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To Our Clients and Friends:

Re: New Tax Legislation Affords Window of Opportunity  
for Tax Planning Regarding Musical Compositions

The recently enacted federal tax legislation has generated much discussion in the press and elsewhere, and we leave it to others to reiterate what you no doubt already know regarding the extension of the 15% tax rate applicable to dividends and capital gains, the AMT "patch", expanded opportunities for converting IRAs to so-called "Roth IRAs," etc. We write instead to bring to your attention two less-publicized provisions of the new legislation, which may be material to U.S. citizen or resident composers of musical compositions and those wishing to acquire musical compositions.

**15% tax rate on gain from certain sales of musical compositions.** The first of these provisions allows U.S. citizen or resident composers who sell musical works they created more than one year before the sale to pay tax on the gain at the 15% tax rate applicable to long-term capital gains. Previously, a U.S. composer selling self-created musical compositions would be subject to tax at ordinary income tax rates, which are currently 20 percentage points higher. This new capital gains tax rate provision generally applies for sales that occur between January 1, 2007 and December 31, 2010, after which the capital gains treatment will "sunset" and, unless the new provision were to be extended, the higher ordinary income tax rate would again apply.

**Write-off of acquisition costs of musical compositions over 5 years.** The second provision permits an acquiror of musical compositions to amortize the acquisition cost on a straight-line basis over 5 years, provided the compositions are not acquired as part of the acquisition of a trade or business. Previously, such acquisition costs would generally have been written off over 10 years under an income forecast method. As before, the cost of acquiring compositions as part of the acquisition of a trade or business is written off on a straight-line basis over 15 years. While certainly there are situations where sellers of musical compositions would be considered to be carrying on the trade or business of exploiting their compositions, in which case a purchaser of that business would still be required to amortize the purchase price over 15 years, there are many instances in which composers would not be considered to be in the business of exploiting their compositions. In those instances, the new 5-year rule would apply. The new quicker write-off rule applies only for acquisitions made in years beginning after 2005 and before 2011.

**Planning considerations.** We have a number of preliminary observations on the new legislation:

1. Since it seems unlikely that the substantial reduction of tax on sales of self-created musical compositions will be extended beyond the end of 2010, any composer otherwise considering a disposition of his or her copyrights (or partial interests therein) should seriously consider doing so before the end of 2010 in order to take advantage of the lower capital gains rate that would apply.

2. It is possible that the new law will focus composers and their advisors on the possibility of a sale, particularly as the period during which the provision will be in effect starts to draw to a close, increasing the universe of willing sellers. It may also have the effect of increasing the universe of willing buyers given the quicker write-offs that could obtain.

3. A composer wishing to dispose of his or her copyrights who might be exploiting them in an active manner (as opposed to merely licensing them) may wish to reorganize these activities so that a purchaser may be eligible for a quicker write-off, thereby potentially enhancing the value to the purchaser of the catalogue and justifying a higher purchase price.

4. Where the composer has written a work for a third party as a “work for hire”, so that the copyright is owned by the third party, a sale by the composer of his or her entitlements in respect of that work will not be eligible for the lower capital gains rate under the new legislation.

5. As previously noted, the 5-year write-off provision will not apply to an acquisition of compositions that is part of the acquisition of a business. In addition, the limitations on the deduction of passive losses may limit the ability of acquirors such as individuals and partnerships and LLCs having individuals as members to take advantage of the quicker write-off rules. Not being subject to these limitations, corporate acquirors having an appetite for tax benefits would appear to be able to enhance their returns by the tax benefits attributable to the quicker write-offs.

6. Notwithstanding the tax incentives for selling during the window of opportunity provided by the new law, there will no doubt be many composers not prepared to sell their musical compositions to unrelated third parties. In a number of such instances, and subject to certain limitations, it may still be possible with careful planning to take advantage of the lower capital gains tax rate, while also achieving other material tax savings, even in cases where the acquiring party is subject to the passive loss limitations referred to above. Of course, the details of and benefits from such a transaction will depend on the composer’s specific circumstances.

If you wish to discuss the planning opportunities under these new provisions, please let us know.