deceased) including the estates of Prince, Muddy Waters, Bill Haley, Count Basie. Copyright termination law contributions by Tim Matson, Esq., Fox Rothschild, Minneapolis. Tax law contributions by **Gina DeConcini**, tax attorney at Moss and Barnett, Minneapolis. Research assistance provided by **J.T. Schuweiler, Esq.,** Fox Rothschild, Minneapolis and **Jacob Abdo, Esq.,** Los Angeles.