April 2014

Saving the Next Superman: An Alternative Approach to the Taxation of Copyright Termination Rights

Benjamin Newell

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SAVING THE NEXT SUPERMAN: AN ALTERNATIVE APPROACH TO THE TAXATION OF COPYRIGHT TERMINATION RIGHTS

Benjamin Newell

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I. INTRODUCTION

What if Jerome Siegel had known that a substantial amount of his estate would be depleted with the inclusion of his heirs' future interest in the Superman copyright because the right affords no ability to pay the tax? Would he have sold Superman to DC Comics in 1938—a transaction that led to the proliferation and mass appeal of the Superman character—or would he have retained the copyright, or not even pursued the creation of Superman in the first place? The adage "what you don't know, can't hurt you" is operative here because the transaction took place before the implementation of the Copyright Act of 1976 (the 1976 Act), which statutorily creates termination rights for authors and their heirs upon the disposition of a copyright. However, the author of the next Superman may be more hesitant to sell her copyright, and on the margin the adverse estate tax consequences could incentivize hoarding the copyright. Alternatively, authors and their heirs may devise settlement agreements like those in Larson v. Warner Bros. Entm't Inc., which effectively circumvent the policy goal behind the 1976 Act to protect authors and their heirs.

Part II of this Note explains how copyright termination rights are created and the effects of those rights on both authors and their heirs. Part II also describes the statutory framework governing the inheritance of termination rights and the mechanics of heirs' voting powers under the 1976 Act. It further discusses the basic estate tax assessment rules and the imputation of a

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5 Bridget J. Crawford & Mitchell M. Gans, Sticky Copyrights: Discriminatory Tax Restraints on the Transfer of Intellectual Property, 67 WASH. & LEE L. REV. 74 (2010) ("Enforcement of the wealth transfer tax system would lead to an inefficient hoarding of intellectual property, as creative individuals would seek to minimize their tax exposure.").
6 See H.R. REP. No. 94-1476, at 124 (1976), reprinted in 1976 U.S.C.C.A.N. 5659, 5740 ("The provisions of [17 U.S.C. §] 203 are ... based on the premise ... [of] safeguarding authors against unremunerative transfers ... [and] are needed because of the unequal bargaining position of authors ... [due to] the impossibility of determining a word's value until it has been exploited.").
"stepped-up basis." Finally, Part II will examine how this stepped-up basis affects the income tax consequences of heirs who, after exercising termination rights, reassign a copyright.

Part III first considers the income tax implications of the Internal Revenue Service’s failure to assess an estate tax upon the inheritance of termination rights. This section discusses the problems of liquidity, ability to pay, valuation, and fairness inherent in any potential assessment of an estate tax. It then poses an alternative approach to govern where (1) no estate tax is assessed, (2) no stepped-up basis is created, and (3) the heirs are instead treated as if they took the place of the author for income tax purposes on the reassignment of a recaptured copyright. This alternative approach avoids the tax enforcement problems inherent in the current system, mitigates distortions in the behavior of taxpayers, and ensures that tax consequences optimally approximate economic realities.

II. BACKGROUND

A. INALIENABLE TERMINATION RIGHTS FOR AUTHORS AND HEIRS

When an author produces a creative work, she becomes entitled to a copyright in relation to that work. However, this is not the case when an author produces a creative work while being employed to do so. Although an author is not required to register a creative work for the copyright to vest, registration is a prerequisite to an award of statutory damages in infringement suits. Once produced, a work is protected for the author’s life plus seventy years. Although an author has the exclusive right to freely transfer a copyright or interests therein subject to the life of the copyright, termination rights significantly limit the rights an assignee acquires in a copyright.

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9 Id. § 61(a)(3), (6).
10 See Crawford & Gans, supra note 5, at 74 (“To date, the Service has not sought to enforce any... tax consequences of [termination rights].”).
12 Id. § 201(b).
13 Id. § 408(a).
14 Id. § 412.
15 Id. § 302(a).
16 Id. § 201(d).
17 Id. §§ 203, 304(c).
The Copyright Act of 1976 went into effect on January 1, 1978.\textsuperscript{18} The rules governing copyright termination rights, as promulgated in the 1976 Act, are codified in §§ 203 and 304(c).\textsuperscript{19} The purpose underlying termination rights is to protect authors of creative works and their heirs when the value of the creative work is unknowable or when the buyer of the copyright, usually an institution, has substantially greater bargaining power in the original transaction.\textsuperscript{20} Section 203 effectuates this purpose by allowing authors or their heirs to "terminate" the agreement that originally transferred the copyright.\textsuperscript{21} Furthermore, even if an author purportedly transfers his rights to a creative work for "the remaining life of the copyright," § 203 renders such clauses void beginning thirty-five years after the transfer, once the author or his heirs have exercised the termination right.\textsuperscript{22} Additionally, the 1976 Act does not give any legal effect to transfers by authors or heirs purporting to dispose of termination rights; that is, termination rights are inalienable.\textsuperscript{23}

By providing that a termination right may be exercised thirty-five years after the initial transfer of a copyright,\textsuperscript{24} the 1976 Act ensures that the copyright is more accurately valued based on its performance in the market during that thirty-five year period.\textsuperscript{25} Accordingly, this symmetry of information places authors and heirs on relatively more equal footing with institutional buyers when they seek to terminate the pre-existing copyright agreement, and subsequently reassign the copyright.\textsuperscript{26} In order to recapture the copyright, the author's heirs must first elect to do so under the voting rules provided in § 203.

\textsuperscript{18} Copyright Act of 1976, Pub. L. No. 94-553, § 102, 90 Stat. 2541, 2592.
\textsuperscript{19} 17 U.S.C. §§ 203, 304(c). Section 304(a) applies to copyrights in "the first or renewal term on January 1, 1978" that are subject to "a transfer or license...executed before January 1, 1978." Id. § 304(c). Section 203 applies solely to transfers executed "on or after January 1, 1978." Id. § 203(a).
\textsuperscript{20} See Peter S. Menell & David Nimmer, Pooh-Poohing Copyright Law's "Inalienable" Termination Rights, 57 J. COPYRIGHT Soc'y U.S.A. 799, 802 (2010) ("Congress has sought to protect authors and their families by allowing them to grant their copyrights for exploitation and then, decades later, recapture those same rights.").
\textsuperscript{21} 17 U.S.C. § 203(a)(1)-(2).
\textsuperscript{22} Id. § 203(a)(3), (5) ("Termination of the grant may be effected notwithstanding any agreement to the contrary, including an agreement to make a will or to make any future grant." (emphasis added)).
\textsuperscript{23} Id. § 203(a)(5); see also Menell & Nimmer, supra note 20, at 807 (construing identical language in § 304(c)(5) as congressional intent to render this "scheme inalienable").
\textsuperscript{24} 17 U.S.C. § 203(a)(3).
\textsuperscript{25} See Corcovado Music Corp. v. Hollis Music, Inc., 981 F.2d 679, 683 (2d Cir. 1993) ("[U]nlike real property and other forms of personal property, a copyright is by its very nature incapable of accurate monetary evaluation prior to its exploitation." (alterations in original) (quoting 2 Melville B. Nimmer & David Nimmer, Nimmer on Copyright § 9.02 (1989))).
\textsuperscript{26} See Milne ex rel. Coyne v. Stephen Slesinger, Inc., 430 F.3d 1036, 1046 (9th Cir. 2005) ("The
B. EXERCISE OF TERMINATION RIGHTS BY HEIRS

When an author dies before the “termination window” ends, § 203 determines how the interests in a termination right are divided among the author’s surviving heirs. This division operates without regard to other federal or state inheritance laws and nullifies any testamentary dispositions of termination rights by the author. Likewise, the same result would follow if a statutory heir attempted to dispose of his or her termination right via testation.

Section 203 provides that if only a spouse survives an author, the spouse becomes entitled to the entire interest in the author’s termination right. However, if children also survive the author, the spouse receives a one-half interest and the remaining one-half interest is divided among the surviving children. If a child of the author predeceases the author, but that child’s children survive both the parent and the author, those children will be entitled to their parent’s interest on a “per stirpes” basis. Alternatively, if the author is only survived by his children, or the children of any deceased child, those remaining heirs will become entitled to the entire interest in the termination right on a per stirpes basis. Otherwise, if the author is not survived by a spouse, children, or grandchildren, the entire termination interest passes to “the author’s executor, administrator, personal representative, or trustee.”

In order to terminate an original copyright disposition during the termination window, a majority of an author’s heirs, as defined by their rationale behind the legislation was to ‘safeguard[] authors against unremunerative transfers’ and improve the ‘bargaining position of authors’ by giving them a second chance to negotiate more advantageous grants in their works after the works had been sufficiently ‘exploited’ to determine their ‘value.’” (alteration in original) (quoting H.R. REP. No. 94-1476, at 124 (1976), reprinted in 1976 U.S.C.C.A.N. 5659, 5740)).

27 17 U.S.C. § 203(a)(3) (“Termination of the grant may be effected at any time during a period of five years beginning at the end of thirty-five years from the date of execution of the grant . . . .”).

28 Id. § 203(a)(2).

29 See Menell & Nimmer, supra note 20, at 819 (“Notwithstanding . . . testamentary dispositions, Congress vested the right to terminate transfers automatically in the author’s statutory successors . . . .”).

30 Id. at 813–14.


32 Id. § 203(a)(2)(B).

33 In a “per stirpes” distribution, the interest is proportionately divided between beneficiaries according to their deceased ancestor’s share. BLACK’S LAW DICTIONARY 1260 (9th ed. 2009).


35 Id.

36 Id. § 203(a)(2)(D).
statutory interest, must elect to exercise the termination right. For example, if a spouse and three children survive an author, the spouse and at least one child must elect to exercise the termination right. The spouse acting alone, or the three children acting in unison, could not exercise the right, since they would only represent one-half of the termination interest.

With an established framework for the rules surrounding the inheritance of a termination right, this Note next explores the rules governing the tax consequences of that same event.

C. THE ESTATE TAX ON THE PRESENT VALUE OF TERMINATION RIGHTS

As a general rule, the Internal Revenue Service (the Service) assesses an estate tax based on the fair market value of a decedent’s gross estate at the time of death. The gross estate includes “all property, real or personal, tangible or intangible, wherever situated,” including all property in which the decedent has an interest.

Because the termination right is a kind of intangible property, it presumably is includable in the gross estate of the author. While no cases specifically state whether a termination right is one of the intangible property interests contemplated by §2031, the law is well-established that, in general, future interests in property are includable in the gross estate. For example, in Estate of Raimondi v. Commissioner, in which the decedent had remainder interests in three real properties, the Tax Court held that, under §2031, those remainder interests were includable in the gross estate for estate tax purposes.

When future property interests are included in the gross estate, the estate must pay an estate tax thereon based on the asset’s present value, which is calculated by evaluating its fair market value at the date of the decedent’s death. For example, in Estate of Shackleford v. United States, where the
decedent was entitled to non-assignable future annual payments pursuant to his lottery award, the district court held that the present value of the future lottery payments should be included in the gross estate, which was to be calculated based on the fair market value of the stream of payments. The court also concluded that, even though no actual market could exist for a non-assignable right, it "must assume the existence of a valid hypothetical sale."

An exception to the estate tax assessment is that a certain base amount of the gross estate is excludable from the estate tax. Pursuant to the American Taxpayer Relief Act of 2012, that exclusion amount is five million dollars, adjusted for inflation, with 2011 as the base year. However, Congress modifies the estate tax exclusion frequently and with substantial magnitude. For example, in 1978 the exclusion amount was $134,000. Thus, while the current exclusion is currently $5,250,000, Congress might reduce it substantially in the future in response to either tax revenue shortages from other sources or a general increase in overall governmental spending. At any rate, since the relevant period for determining the estate tax liability exclusion available to heirs who are currently recapturing and reassigning copyrights is the date of the author’s death, the exclusion applicable at that time will apply to the inheritance of termination rights.

Another key exception to estate tax liability is the marital deduction, sometimes referred to as the “unlimited marital deduction.” When a spouse

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48 Id. at *5.
52 Id. at *5.
54 Jacobson et al., supra note 53, at 122 fig.D.
55 I.R.S. News Release IR-2013-4 (Jan. 11, 2013) (“Estates of decedents who die during 2013 have a basic exclusion amount of $5,250,000, up from . . . $5,120,000 . . . in 2012.”).
56 See Glenn Ruffenach, Coming Soon: More Estate-Tax Battles, MARKET WATCH BLOG (Apr. 29, 2013, 12:09 PM), http://blogs.marketwatch.com/encore/2013/04/29/coming-soon-more-estate -tax-battles/ (discussing President Barak Obama’s budget plan for the 2014 fiscal year, which calls for a reduction in the estate tax exemption to $3.5 million in conjunction with the government’s greater need for revenue).
58 Id. § 2056(a).
inherits the property interest of her deceased spouse, no estate tax liability is assessed on that property to the extent it came from the deceased spouse.60

In the case of termination rights, because a surviving spouse receives a statutory interest in her deceased spouse’s termination right,61 the marital deduction would apply to the extent of the surviving spouse’s interest.62 Three possible scenarios ensue. First, where a deceased author is survived by a spouse and no children or other statutory heirs, the surviving spouse would acquire the entire interest in the termination right and thus the marital deduction would apply to the entire value, hence no estate tax would be assessed on the value of the termination right.63 Second, if a deceased author is survived by a spouse and children or other statutory heirs, the surviving spouse would acquire a one-half interest in the termination right and the marital deduction would apply to fifty percent of the value, with an estate tax assessed on the other fifty percent.64 Finally, where a deceased author is not survived by a spouse, the marital deduction would not apply.65

Once a property interest is included in the gross estate, the heirs then attain a stepped-up basis66 in that property interest, which lowers the income tax liability upon the disposition of the property interest.67

D. THE ADVANTAGE OF A STEPPED-UP BASIS

When property is disposed of, the gain or loss on that transaction is determined by subtracting the “adjusted basis”68 from the “amount realized.”69 The amount realized is typically the sale price or, in a transaction involving a future payment or stream of payments, the present value of those payments.70

59 BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION INCOME, ESTATE & GIFTS ¶ 129.6 (2013).
66 The stepped-up basis is “[t]he beneficiary’s basis in property transitory by inheritance, equating the fair market value of the property on the date of the decedent’s death or on the alternate valuation date.” BLACK’S LAW DICTIONARY 172 (9th ed. 2009).
68 The adjusted basis is the “[b]asis increased by capital improvement and decreased by depreciation deductions.” BLACK’S LAW DICTIONARY 171 (9th ed. 2009).
70 Id. § 1001(b); Treas. Reg. § 1.1001-1(a) (2013).
Often, a grantee’s adjusted basis will differ from the grantor’s. In the case of an author, the adjusted basis is derived from the costs she expended in creating the copyrighted work.\textsuperscript{71} However, an author is not allowed to incorporate the value of her own time spent in the creation of the copyrighted work, which typically represents most, if not all, of the work’s value.\textsuperscript{72} For example, in \textit{Maniscalco v. Commissioner}, the Sixth Circuit disallowed a charitable deduction for a professional artist who sought to offset his “cost basis” in three of his paintings that he had donated.\textsuperscript{73} The court, after finding that “[t]he value of [the] paintings was attributable almost exclusively to the creative labor of the taxpayer,”\textsuperscript{74} held that the artist's labor was not the type of expense that could give rise to a cost basis.\textsuperscript{75}

In the case of an heir, the adjusted basis is equal to the “stepped-up basis” in the property acquired from the deceased author.\textsuperscript{76} The stepped-up basis is calculated as “the fair market value of the property at the date of the decedent’s death.”\textsuperscript{77} This is equivalent to the calculation used to determine an asset’s present value for estate tax purposes.\textsuperscript{78} For example, in \textit{Levin v. United States}, the taxpayer inherited a promissory note that entitled her to a stream of future payments, on which an estate tax equal to the fair market value of the note at the decedent’s death had been paid.\textsuperscript{79} The First Circuit held that “the estate tax valuation” is the measure used to establish the heir’s adjusted basis in the note for income tax purposes.\textsuperscript{80}

While the value at which an estate tax is assessed on a property interest gives rise to the heir’s stepped-up basis in that property interest, non-payment of the estate tax, seemingly, does not preclude the stepped-up basis in the case of termination rights.

\textsuperscript{71} See 26 U.S.C. § 1012(a) (“The basis of property shall be the cost of such property . . . .”).
\textsuperscript{73} \textit{Maniscalco v. Comm’r}, 632 F.2d 6 (6th Cir. 1980) (per curium).
\textsuperscript{74} \textit{Id.} at 7.
\textsuperscript{75} \textit{Id.} at 7–8.
\textsuperscript{76} 26 U.S.C. § 1014.
\textsuperscript{77} \textit{Id.} § 1014(a)(1).
\textsuperscript{78} Compare Treas. Reg. § 1.1014-1(a) (2013), with Treas. Reg. § 20.2031-1(b), and supra notes 45–46 and accompanying text.
\textsuperscript{79} \textit{Levin v. United States}, 373 F.2d 434, 436–37 (1st Cir. 1967).
\textsuperscript{80} \textit{Id.} at 439.
E. BASIS IN TERMINATION RIGHTS

As mentioned previously, an author’s cost basis in creating a copyrighted work gives rise to the author’s basis in the termination right. However, in most cases the author is not permitted a cost basis with regard to her labor inputs. As with other types of reversionary interests, the basis in a termination right carries over and establishes the basis in a copyright acquired through the exercise of that termination right. For authors, whose initial cost basis in the copyrighted work was minimal, this basis continues to be negligible. However, for heirs, the stepped-up basis derived at the time of inheritance can be substantial.

Heirs can deduct the stepped-up basis they acquire in a termination right from the amount they ultimately receive upon selling the corresponding copyright. This, in turn, will reduce the income tax assessed on that transaction. For example, in Williams v. Commissioner, the estate tax assessment was based on the fair market value of a reversionary interest in a hotel the taxpayer inherited on property the taxpayer’s father had leased to a real estate developer pursuant to a ground lease, which had not yet expired at the time of the father’s death. The taxpayer sought to deduct that amount from the amount realized upon its disposition for income tax purposes. The Tax Court concluded that the estate tax valuation as to the reversionary interest incorporated the present value of the ownership rights beginning upon the ground lease’s expiration. The court then held that the taxpayer’s stepped-up basis established at the time the taxpayer acquired the reversionary interest via inheritance was also the taxpayer’s stepped-up basis in the hotel after the ground lease expired.

82 See Norton L. Steuben, The Income Tax Treatment of Interests Acquired from A Ground Lessor, 23 FLA. ST. U. L. REV. 863, 878 (1996) (construing Comm’r v. Pearson, 188 F.2d 72, 74 (5th Cir. 1951)) (deducting that although a lessor may not have a cost basis in a building constructed by a tenant pursuant to a ground lease, the lessor’s heir may acquire a stepped-up basis under 26 U.S.C. § 1014 in the reversionary interest in the building that matures upon the ground lease’s termination).
83 This is especially true where the author passes away near in time to when the termination right window begins. See generally Treas. Reg. § 20.2031-7(d)(7) & tbl.5 (2013) (establishing the extent to which time from a future interest’s maturity decreases its present value).
86 Id. at 1102–03.
87 Id. at 1105.
88 Id.
F. THE STEPPED-UP BASIS INDEPENDENT OF THE ESTATE TAX

Because the 1976 Act did not become effective until 1978, termination rights derived from the earliest copyright dispositions in 1978 did not mature until 2013. Accordingly, income taxes on re-assigned copyrights acquired via the exercise of termination rights did not become due until 2014. Thus, courts have not had the opportunity to adjudicate disputes regarding whether or not the Service will permit heirs a stepped-up basis in dispositions where the Service did not assess, and the author’s estate did not pay, an estate tax. The pivotal issue is whether a stepped-up basis in a termination right is independent from the assessment and payment of the estate tax. Related tax concepts, equitable tax doctrine, and statutory interpretation provide some guidance as to how taxpayers and the Service will approach the issue.

As a starting point, the marital deduction provides an example of the estate tax operating independently from the stepped-up basis. Where a spouse survives an author, the marital deduction precludes an estate tax assessment on the interest in any termination rights the surviving spouse acquires. Nonetheless, the surviving spouse still receives a stepped-up basis in her interest in that termination right. For example, in Patten v. United States, the taxpayer inherited her deceased husband’s interest in a parcel of real property. While the marital deduction exemplifies the mechanics of how a taxpayer can establish a stepped-up basis independent of the payment of an estate tax, the duty of consistency, an equitable tax doctrine commonly used by the Service to prevent a taxpayer from taking a position in a later period that is inconsistent with a position taken by the taxpayer in an earlier period, helps identify the legal principles

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91 See Crawford & Gans, supra note 5, at 74 (“To date, the Service has not sought to enforce any of the . . . estate tax consequences of sticky copyrights.”).
93 Id. § 1014(a)(1).
94 Patten v. United States, 116 F.3d 1029, 1031 (4th Cir. 1997).
95 Id.
underlying this dichotomy when applied to cases where the recipient of an asset is not a spouse.

The duty of consistency is particularly useful for the Service when the relevant statute of limitations has expired because it permits the Service to circumvent the statute in certain cases. The statute of limitations by which the Service must audit and assess a tax on an individual is three years from the later of the date when the tax was due or filed. However, where the taxpayer omits greater than twenty-five percent of her gross income, the statute of limitations is extended to six years. The statute of limitations applicable to the estate tax expires ten years after the decedent's date of death.

Although not every jurisdiction permits the Service's use of the duty of consistency to circumvent the statute of limitations in order to reassess tax liability, the majority of courts have recognize the doctrine. In jurisdictions that do permit the duty of consistency defense, the courts commonly utilize the Triune standard, which requires (1) the taxpayer represented or reported an item in one year, (2) the Service accepted or relied on that representation, and (3) the taxpayer seeks to alter that representation in a later year after the statute of limitations relating to the earlier year has closed. For example, in Beltzer v. United States, the taxpayer reported the fair market value of stock he inherited in 1959 as $59,713 for estate tax purposes. However, when the taxpayer later sold that stock in 1966, he claimed that the actual fair market value, and therefore the stepped-up basis, of the stock in 1959 was $118,019. After concluding that (1) the taxpayer sought to change a prior representation for tax purposes in a later year, (2) the Service had relied on that earlier representation, and (3) the statute of limitations had run, the district court held that the taxpayer was estopped from altering his earlier valuation of the stock for income tax purposes. In contrast, in Hunt v. Commissioner, the taxpayers

97 Id. at 542.
99 Id. § 6501(c)(1)(A).
100 Id. § 6324(a)(1).
101 Johnson, supra note 96, at 539–41 (“[T]he Second Circuit developed into the circuit most hostile to [the duty of consistency doctrine].” (citing McCullough v. Comm'r, 153 F.2d 345, 347 (2d Cir. 1946); Salvage v. Comm'r, 76 F.2d 112, 114 (2d Cir. 1935), aff'd, 297 U.S. 106 (1936))).
102 Id. at 539–40.
105 Id.
106 Id.
acquired the decedent's estate, which required them to pay half the estate's operating expenses. Pursuant to a settlement agreement with the Service, the taxpayers agreed to a set maximum of allowable deductions with respect to the expenses associated with the estate. Thereafter, the taxpayers sought to take interest deductions on the estate's accounts payables that accrued after the settlement in excess of the agreed maximum limit. The Tax Court, after finding that the settlement agreement was silent as to such interest deductions, held that the duty of consistency was not applicable because the taxpayers "made no affirmative representation with respect to claiming a deduction for interest paid or accrued," and therefore the taxpayer was not estopped from claiming the interest deductions.

In conjunction with the duty of consistency, direct statutory interpretation also sheds some light on how a court might textually resolve a case in which the Service has failed to assess an estate tax on the value of a termination right, but on which the heir claims an income tax deduction for the amount that should have been assessed.

Section 1014 provides that, where the executor has not elected an alternative valuation through any of subsections (a)(3)-(4), the heir's basis in inherited property is equal to its fair market value at the time of the decedent's death. The provision does not explicitly make the entitlement to a stepped-up basis contingent on the assessment or payment of an estate tax related to the inherited property. In fact, none of the relevant estate tax provisions are explicitly conditions precedent to a stepped-up basis. The regulations that provide guidance on the interpretation and application of § 1014 state that "in general, [the] basis for property acquired from a decedent [] is equal to the value placed upon such property for purposes of the Federal estate tax." Here, Treasury Regulation § 1.1014-1 refers to the value placed upon the property, rather than to the value upon which an estate tax was actually paid. The legislative history of § 1014 states that "[f]or the purposes of determining what property is given a stepped-up basis, the test is generally whether the property was included in the gross estate of the decedent." Here, the
legislative history specifies the term *included*, rather than the more encompassing term, *includable.* However, the history fails to further define the parameters of the test’s applicability. Finally, in *Treat v. Commissioner,* the taxpayer inherited real property, which for Massachusetts state estate tax purposes, she reported only fifty percent of the value that she had reported for federal estate tax purposes. She then sought to use the federal estate tax valuation as the stepped-up basis for state income tax purposes when she sold the property. The Appeals Court of Massachusetts determined that because the state tax provision incorporated federal income tax provisions, the state tax provision should be interpreted in the same way a federal court would interpret the corresponding federal tax provisions. Accordingly, the court held that the taxpayer's stepped-up basis for state income tax purposes was limited to the amount on which state estate taxes were actually paid.

Thus, while the majority of authorities suggest that a stepped-up basis is independent from remittance of an estate tax, some do support what will most likely be the Service’s position, that the two are not independent.

G. A LIQUIDITY-BASED ESTATE TAX PROPOSAL

In *Taxation Without Liquidation: Rethinking “Ability to Pay,”* Professor Pareja proposes an alternative approach to estate taxation and the establishment of a stepped-up basis of all assets that are includable in the gross estate. Under Professor Pareja’s approach, all of a decedent’s assets would be divided into two categories: (1) liquid assets, and (2) illiquid assets. Liquid assets would consist of “cash or cash equivalents,” such as publicly traded securities. Illiquid assets would consist of all other assets that are not in the former category. The estate tax and the stepped-up basis would apply as it currently does to the liquid assets. Conversely, the heir would have the choice between treating the

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117 Id.
118 Id.
120 Id. at 785.
121 Id. at 787.
122 Id. at 787–88.
124 Id.
125 Id. at 876.
126 Id.
127 Id.
illiquid assets as they currently are treated, or deferring the tax until the assets are sold by taking a zero basis in the assets upon the decedent's death.\textsuperscript{128}

III. ANALYSIS

A. UNSTOPPABLE ESTATE TAX AVOIDANCE

When an author who has previously disposed of a copyright dies, and her statutory heirs become entitled to her termination right, an estate tax based on the fair market value of the termination right at the date of the author's death is technically due.\textsuperscript{129} However, where the estate does not remit this tax, termination rights will likely escape the resulting estate tax lien\textsuperscript{130} once the statute of limitations expires.\textsuperscript{131}

In the usual testamentary transfer of assets, if the estate tax is not timely paid, a tax lien attaches to those assets until the executor of the estate pays the estate tax.\textsuperscript{132} In that event, the heirs would not receive the assets free and clear.\textsuperscript{133} However, because § 203 creates the termination rights of heirs pursuant to the death of an author but does not make the payment of an estate tax a condition precedent to the entitlement of the termination rights,\textsuperscript{134} the heirs would instantly obtain the termination rights upon the author's death, free and clear, with only the estate remaining liable for the estate tax. More precisely, because termination rights are inalienable, the Service cannot seize them to pay the estate tax.\textsuperscript{135} If the executor of the estate does not recognize that an estate tax is owed on the termination rights, and the Service does not seek payment within ten years of the author's death, the statute of limitations would preclude the Service from assessing a tax liability on the inherited termination rights at any later date.\textsuperscript{136}

The point at which an heir and the Service are likely to recognize the estate tax liability is when, after exercising the termination right and recapturing the underlying copyright, the heir re-assigns the copyright. For copyrights with a seemingly perpetual value, such as the Superman copyright, re-assignment

\textsuperscript{128} Id.

\textsuperscript{129} Treas. Reg. § 20.2031-7(a), (d)(2)(ii) (2013).

\textsuperscript{130} 26 U.S.C. § 6321 (2012).

\textsuperscript{131} Id. § 6324(a)(1).

\textsuperscript{132} Id.

\textsuperscript{133} Id. § 6324(a)(2).

\textsuperscript{134} 17 U.S.C. § 203.

\textsuperscript{135} But see 26 U.S.C. § 6334(a), (e) (precluding levy-exempt status of any assets not listed, and omitting termination rights). Thus, this result directly conflicts with the Code.

\textsuperscript{136} Id. § 6324(a)(1).
transactions could result in exceptionally high returns. After realizing such a large sum in a single tax year, the heir will most likely attempt to reduce her income tax liability. Because an income tax is assessed only on the net income from the copyright re-assignment transaction, the taxpayer will remit an income tax on the amount realized from the transaction after reducing it by the adjusted basis in the copyright. The relevant adjusted basis is the stepped-up basis of the transaction right under §1014. The question in this situation is whether the heir should be allowed to reduce her income tax liability by an amount equal to her stepped-up basis in a termination right on which no estate tax was paid.

If the heir seeks to utilize the stepped-up basis to reduce her income tax liability within ten years of the author’s death, the statute of limitations will remain open and the Service may revise its tax assessment of the estate, in which the termination right was included. In this scenario, while the Service would not be able to obtain a tax lien that would attach to the termination right or underlying copyright, the Service could obtain a lien based on the value of the termination right that would attach to other assets in the author’s estate.

Because termination rights only mature thirty-five years after the author’s initial disposition of a copyright, a situation in which the author passes away within twenty-five years after this disposition would not be uncommon. Accordingly, where the statute of limitations has expired after the ten-year mark, the Service may seek to circumvent the statute in order to maintain the integrity of the relationship between the estate tax, the stepped-up basis, and the income tax. In order to reassess the estate tax attributable to the value of a termination right when the statute of limitations has expired, the Service will likely make an equitable argument relying on the duty of consistency.

Since authors and heirs will recapture and reassign copyrights under §203 for the first time in 2013, the Service has not yet pursued litigation relating to 2013 income tax returns that incorporate the proceeds from such a transaction. However, based on the particular facts surrounding termination rights, the Service’s duty of consistency argument will most likely fail and the courts will not force the relevant estates to remit estate tax payments once the statute of

139 Id.
140 Id. §6665.
141 Id. §6324(a)(1).
142 17 U.S.C. §203(a)(3); see also supra text accompanying notes 19–22.
limitations has expired. Just as the taxpayers in Hunt remained silent on the taxable value of interest deductions in their estate tax settlement agreement with the Service, so too have executors of estates that include termination rights remained silent with respect to claims of the taxable value of those termination rights. Unlike the taxpayer in Beltzer, who made an affirmative representation of the value of his stock for estate tax purposes, and then later asserted a higher value with respect to the stepped-up basis in the stock for income tax purposes when he sold it, executors have *passively* presumed the non-existence of any estate tax liability stemming from termination rights. Because executors have passively failed to acknowledge a tax liability in relation to the inheritance of termination rights, the heirs then may seek to establish a value of the stepped-up basis. This is distinguishable from a situation in which the heirs actively assert one (lower) value at the time the estate tax is assessed and then assert another (higher) value for the purpose of reducing income tax liability upon disposition. Accordingly, a duty of consistency argument is precluded because there would be no inconsistency. Thus, the reality of termination right inheritance, where executors have failed to remit an estate tax, more closely resembles the facts of Hunt. If Hunt governs, the courts will not permit the Service to reassess an estate tax liability based on the duty of consistency after the statute of limitations closes.

Under the peculiar facts that surround termination rights, the Service and the Code will often fail to ensure that the tax consequences associated with the reassignment of copyrights under § 203 reflect economic realities. That is, some amount of taxable revenue relating to the claimed stepped-up bases will not have been paid. Prospectively, the Service will have only one method of recourse for remediying this tax avoidance: actively assessing an estate tax on termination rights under § 201.

**B. TAX POLICY CONSIDERATIONS: THE FAIRNESS VS. EFFICIENCY DEBATE**

The three traditional tax policy considerations are equity, simplicity, and neutrality.¹⁴³ This Note will also consider a fourth factor that relates to tax policy, which is contextually relevant to termination rights: liquidity.

Tax equity encompasses three primary concepts: horizontal equity, vertical equity, and relatedly, ability to pay.¹⁴⁴ Horizontal equity represents the notion

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¹⁴⁴ Pareja, *supra* note 123, at 858; *see also* Pechman, *supra* note 143 (dividing equity into "vertical" and "horizontal" equity).
that taxpayers who are similarly situated should be taxed similarly.\textsuperscript{145} For example, if one estate includes a one million dollar stock portfolio, and another estate includes property worth one million dollars, the estate tax liability should be the same in each instance. Vertical equity represents the belief that taxpayers should be taxed in proportion to their relative abilities to pay.\textsuperscript{146} For example, the tax system reasons that a taxpayer with a $1 million salary is able to part with a greater percentage of her salary than a taxpayer with a $10,000 salary. This reasoning is used to justify the progressivity of tax rates.\textsuperscript{147} Incidentally, the ability to pay theory does not consider issues relating to the liquidity of various types of assets.\textsuperscript{148}

The concept of simplicity refers to both the taxpayer's ability to comprehend and comply with the relevant tax provisions, and the Service's ability to assess, administer, and enforce the tax code.\textsuperscript{149} Simplicity is favored because it lowers the costs of administering and complying with the tax code.\textsuperscript{150}

Tax neutrality embodies the goal of avoiding distortion in the economic behavior of taxpayers.\textsuperscript{151} For example, if artists were exempt from paying income taxes, this rule would distort economic behavior, as some taxpayers who would not have otherwise pursued the profession of art might forego another profession simply for the tax benefit. This result would lead to a general distortion in the labor market and produce economic inefficiency. However, in some cases policymakers purposefully use the tax code to generate preferences for certain individuals, industries, or activities in order to achieve an explicit policy goal.\textsuperscript{152} For example, if the creation of intellectual property encompassed by copyright law was viewed as exceptionally beneficial to the economy as a whole, Congress might create a tax preference for authors permitting them to deduct the costs of their labor expended in the creation process, while such deductions for other professionals such as lawyers might continue to be disallowed.

\textsuperscript{145} MICHAEL A. LIVINGSTON & DAVID S. GAMAGE, TAXATION: LAW, PLANNING, AND POLICY 8 (2d ed. 2010).
\textsuperscript{146} Pareja, \textit{supra} note 123, at 858.
\textsuperscript{148} Pareja, \textit{supra} note 123.
\textsuperscript{150} Id. at 436–37.
\textsuperscript{151} Pareja, \textit{supra} note 123, at 864.
\textsuperscript{152} Id. at 842.
Liquidity is defined as the ease with which a taxpayer can convert an asset into cash or its equivalent.\textsuperscript{153} Cash is, by definition, the most liquid asset. Assets such as publicly traded stocks and bonds, for which national and international market exchanges with many buyers and sellers exist, are also very liquid assets.\textsuperscript{154} In contrast, assets such as houses or boats, which usually require high transaction costs in order to identify a willing buyer, are considered comparably less liquid assets. Finally, something that cannot be sold, but has value, would represent an absolutely illiquid asset. Termination rights fall squarely within this last category, as they are in many instances valuable future property interests, but pursuant to § 203 cannot be readily sold and are therefore illiquid assets. While the U.S. tax system usually does not distinguish between liquid and illiquid assets,\textsuperscript{155} from a practical standpoint taxing an illiquid asset can exact an excessive burden on a taxpayer who must expend resources converting her property into cash with which to pay the tax.\textsuperscript{156}

These policy considerations are particularly crucial if, and when, the Service begins to assess an estate tax on the inheritance of termination rights.

C. THE NORMAL TAX RULES DO NOT WORK FOR TERMINATION RIGHTS

Under the current estate tax provisions, the value of a termination right on the date of an author's death, to the extent that any family members other than the author's spouse inherit it, is includable in the gross estate.\textsuperscript{157} However, because termination rights, or any interests therein, cannot be assigned, an author's heirs have no way to derive value from the termination right in order to pay the estate tax liability. If the estate includes other personal or real property, a disproportionate amount of those assets will then have to be sold in order to pay the estate tax on the value of the termination right. If the estate does not include other assets of substantial value, to the extent that the value of the termination right exceeds the exclusion amount, the estate may literally be unable to pay the tax.

The estate tax exclusion incorporates a progressivity similar to that of the income tax with the notion that estates valued above the exclusion amount have

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\textsuperscript{153} BLACK'S LAW DICTIONARY 1014 (9th ed. 2009).
\textsuperscript{154} Id.
\textsuperscript{155} But see Starker v. United States, 602 F.2d 1341, 1352 (9th Cir. 1979) ("The legislative history reveals that § 1031 was designed to avoid the imposition of a tax on those who do not 'cash in' on their investments.").
\textsuperscript{156} JOSEPH BANKMAN ET AL., FEDERAL INCOME TAXATION 11 (Vicki Been et al. eds., 16th ed. 2012).
\textsuperscript{157} 26 U.S.C. §§ 2001(a), 2056(a) (2012).
a greater ability to pay an estate tax.\textsuperscript{158} However, this justification does not hold true for termination rights, the value of which constitute wealth in an accounting sense, but not as an economic reality at the date of the author's death. Thus, the more valuable a termination right, as determined by the value of the author's underlying copyright, the more disadvantaged the heirs are in an absolute sense for purposes of the estate tax because they must sell more assets to pay the tax. Therefore, the notion of vertical equity—that those in a higher tax bracket pay more taxes because they have a greater ability to pay—does not hold true for termination rights.

The same conclusion follows by comparing the tax consequences associated with two equally valued estates, in which one includes a termination right and the other does not. Again, in an accounting sense the tax system would deem these estates as similarly situated. However, the tax consequences are harsher for the estate with the termination right because the other can choose among its assets which ones it should sell to cover the estate tax. Yet, § 203 restricts an estate's disposition of a termination right and forces it to deplete other assets to cover the estate tax. Alternatively, if the author died within the termination window, the executor could be forced to quickly terminate the original transfer and re-assign the copyright of a disadvantageous price. The after-tax result in these situations is not consistent with horizontal equity because the estate without a termination right has more freedom to choose which assets it will use to pay the estate tax.

The fact that termination rights cannot be used in any way to pay an estate tax also inhibits the administrability of the tax system. The difficulty of valuing an asset is usually not dispositive of whether it should be taxed or not, since the Service goes to great lengths to establish methods of valuing various assets for tax purposes. Thus, even though predicting the value of an underlying copyright upon the maturation of a termination right would be extremely difficult, if not impossible, the Service still would require such a valuation.\textsuperscript{159} A very problematic issue of administrability arises when the vast majority of the value in a gross estate is comprised of one or more termination rights. If the remaining assets cannot cover the estate tax liability and the Service cannot attach a tax lien to the termination rights, the heirs would attain the termination rights without the estate paying a corresponding tax. This would undermine the goal of horizontal equity, since estates with termination rights would, in effect,


\textsuperscript{159} Comm'r v. Logan, 283 U.S. 404, 413 (1931) ("Some valuation—speculative or otherwise—is necessary in order to close the estate.").
face lower tax consequences than those estates that contained other types of similarly valued assets.

If the Service were to begin enforcement of the estate tax on termination rights, authors who comprehend the burden that the inclusion of termination rights in their gross estate could place on their heirs may react either by not disposing of their copyright in the first place, or in the extreme case, by pursuing another profession where the work-product is not taxed in a situation where it affords no ability to pay an after death tax.\textsuperscript{160}

Alternatively, the adverse tax consequences that would result from the inheritance of termination right could encourage authors and their heirs to enter into settlement agreements with the recipients of the original copyrights. Under such an agreement the author or her heirs would promise not to exercise their termination right in return for monetary consideration.\textsuperscript{161} In Larson, the court characterized such agreements as a "revocation and re-grant" and held that they were not agreements contrary to §504 because they effectively fulfilled Congress's policy goal; such an agreement is not an unremunerated transfer of the author or the heir's reversionary interest.\textsuperscript{162} However, this is analogous to the historical path of inalienable copyright renewal rights created by the Copyright Act of 1909, which were ultimately rendered ineffective when the Court in Fred Fisher Music Co. v. M. Witmark & Sons upheld the author's right to prematurely dispose of the aforementioned reversionary interest.\textsuperscript{163} Similarly, the present taxation of termination rights, in conjunction with the willingness of some modern courts to hold settlement agreements binding upon the parties, may incentivize authors to prematurely dispose of their termination rights in order to avoid the burden the estate tax would impose on their heirs.

Such a result would mean that the estate taxation of termination rights would not be neutral. If these behavioral distortions are widespread, they would undermine the 1976 Act, impede the growth of intellectual property, and potentially distort the macroeconomy.

In light of these shortcomings, and the potential unfairness to heirs of termination rights in a tax scheme that imposes an estate tax on termination

\textsuperscript{160} Crawford & Gans, supra note 5, at 74.

\textsuperscript{161} Larson, 2013 WL 1688199, at *1.

\textsuperscript{162} Id., at *2–3 (citing Penguin Grp. (U.S.A) Inc. v. Steinbeck, 537 F.3d 193 (9th Cir. 2005); Milne ex rel. Coyne v. Stephen Slesinger, Inc., 430 F.3d 1036 (9th Cir. 2005)).

rights, the time is ripe for an alternative approach that maintains the integrity of the tax system and better serves tax policy considerations.

D. AN ALTERNATIVE APPROACH: NO ESTATE TAX, NO STEPPED-UP BASIS

In *Taxation Without Liquidation: Rethinking “Ability to Pay,”* Professor Pareja focuses primarily on liquidity.\(^\text{164}\) That is, the actual ability of the estate to pay an assessed tax.\(^\text{165}\) With liquid assets, this ability comes easily: The estate simply writes a check or sells off some portion of its liquid assets. With assets that are not as liquid, however, the estate would have to expend resources locating a buyer at a reasonable price. Presumably, an estate tax system that forces an estate to prematurely dispose of its assets would distort capital markets and exact hardship on the heirs, who might achieve a greater return on those assets by waiting until the value of the assets appreciates from a potential upswing in the market. Accordingly, the Service would also derive greater revenue if it instead taxes assets when an heir disposes of them at a higher price, particularly if the basis in those assets is lower than the fair market value thereof on the date of the decedent’s death.

Drawing a line between liquid and illiquid assets for estate tax purposes might lead to an inevitable gray area somewhere in the middle. However, this distinction is not troublesome in the case of termination rights. Termination rights are not only less liquid relative to other types of assets, they are also illiquid in an absolute sense because of their inalienability. Thus, termination rights fall on the very end of the illiquid side of the liquidity spectrum.

An approach similar to Professor Pareja’s—that could be applied to termination rights—is to impose no estate tax upon the author’s death and provide the heirs with a carryover basis from the deceased author. Under this approach, when the heirs ultimately exercise the termination right, recapture the underlying copyright, and reassign the copyright, the heirs would have an income tax liability on the difference between the price at which they reassign the copyright and the carryover basis.

In contrast to Professor Pareja’s approach, which provides for a zero basis where the heir makes a deferral election for an illiquid asset,\(^\text{166}\) a carryover basis is more efficient in the case of termination rights. A carryover basis is the same approach the Code uses for property acquired by gifts.\(^\text{167}\) Professor Pareja points out that such an approach in the realm of inheritance can be problematic.

\(^{164}\) *Id.* at 843.

\(^{165}\) *Id.* at 843–44.

\(^{166}\) *Id.* at 890–91.

for property that has remained in a family for numerous generations.\textsuperscript{168} In such a situation, the heir may not be able to identify the cost at which the property was initially acquired.\textsuperscript{169} However, this problem is minor or nonexistent in the context of termination rights. Because a termination right expires forty years after the initial copyright disposition, the right could only be inherited within this same window. Accordingly, the issue of obtaining financial records in the case of termination rights is less of a concern, since it is not likely that more than two generations would be involved in the inheritance. This is in contrast with the situation contemplated by Professor Pareja where the necessary records relate to a transaction that could have taken place over one hundred years prior.

As previously discussed, an author's cost basis in a copyright, and consequently in the termination right, is often negligible because the value of an author's time and efforts are not included.\textsuperscript{170} However, in those cases in which the cost basis is substantial, a zero basis in the property leads to an unfairly greater ultimate tax liability upon the reassignment of the copyright. On the margin, such a rule could have the effect of discouraging authors from pursuing creative careers or cause them to engage in settlement agreements to circumvent the estate tax.

This proposed alternative approach does not provide an election to permit an estate to treat termination rights as they are treated currently. The stepped-up basis is a significant tax preference and can incentivize families to wait to transfer property until the death of the owner, since the stepped-up basis usually is greater than the carryover basis. Accordingly, a family would be able to escape taxation on the difference between what would be the carryover basis and the stepped-up basis. If the estate has liquid assets, Professor Pareja would allow families to take advantage of the stepped-up basis if the estate can afford to feasibly pay the estate tax on the value of the gross estate. The problem with this approach is that if the estate contains a termination right, it raises the previously discussed issue of tax avoidance. If the Service fails to assess an estate tax when an author dies and the statute of limitations has expired, heirs could attain a stepped-up basis without paying a corresponding estate tax by retroactively making such an election. Additionally, with an approach that only allowed the election going forward, problems relating to valuation and the administration of an estate tax on termination rights would remain.

\textsuperscript{168} Pareja, \textit{supra} note 123, at 890.
\textsuperscript{169} Id.
\textsuperscript{170} See \textit{supra} notes 71-75 and accompanying text.
E. THE ADVANTAGES OF THE ALTERNATIVE APPROACH

The policy concerns of liquidity, equity, simplicity, and neutrality support the implementation of an alternative tax approach to termination rights that consists of no estate tax and a carryover basis.

Because no estate tax would be assessed under the alternative approach, no liquidity problem would arise for an author's estate that includes unmatured termination rights—at least not with respect to the termination rights. When a termination right does mature, the heirs may exercise the right, and ultimately sell the recaptured copyright; again, no illiquidity problem would arise in connection with the income taxation of this transaction. While the heirs might be compensated in some form other than cash, such as a promissory note, the tax code affords no leniency in this situation pursuant to the theory of constructive receipt and the tax benefit doctrine. That is, because the taxpayer could exchange the promissory note for cash, albeit at some discount, the transaction constitutes a tax recognition event. With termination rights, the problem is that because such rights are inalienable, they cannot be sold at any price, which makes them absolutely illiquid. Once the copyright is sold for a promissory note, even though this form of compensation is relatively less liquid than cash, it is not in the same category of illiquidity as termination rights.

With respect to horizontal equity, the differing rate structures of the estate tax and income tax preclude perfect equality between two heirs who inherit assets of equal value if one of those assets is a termination right. When an asset is taxed as part of an estate, the key advantage is that the estate can utilize the estate tax exclusion amount. Conversely, the advantage of deferring taxation until the heir ultimately sells the asset is that the heir will benefit from the time value of money concept. In other words, even though the gross income from the disposition of the asset will be taxed at the heir's marginal rate in the year in which the heir sells it, the heir could theoretically set aside a lesser amount in an earlier year and invest it in anticipation of the tax. Under the proposed approach, the reassignment of a copyright that was obtained via a termination right would be taxed as ordinary income. Because the rates and exclusion amounts change over time, it would be highly difficult to compare the equities between the two aforementioned heirs across all the relevant years and at each tax rate. As a general rule, where the termination right would have been included in a gross estate that was less than the exclusion amount, the heir to the other asset is better off. At a certain valuation of the gross estate above the

171 BANKMAN ET AL., supra note 156, at 256–57.
exclusion amount, the heir to the termination right, which is not included in the gross estate, ultimately sees less of the value of his or her asset depleted from the payment of taxes. Therefore, the consideration of horizontal equity is not necessarily satisfied in any given situation, but under the proposed approach, no systematic bias favoring heirs of termination rights or other assets would exist.

The goal of progressivity embodied by vertical equity and the ability to pay is necessarily satisfied under the proposed approach with respect to termination rights. Because no estate tax would be assessed, the problems relating to illiquidity and the fairness of the exclusion amount would not arise. The only time that the termination right heirs would owe a tax liability is when they ultimately reassign the underlying copyright. As this would be an income tax liability, the same rate progressivity that applies to other forms of income also would apply to recaptured copyrights. Therefore, the proposed approach to the taxation of termination rights would achieve vertical equity to the same extent that the income tax system ordinarily does.

Under the proposed approach, the heirs would not be required at the time of the author’s death to calculate the present value of the right to recapture the underlying copyright at some future date that is necessary for the estate tax. Because such computation incorporates long-run economic forecasting, varying levels of risk, and discounting in relation to certain interest rates, this valuation is difficult, costly, and inherently speculative. When an item is taxed as income the only calculation required is the subtraction of the basis from the sale price. Because these values are objective and easily identifiable, termination right heirs could comply with the tax code at a much lower cost and with greater certainty under the proposed approach.

Similarly, under the proposed approach, the Service would not have to double-check the aforementioned forecasting and discounting calculations for the estate tax valuation of termination rights. Instead, it would only need to inspect documents of sale relating to the recaptured copyright upon the remittance of the corresponding income tax. Therefore, the Service could more easily and cheaply administer the taxation of termination rights under the proposed approach.

Because recaptured copyrights would be taxed the same as other forms of income under the proposed approach, it would be tax neutral by comparison. However, as previously discussed, differing rate structures of the estate and income taxes cause horizontal inequity and thus have the potential to distort taxpayer behavior. Yet, because the bias is not systematic, authors would not be prospectively incentivized to or deterred from pursuing creative careers or prematurely settling their termination rights because of tax considerations.
Therefore, in the aggregate, the proposed approach would offer a tax neutral alternative to the current taxation of termination rights.

One policy argument could be made against the proposed alternative because the structure of the approach is such that it defers some amount of taxation on the right of heirs to recapture and reassign a copyright. The amount deferred will equal the difference between the fair market value of the termination right at the time of the author's death and the author's cost basis. In present value terms, this means that the Treasury would be disadvantaged because if it had the tax revenue in the earlier period it theoretically could have invested it and, under the time value of money concept, by the time the heir reassigned the recaptured copyright, the Treasury then could have derived a greater sum. This reasoning seems to undermine the logic behind the proposed alternative approach, but the proposed alternative is revived by the fact that the Service has failed to assess the estate tax on termination rights under the current approach. At any rate, it is not clear that the investment interest that the Treasury could accrue under the current approach is enough to offset its enforcement costs. Again, the evidence of non-enforcement seems to suggest this conclusion.

The policy goals of vertical equity, ease of compliance and administration, and taxing only taxpayers who have the present ability to pay, would be categorically better served by the proposed approach to the taxation of termination rights. To be sure, horizontal equity and tax neutrality would not necessarily be achieved in every instance under the proposed approach. However, these goals would not suffer from a systematic bias as they do under the present approach. Although the Treasury might obtain less revenue in the long-run in present value terms under the proposed approach, this concern is rendered moot by the Service's failure to enforce the estate tax under the current approach. Accordingly, the major policy goals of the tax system would be better served by the Government's adoption of the alternative approach to the taxation of termination rights.

IV. CONCLUSION

The primary problem with the current approach to the taxation of termination rights is that termination rights are inalienable, and thus an author's estate may not be able to pay a tax on the termination rights unless it sells off other assets. This financial conundrum for heirs, on the margin, could deter

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173 See Crawford & Gans, supra note 5, at 74 ("To date, the Service has not sought to enforce any . . . tax consequences of [termination rights].").
potential authors from a creative career or lead them to seek ways to subvert
the Copyright Act of 1976, and in many cases is unfair. In reality, because the
Service has failed to enforce this estate tax and the inalienability of termination
rights precludes the attachment of a tax lien, when the relevant statute of
limitation expires, heirs can effectively avoid the estate tax liability. This result
is manifestly unjust with respect to other similarly situated taxpayers.

By adopting the proposed alternative approach to the taxation of
termination rights whereby no estate tax is assessed, heirs receive a carryover
basis from the author, and subsequently pay an income tax on the sale price of
the recaptured copyright, less the carryover basis. Under the proposed
approach, estates would not be taxed when they are absolutely illiquid, heirs
would be able to more easily comply with the tax code, and the Service could
effectively enforce it. Moreover, when heirs seek to exercise their termination
rights and reassign the underlying copyrights for the first time in 2013, they
would not be able to claim a § 1014 basis for which no corresponding estate tax
was ever paid.

Many factors go into one’s selection of a profession. A major consideration
is the legacy one will leave for his or her heirs. This legacy includes the fruits of
one’s labor that comprises the value of what one passes on to future
generations, and the tax code should not distort these considerations. The
proposed alternative should be adopted because it is the simplest way to
preserve non-tax incentives and prevent tax avoidance in the termination right
context.

Jerome Siegel created Superman before the implementation of the 1976 Act
that created termination rights for authors and their heirs. Thus, he did not
have to worry at the time about the effect of this Act on his heirs. But now,
post-1976, creators of copyrighted intellectual property will have to worry about
the effect of the Act on theirs. One of these individuals could be the author of
the next Superman, whose creative genius and resulting intellectual property may
cause tax problems for his or her heirs. The proposed alternative approach to
taxing termination rights, if adopted, would give the creative genius some peace
of mind.