

The taxman's taken all my dough...

Patrick Way KC discusses the tax issue that may arise when an artist sells their back catalogue

Many rock musicians are selling their rights in respect of recordings and publishing rights and the market has become very buoyant.

The receipts, however, are typically treated as income receipts subject to tax at a marginal rate of 45% rather than capital receipts taxable at capital gains tax rates of 20%.

There is little room for manoeuvre but, if possible, planning should be exercised to enable the capital gains tax rate of tax to be due rather than the income tax rate.

Taxation of receipts for sales of music rights

In 1966 the Kinks released their song 'Sunny Afternoon'. The opening words of the song are:

*"The taxman's taken all my dough
And left me in my stately home
Lazin' on a sunny afternoon
And I can't sail my yacht
He's taken everything I've got
All I've got this sunny afternoon."*

Ray Davies of the Kinks was not alone in being worried about the high rate of tax that was charged in the 1960s. The top rate of income tax on earned income was 83%; and the top rate of tax on unearned income was 98%.

Also in 1966, George Harrison wrote 'Taxman', in which he berated the fact (as he saw it) that the UK Exchequer imposed such a high rate of tax.

Indeed, as an aside, bands at that time (including the Beatles) often entered into forward sales agreements. Missing a lot out these agreements sought to wrap up future rights to income from songs in the form of a one-off capital payment in the hope that a much-reduced rate of tax (or even no tax) would arise.

That scheme (sometimes known as the "Silver Beatles scheme") was stopped by the sales of occupation income rules which are currently found within Income Tax Act 2007, Part 13, Chapter 4 starting to read at s.773. Broadly speaking, the capital receipt in that example would be treated as income.

Moving on to the present day, the market for the purchase of the songbooks of rock bands and rock singers is very hot. This may be because it is so easy to stream music now – thanks to Spotify and others. Or it may just simply mean that a lot of the famous rock groups are reaching the age where it makes sense to cash in their hard-earned legacy.

The question arises, however, as to whether a sale of those rights will produce income or capital.

In the past 12 months I have advised on three multi-million pound sales by famous rock legends. The position broadly speaking is that if the musician has created the rights themselves then those rights are income or give rise to an income tax receipt; whereas if the rights have been created by somebody else then a disposal of those rights would give rise to capital gains tax.

I should say that I have seen HMRC arguing the opposite and have tried to argue (albeit in a case that collapsed for other reasons) that a sale of a bundle of income rights for a one-off sum should be treated as

a capital amount subject to capital gains tax by reference to the case of CIR v. John Lewis Properties plc (CA 2002, 75 TC 131).

My reason for saying that the rights are income (and not capital) is by reference to some key cases:

Glasson v Rougier (KB 1944 26 TC 86) – (the ‘Georgette Heyer case’)

In this case, Georgette Heyer entered into certain publishing agreement regarding royalties on books sold. After some years the agreements were cancelled and instead she received lump sums from the publisher for the publishing rights. It was held that the sums were revenue receipts of her vocation. This was on the basis, in effect, that there was a commutation of annual sums.

Mackenzie v. Arnold (CA 52 33 TC 363) (the ‘Compton Mackenzie case’)

In this case, Compton Mackenzie sold the copyright of various novels which he had

written whilst not resident in the United Kingdom. He was assessed to income tax on the proceeds and his appeal to the effect that the sale proceeds were capital failed, in due course, before the Court of Appeal. The rights were income.

Howson v. Monsell (Ch.d 1950 31 TC 529) (the ‘Margaret Irwin case’)

In this case Margaret Irwin sold the film rights in two of her books in return for fixed sums which were paid in instalments over a period of several years. The amounts in question were held to be receipts of her vocation and were chargeable to income tax.

Accordingly, based on these cases, and taking account of HMRC’s usual practice, the income in question will be treated as miscellaneous income under ITTOIA 2005 ss.687 to 689.

There is an exception where, as mentioned, the sale is by someone who did not produced the rights themselves.

This brings me to the next case:

Nethersole v. Withers (HL 1948 28 TC 501) (the ‘Rudyard Kipling case’)

In this case Olga Nethersole obtained the rights to produce a play based on the novel ‘The Light That Failed’ by Rudyard Kipling.

In 1914, Kipling further agreed to pay to her one-third of the receipts from any film version of the book or play. He died in 1936 and in 1939 his wife assigned the film rights for 10 years for £8,000 to a third party of which – pursuant to the above agreement – £2,666 was paid to Olga Nethersole.

The Inland Revenue issued assessments charging income tax on the £2,666. Nethersole appealed, contending that it was a capital receipt for the sale of copyright. The Court of Appeal accepted this contention and allowed her appeal.

In due course the House of Lords upheld that decision unanimously. Viscount Simon held that Olga Nethersole had “made a partial assignment of her copyright and ceased to be owner of the portion assigned”. This amounted “to a sale of property by a person who is not engaged in the trade or profession of dealing in such property”. It was a “sum in the nature of untaxable capital [capital gains being untaxed at that time] and not in the nature of taxable revenue”.

Conclusion

The distinction in relation to the cases above is that Olga Nethersole played no part in the creation and writing of the relevant book and therefore was “at arm’s length” from the creative process. So her receipts were capital not income.

This can lead to oddnesses where the musician has died and the rights have been inherited by the musician’s heirs. The heirs then, when they come to sell the rights, will be subject to capital gains tax not income tax.

Taxman – the Beatles

This brings me back to George Harrison's 'Taxman'. The verses include the following:-

*“Let me tell you how it will be
There's one for you, 19 for me
'Cause I'm the taxman
Yeah, I'm the taxman
Should five per cent appear too small
Be thankful I don't take it all
'Cause I'm the taxman
Yeah, I'm the taxman”*

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