RECENT CASES

Owners of copyrights to Gone With the Wind obtain preliminary injunction against production of musical comedy stage play Scarlett Fever

The difference between permissible parody and impermissible copyright infringement has been the subject of many a lawsuit, including well-known cases involving the movies “Gas Light” and “From Here to Eternity,” and Walt Disney’s cartoon characters. Recently, another case has tackled the issue, this one concerning the book and movie “Gone With the Wind.”

Last fall, the Showcase Cabaret in Atlanta presented a musical comedy stage play entitled “Scarlett Fever,” which, according to its producers, was a spoof of “Gone With the Wind.” Although the production was "humorous, entertaining and skillfully performed" — according to a Federal District Court judge in Atlanta — MGM, the MacMillan Company, and the trustees for the heirs of author Margaret Mitchell were not amused. MGM owns the copyright to the movie version of "Gone With the Wind." MacMillan owns the copyright to the original novel. And the trustees own certain residual rights, including the stage rights. They felt that "Scarlett Fever" infringed their various copyrights and filed suit. Immediately thereafter they applied for a preliminary injunction which has been granted, despite the judge's regard for the quality of the defendants' play.

The court found there to be substantial similarity between "Scarlett Fever" and "Gone With the Wind." The locale, settings, characters, situations, and relationships were found to be basically the same in both. And even the dialogue in the play and movie was often near verbatim. In fact, the defendants did not deny these substantial similarities. Rather, they contended that their play was a satire or parody of "Gone With the Wind," and as such was protected by the "fair use" doctrine.

The court defined a parody to be a work in which the language or style of another work is closely imitated or mimicked for comic effect or ridicule. It defined a satire to be a work which holds up the vices or shortcomings of an individual or institution to ridicule or derision, usually with an intent to stimulate change, or the use of wit, irony or sarcasm for the purpose of exposing and discrediting vice or folly.

However, the court added that for parody to be eligible for fair use protection, it must do more than merely achieve comic effect. It must also make some critical comment or statement about the original work, thereby giving the parody social value beyond its entertainment function. Otherwise, said the court, any comic use of an existing work would be protected, and that would negate the purpose of the copyright law, which is to protect original works from unfair exploitation.

Applying this standard, the court found that "Scarlett Fever" was not a parody or satire, because it was not a critical commentary on either the movie or novel "Gone With the Wind." Thus, the court held that "Scarlett Fever" was not protected by the fair use doctrine.

Moreover, the court also held that even if "Scarlett Fever" were a parody or satire in its overall effect, it still would not be protected by the fair use doctrine, because it incorporated more material from "Gone With the Wind" than the fair use doctrine allows. The fair use doctrine does permit a parodist to copy a sufficient amount of material for the reader or viewer to "recall or conjure up" the original. But the court found that "Scarlett Fever" incorporated much more of "Gone With the Wind" than was necessary for that purpose.

The defendants also argued that "Scarlett Fever" would not harm the market for "Gone With the Wind," because a prior authorized stage production had failed and no other authorized stage play was planned for the immediate future, and because the Showcase Cabaret holds such small audiences that it would not make a "dent" in the value of the plaintiffs' interests. The court disagreed, however. It held that "Scarlett Fever" could harm the potential value of a stage version of "Gone With the Wind," and that furthermore, a presumption of irreparable injury exists for the purpose of a preliminary injunction once a case of copyright infringement has been made.

Finally, the court rejected the defendants' arguments that "Scarlett Fever" was protected by the First Amendment, and that the plaintiffs had abandoned copyright protection against satires because they had failed to take action against earlier spoofs of "Gone With the Wind."

Metro-Goldwyn-Mayer, Inc. v. Show case Atlanta Co-operative Productions, Inc., CCH Copyright Law Reports, Para. 25,122 (N.D.Ga. 1979) [ELR 1:19:1]

DC Comics obtains preliminary injunction barring broadcast of television commercial copied from Superman television series

DC Comics is the owner of the copyrights to the Superman comic books and television series. It licenses the use of the Superman character for the promotion of consumer goods and, on occasion, has licensed its use by a consumer electronics retailer known as Crazy Eddie.

Last year, Crazy Eddie produced a television commercial for his business nearly every aspect of which was copied in detail from the "trailers" for the Superman television series, according to DC Comics. Crazy Eddie had not obtained a license to make his commercial, however; and as a result, DC Comics filed suit and immediately sought a preliminary injunction barring further broadcasts of the commercial.

A Federal District Court in New York City agreed with DC Comics that Crazy Eddie's commercial was copied from the Superman trailers. The court found that the only variation was that in the commercial, Crazy Eddie's name and business purpose were substituted for Superman's name and purpose. According to the court, the commercial captured both the "total concept and feel" and the characteristic detail or particularized expression of the Superman trailers. And the court found that the average lay observer would instantly identify Crazy Eddie's commercial with the Superman series.

Crazy Eddie did not dispute DC Comics' ownership of the Superman copyrights, or their validity. He did argue, however, that his commercial was a parody which is accorded greater license under the copyright law, and that even if his commercial did infringe, injunctive relief was unnecessary and inappropriate because DC Comics' damages could be determined by reference to its license fee for such a use.

The court disagreed with both contentions, however. Although it recognized that parody is entitled to greater freedom than other uses, it found, without discussion, that Crazy Eddie's commercial was not a parody. It also agreed with DC Comics that the commercial would irreparably impair Superman's licensing value, and it held that such an injury "cannot readily be reduced to monetary terms." Accordingly, it granted the preliminary injunction DC Comics had requested.

DC Comics, Inc. v. Crazy Eddie, Inc., CCH Copyright Law Reports, Para. 25,097 (S.D.N.Y. 1979) [ELR 1:19:2]

Federal District Court refuses to dismiss scientist s lawsuit against author and publisher of In His Image, The Cloning of a Man

Early in 1978, the J. B. Lippincott Company published a book by David Rorvik entitled "In His Image, The Cloning of a Man." The book purported to be a factual account of a secret experiment which resulted in the successful creation of a human genetic "twin" by cloning. Although propagation of plants by cloning is common, the reproduction of mammals — and especially humans — by this method would be revolutionary; and the book generated enormous controversy.

Dr. J. D. Bromhall is a recognized authority in the field of experimental embryology. His Oxford University doctoral thesis was an account of his extensive original research and experimentation with the transfer of cell nuclei into unfertilized rabbit eggs. While working on "In His Image," Rorvik wrote to Bromhall, seeking information about his research, ostensibly in connection with Rorvik's preparation of a serious article or book about scientific research into cell-transplantation. In response to his inquiry, Bromhall sent Rorvik a ninepage summary of his doctoral thesis.

The text of "In His lmage" refers to the work of an "Oxford scientist" who is identified in a footnote as being Dr. Bromhall. The footnote also sets forth at great length and in detail the techniques employed by Bromhall in his research, and the results of his experiments. The book also contains a bibliography of more than 200 books and reports, including Bromhall's doctoral thesis, an article he had written for Nature magazine, and a "personal communication" with Rorvik.

Bromhall asserted that "In His Image" was a "hoax," and he filed suit against the book's author and publisher seeking to recover damages for libel, copyright infringement, and invasion of privacy, and for equitable relief.

In support of his libel claim, Bromhall contended that the book is false and defamatory because it conveys the impression that his own research had the goal of cloning human beings, and because it conveys the impression that he supported the authenticity of the secret cloning experiment described in it. However, a Federal District Court in Philadelphia has noted that the direct references to Bromhall in the book were not false; and that even if it were assumed that the premise of the book is false, "accurate statements . . . do not become libelous merely because they are included in a book which is false in other respects." The court a also concluded that the words used in the book were incapable of defamatory meaning, and the innuendo ascribed to them was entirely unwarranted. Accordingly, the court dismissed Bromhall's libel claims.

The court also dismissed Bromhall's copyright claim. Although the court assumed that he had a valid copyright in his doctoral thesis, and in the nine-page summary, the alleged infringement took place when "In His Image" was published, after the effective date of the Copyright Act of 1976. The Copyright Act of 1976 abolished common law copyright, and provides that no copyright action may be brought until registration of the copyright has been made. Because neither Bromhall's thesis nor the summary of it had ever been published, he had not registered his copyright prior to the effective date of the Copyright Act of 1976, nor had he registered his copyright thereafter, either. It was for this reason the court dismissed his copyright claim.

The court refused to dismiss Bromhall's invasion of privacy and equitable relief claims, however. The court concluded that Bromhall's privacy claims "do not fit squarely" within the "false light" category of privacy, nor within any of the other clearly recognized privacy categories. However, said the court, it could be argued that the defendants appropriated Bromhall's name for their own use and benefit, in that they used his name and reputation "to lend a false air of scholarship to Rorvik's literary efforts." To the extent they did so, "and thereby drew him against his will into the limelight of public controversy, it may be that they invaded privacy interests entitled to the law's protection," the court said. Before the court decides the issue, it said it ought to consider facts concerning whether Bromhall's standing in the scientific community has been adversely affected; whether his entry into the limelight of public controversy was involuntary, or a self-inflicted wound; and the degree of malice or other culpability on the part of Rorvik and the J.B. Lippincott Company.

The court also was persuaded that Bromhall may have a right to equitable relief. He contended that the experimental techniques used in the book to clone a human being were identical to the techniques he had developed in his research and had communicated to Rorvik. Bromhall also contended that Rorvik's unauthorized use of those techniques greatly enhanced the credibility and sales potential of the book, so that the defendants have been unjustly enriched from their allegedly improper actions. The court held that in order for Bromhall's techniques to qualify for protection, they must be new, novel and concrete. The court said that the pretrial record then before it did not indicate that Bromhall's techniques failed to meet that test.

The court also ruled that to the extent Bromhall's claims were based on fraud, it could not be determined at the pretrial stage whether Rorvik had made adequate disclosure of his intended use of Bromhall's material, nor could it be determined whether Bromhall freely consented to such use.

Bromhall v. Rorvik, CCH Copyright Law Reports, Para. 25,121 (E.D.Pa. 1979) [ELR 1:19:2]

Theatrical producer David Merrick required to pay New York State business tax on some, but not all, of his income from play producing activities

A New York appellate court has held that income received by theatrical producer David Merrick, as the sole general partner of several limited partnerships producing stage plays, was income subject to New York States unincorporated business tax (a tax imposed on income from a trade, business or occupation carried on within New York State by an individual).

Merrick's salary from David Merrick, Inc. Services also was held to be subject to the unincorporated business tax. The corporation was formed to rent office space and facilities to limited partnerships organized to finance and produce plays, and its services were found to be an "integral part" of Merrick's unincorporated businesses.

The court also found that gain realized from the sale of Merrick's interest in the Dolly Company partnership was properly included in his unincorporated business income.

However, royalties Merrick received from a record company that used his name on the jacket of a record, and royalties he received after purchasing the rights of a composer and lyricist, were held to constitute investment income and bore no relationship to his unincorporated businesses. Gains realized from the liquidation of several wholly owned corporations that had been in the business of renting stage lighting equipment also were not subject to the tax, since these were independent corporations, not unincorporated businesses.

The court refused to allow Merrick to make any allocation between his earnings in and out of the state, since it was found that Merrick did not maintain any regular place of business outside the State of New York.

Merrick v. Tully, 417 N.Y.S.2d 312 (N.Y App. 1979) [ELR 1:19:5]

Federal Court of Appeals upholds contempt citation against Sound Technicians Local 695 for failure to execute collective bargaining agreement with the AMPTP

In 1976, Sound Technicians Local 695, a member of the International Alliance of Theatrical Stage Employees (IATSE), challenged IATSE's revised bylaws regarding the ratification of agreements negotiated by the union on behalf of its member locals. The new procedures provided that all local agreements would become effective upon an aggregate majority vote of the membership of the member locals. Thus "a given local could be bound by a local agreement even though a majority of its membership voted to reject the agreement."

IATSE reached a tentative local agreement with the Association of Motion Picture & Television Producers (AMPTP, the employer organization), which included a provision for two-person manning for certain sound crews. According to the court, Local 695 had "resisted every attempt by AMPTP to reduce the manning requirement . . . from three to two persons." Although a majority of Local 695's members voted to reject the agreement, a majority of the votes cast by the members of all of the affiliated locals approved the agreement. After a proceeding before the NLRB, in which Local 695's practice of fining members who worked the two-person crews was ruled an unfair labor practice, the Local sued IATSE and AMPTP in Federal District Court, alleging breach of fair representation and seeking declaratory relief that it was not bound by the 1976 local agreement.

IATSE then imposed a trusteeship on Local 695 (the validity of which was challenged in a separate action), and the trustee entered into a settlement agreement with IATSE and AMPTP providing that the 1976 local agreement was binding upon Local 695 and would be executed. The settlement agreement was then incorporated into a final judgment. Local 695 continued to refuse to execute the 1976 local agreement, however, and was found in contempt by the District Court and ordered to pay AMPTP $500 per day, for a maximum of 20 days, until the local and James Osburn, its business representative, signed the agreement. The court also ordered Osburn jailed at the end of the 20-day period unless and until the agreement was signed.

On appeal, Local 695 contended that the NLRB possessed exclusive jurisdiction over the matter. A Federal Court of Appeals in California, however, noted that the Local had not challenged the validity of the 1976 settlement agreement and was therefore bound to execute the local collective bargaining agreement. However, because the sanctions imposed by the District Court "were intended to be coercive and not compensatory," the matter was remanded and the judgment was ordered modified to require payment of the fine to the United States rather than to AMPTP.

A petition for a rehearing has been filed by Local 695 and James Osburn on the ground that the 1979 basic industry agreement now in force makes the sanctions imposed moot and on the ground that the validity of the settlement agreement had indeed been challenged by the Local soon after the termination of the trusteeship.

A dissenting opinion pointed out that the original action may not have been within the jurisdiction of the District Court since the basic claim for relief involved an alleged violation of IATSE's constitution and bylaws. Further, the dissent thought it an abuse of discretion to impose sanctions "in order to compel . . . the performance of a vain and useless act," finding that the settlement agreement was not voluntary but rather was "self-executing, conceived and negotiated by a trustee, the validity of whose presence was the subject of litigation, an agreement which was approved by the court and decreed to be in effect irrespective of its execution by anyone, an agreement with the substantive terms of which the Local Union has fully complied [and] which, if violated . . . was an illusory violation which concededly caused no harm to anyone and invoked sanctions which benefited no one . . .”

In another matter involving Local 695, a Federal District Court in California has upheld an arbitrator’s decision that the Local’s grievance against a producer of theatrical and television motion pictures should be dismissed (rather than determined in an “expedited” proceeding as provided for under the collective bargaining agreement), because the subject matter of the grievance — the contractually required size of the sound crew — was already being considered in a “regular” arbitration proceeding involving another employer.

International Sound Technicians Local 695 v..International Alliance of Theatrical Stage Employees, 611 F.2d 266 (9th Cir. 1979); International Sound

Technicians Local 695 v. GJL Productions, 471 F.Supp. 1085 (C.D.Cal. 1979) [ELR 1:19:5]

Termination of advertising in Las Vegas newspaper by Hughes Resorts did not violate antitrust laws

In 1967, Hughes Tool Company (the defendant Summa Corporation's predecessor) agreed with the Las Vegas Sun that Hughes Tool would advance $500,000 to the Sun for prepaid advertising. Hughes Tool would then be entitled to designate any of six hotel casino resorts controlled by Hughes or any other Hughes business to draw on this credit for their advertising in the Sun. Beginning in about 1970, the Sun reversed its previously pro-Hughes editorial policy, and this factor, as well as the approaching exhaustion of the prepaid advertising credit, led the Summa Public Relations Department to study the cost-effectiveness of Hughes Resorts' newspaper advertising. Ultimately, in 1976, when the prepaid advertising account had been reduced to a "trivial amount," Robert Bennett, the head of the Public Relations Department, decided to cancel all Hughes Resort advertising in the Sun, and directed each of the resorts controlled by Hughes to purchase no new advertising space.

The Sun contended that various corporations and individuals "combined and conspired to ruin the Sun's business by withdrawing their advertising from the newspaper, thereby violating the Sherman and Clayton Antitrust Acts as well as Nevada common law." The judgment of a Federal District Court in Nevada finding that the antitrust laws had not been violated by the defendants, that Bennett had withdrawn the advertising based upon legitimate business considerations, and that the Sun's business had not been ruined by Summa's termination of advertising, has been upheld by a Federal Court of Appeals.

The plaintiff alleged that the six resorts were separate, competing business entities and that they had "conspired" to restrain trade, violating section 1 of the Sherman Act (15 U.S.C. section 1). Two officials of Summa who were named as defendants, were also alleged to have simultaneously acted as directors of competing corporations in violation of section 8 of the Clayton Act (15 U.S.C. section 19). But the District Court concluded that "the corporations involved neither competed among themselves, nor were separate entities capable of `conspiring.'" The Court of Appeals agreed, noting that the corporations were not sufficiently independent of each other to raise antitrust concerns and that the Sun had dealt with "a single economic entity," because the late Howard Hughes had personally held (along with certain other individuals) each casino's gambling license, the resorts were operated as divisions of Summa and were held out to the public as a single business. The decision not to renew the advertising account was made soley by Bennett on the basis that advertising in a competitive newspaper would be less expensive and was not a concerted refusal to deal with the Sun.

Similarly, a common directorship on the boards of the three controlling corporations involved would not be a violation of the Clayton Act, because in the absence of competition among the resorts, the statute would not apply.

The Court of Appeals also pointed out that even if the defendants were capable of conspiring, there would be no Sherman Act violation, because the termination of advertising "had neither an anticompetitive purpose not a significant anticompetitive effect," and therefore Summa's action did not violate the "rule of reason." According to the court, "[n]ot all agreements between competitors to cease dealing with a third party are per se `restraints of trade' within the meaning of section 1 of the Sherman Act," and an agreement among competitors might be upheld under certain circumstances, particularly when a legitimate business objective motivates the action in question.

The claim under Nevada common law was also rejected by the court, as was the plaintiffs contention that it was entitled to a jury trial.

Las Vegas Sun v. Summa Corporation, 1980-1 CCH Trade Cases, Para. 63,018 (9th Cir. 1979) [ELR 1:19:6]

Briefly Noted:

Labor Arbitration.

An arbitrator in St. Louis Missouri has upheld a television station's use of "unmanned" television cameras despite the union's contention that its members had the sole right to operate television equipment and that there had been a "practice" for over 20 years of manning the cameras. The arbitrator found that the jurisdiction provision of the parties' contract did not require manning "when manning is not physically required," that technological advances had made the claimed practice inapplicable, and that there had been no bargaining negotiations regarding the use. of such cameras.

Mid-America TV and International Brotherhood of Electric Workers, Local Union No. 702, 79-2 CCH Labor Arbitration Awards, Para. 8456 (1979) [ELR 1:19:7]

Labor Arbitration.

The question of whether the termination of certain film cameramen by CBS constituted a "discharge" or a "lay-off" was a matter for arbitration pursuant to the collective bargaining agreement between CBS and the union, providing for arbitration of disputes involving a "discharge or suspension," according to a Federal Court of Appeals in New York City. A dissenting judge concluded that the dispute was not arbitrable, because the cameramen were not terminated due to unsatisfactory performance. Rather, they were laid off when electronic minicams were introduced and their jobs were no longer necessary.

CBS, Inc. v. International Photographers of the Motion Picture Industries, Local 644, IATSE, 603 F. 2d 1061 (2d Cir. 1979) [ELR 1:19:7]

Obscenity Law.

The Supreme Court of Iowa has upheld the constitutionality of a state statute prohibiting nudity in establishments where liquor or beer is sold. The court, citing the leading case of California v. LaRue, 409 U.S. 109 (1972), reh. den. 410 U.S. 948 (1973), found that the statute was within the state's police power and was not vulnerable to a due process attack because, according to the holding in LaRue, "the nudity-alcohol compound sufficiently involves the public safety, health and morals." The court also found sufficiently definite language in the statute excepting a "theater, concert hall, art center, museum, or similar establishment" from its provisions.

Three K.C. v. Richter, 279 N.W. 2d 268 (Iowa 1979) [ELR 1:19:7]

Riding Regulation.

Stewards' rulings ordering the forfeiture of purse monies won by the plaintiffs' horses, because a drug stimulant was detected in postrace urine specimens of the horses, were upheld by the Illinois Racing Board. On appeal, an Illinois Appellate Court held that the Board was not required to hold a hearing within 7 days of receiving a notice of appeal, as in the case when a racing license is suspended.

Schumpp v. Illinois Racing Board 392 N.E.2d 193 (Ill.App. 1979) [ELR 1:19:7]

Racing Regulation.

Monies accumulated in Illinois' Race Track Improvement Fund may be disbursed at the particular race track where the money was generated, upon application of the track and under the supervision and direction of the Racing Board. An Illinois Court of Appeals rejected a racetrack licensees contention that licensees should have the sole authority to designate the particular racetracks to be improved and the amounts allocated to each one.

Illinois Racing Board v. Arlington Park Thoroughbred Race Track Corporation, 395 N.E 2d 93 (Ill.App. 1979) [ELR 1:19:7]

Racing Regulation.

The Supreme Court of Illinois has upheld the introduction into evidence of the resuits of urine and blood tests done on the plaintiff's horses in an Illinois Racing Board license revocation hearing. The court reversed a lower court's injunction against the hearing, finding that available administrative proceedings and judicial review would adequately protect the horse owner against any threatened loss of income or harm to his reputation.

Graham v. Illinois Racing Board, 394 N.E.2d 1148 (Ill. 1979) [ELR 1:19:7]

Fraud.

The purchaser of a "tape package" distributorship claimed that false representations had been made by the defendant's regional distributor regarding the company's right to duplicate recordings included in the package and the payment of royalties. A Court of Appeals in Oregon has upheld an award of damages to the plaintiff based on the difference between the price paid for the distributorship and its market value on the date of its purchase, as well as damages resulting from the difference between the purchase price and the market value of the inventory. Since other unsupported elements of damages had been included in the jury's award, the matter was remanded for retrial on the issue of damages.

Criqui v. Pearl Music Company, Inc., 599 P.2d 1177 (Or.App. 1979) [ELR 1:19:7]

Broadcast Regulation.

An order of the FCC requiring KCMC, Inc. to divest itself of its television broadcast station in the Shreveport-Texarkana market has been vacated by a Federal Court of Appeals in Washington, D.C. The FCC contended that the station was under common ownership with the only daily newspaper in Texarkana and was therefore subject to divestiture pursuant to an FCC regulation prohibiting common ownership of newspaper-broadcast combinations in the same community. But the court found that the station did not encompass the entire community with a city-grade signal, and thus was exempt from the divestiture requirement under the ”plain language” of the regulation.

KCMC, Inc. v. Federal Communications Commission, 600 F.2d 546 (5th Cir. 1979) [ELR 1:19:8]

NEW LEGISLATION AND REGULATIONS

Federal Communications Commission initiates children s television programming rulemaking proceeding

The FCC has initiated a rulemaking proceeding to consider policy options regarding children's television programming. A 1979 report of the FCC's Children's Television Task Force concluded that while industry self-regulation had resulted in compliance with advertising guidelines for children's programs, standards for programming set forth in the 1974 Children's Television Report and Policy Statement had not been met. The

FCC has therefore requested public comment on methods by which broadcasters can improve the amount, scheduling and type of children's programs and thereby fulfill their "special obligation" to children.

The FCC specifically seeks improvement in the overall amount of programming specifically designed for children on commercial television; the scheduling of those programs throughout the week, not just on weekends; the development and production of more educational and informational programs; and the presentation of programs directed at specific age groups of children, including preschoolers.

Among the possible options suggested by the FCC are: rescinding its 1974 Policy Statement and relying on other program sources such as public broadcasting, federally-funded children's programs and cable television; maintaining the Policy Statement and continuing broadcaster self-regulation with the possibility of modifying the television license renewal form to obtain more information about licensee programming practices for children; interim mandatory programming rules establishing minimum amounts of weekday educational programming (though such rules might be rescinded when the number of video outlets in each market would insure the likelihood that educational programming would be available without FCC intervention); or the adoption of a processing guideline, i.e., license renewal applications would be reviewed to determine whether standards for educational children's programming have been met.

The FCC has concluded that it possesses constitutional and statutory authority for a mandatory programming rule, including a rule requiring specific categories of programming for a minimum number of hours; but it has requested comment on the legality of permitting classes of licensees, such as network affiliates and independent stations, to be treated differently.

In separate statements, several commissioners commented on First Amendment questions in mandating amounts of programming, the difficulty of distinguishing between "educational" and entertainment programs, and the possibility that selfregulation might eventually achieve FCC objectives.

Comments must be received by the FCC by June 2, 1980 and reply comments by August 1, 1980. For further information, contact Susan Greene, (202) 653-5940.

Notice of Proposed Rulemaking in Docket No. 19142, Children's Television Programming and Advertising Practices, 45 Fed. Reg. 1976 (1980) [ELR 1:19:3]

Internal Revenue Service issues two rulings eliminating anticipated advantages of art acquisition tax shelters

It appears that the merchandising of fine art can be as businesslike as the promotion of any product. Recently, however, two creative plans for the sale of art works as "tax shelters" have had their anticipated tax advantages eliminated by rulings of the Internal Revenue Service.

In one revenue ruling, a taxpayer bought limited edition art books, at a substantial discount, from the books' foreign distributor. The taxpayer was told that the fair market value of the books was their established retail price in the foreign country; that the books could be held for a year and then donated to charitable organizations; and that the taxpayer then would be able to claim a charitable deduction for the amount of the retail price of the books. The foreign distributor warehoused the books for the taxpayer for just over a year, and then mailed them directly to charitable organizations selected by the taxpayer.

The IRS ruled that the taxpayer's contribution activity was tantamount to that of a dealer selling books as a part of its trade or business. In such cases the charitable deduction is reduced by the amount of the gain that would not have been recognized as long-term capital gain, if the books had been sold by the taxpayer for their fair market value. Generally, this means that the charitable deduction will be reduced to the cost of the books. However, the IRS also questioned whether the fair market value of the books in this country would be the same as their retail sales price in a foreign country. The IRS indicated that the book's fair market value here might be even less than what the taxpayer paid for them. If so, the charitable deduction would be limited to their fair market value here in the United States.

The second ruling involved the sale of an original "master" lithographic plate, the right to 300 limited edition prints made from it, and all copyrights to the master and its images. The purchase price was S200,000, only $30,000 of which was paid in cash. The $170,000 balance was payable pursuant to the terms of what was described as a "partial recourse" note. The taxpayer allocated the entire $200,000 purchase price to the master plate, which he intended to depreciate and for which he intended to claim investment tax credit.

The issues ruled upon by the IRS were: (1) whether the $170,000 note could be included by the taxpayer in his basis, (2) whether the taxpayer's basis could be allocated entirely to the master plate, (3) whether the taxpayer could depreciate his investment, and (4) whether the taxpayer could claim investment tax credit.

The IRS ruled that the $170,000 note could not be included in the taxpayer's basis. Although the terms of the note made it a full recourse note for $70,000, the taxpayer's liability even for that amount could be discharged by transferring prints to the noteholder at a price, determined by a formula, which could be greater than the prints fair market value. The IRS therefore concluded that the note was entirely nonrecourse. Nonrecourse notes may not be included in basis, unless the value of the property purchased can be shown to be approximately the value of the entire purchase price, including the note. In this case, the IRS concluded, from expert opinion, that the primary value of the items purchased was in the 300 prints; that the master plate had little value; and that the fair market value of the items purchased was only $30,000. Accordingly, the IRS ruled that the basis was $30,000, not $200,000.

The IRS also ruled that the $30,000 basis had to be allocated between the master plate and the 300 prints in accordance with their relative values, and that the taxpayer could not allocate the entire basis to the master plate itself.

The IRS also ruled that the taxpayer could not depreciate the basis, because art objects do not have a determinable useful life.

Finally, the IRS ruled that the taxpayer could not claim investment tax credit for the amount allocated to the master plate, because it had a useful life of less than three years (because it would not be used after the 300 prints were made).

More over, the IRS pointed out that if the taxpayer was deemed to be engaged in the trade or business of selling art, the prints would be his stock in trade, and no depreciation or investment tax credit would be allowable with respect to them for that reason also.

Internal Revenue Rulings 79-419 and 79-432, 1980(10) CCH Standard Federal Tax Reports, Para. 6265 and 6272 [ELR 1:19:4]

DEPARTMENTS

In the Law Reviews:

Sunlight in the County Jail: Houchins v. KQED, Inc. and Constitutional Protection for Newsgathering by Roberta L. Cairney, 6 Hastings Constitutional Law Quarterly 933-973 (1979)

Should Children be Protected from TV Commercials? by Joseph Mathews, 8 Human Rights 24-27 (1979)

Corporate Plaintiffs in Libel Actions: Rosenbloom Resurrected?, 1 Western New England Law Review 741-758 (1979)

Symposium on the Press Clause, 7 Hofstra Law Review 559-720 (1979)
Equine Syndications: Are They Securities 6 Northern Kentucky Law Review 361-378 (1979)

FCC Parts with Traditional Policy In Its Children's RuleMaking by Richard E. Wiley, The National Law Journal, February 11, 1980, pg. 25 [ELR 1:19:8]

Book Note:

The Musician s Manual

The Beverly Hills Bar Association Barristers Committee for the Arts, in conjunction with its recent Music Symposium, has compiled "The Musician's Manual - A Practical Guide to Your Career." The manual provides a helpful basic introduction for musicians and attorneys to many practical and legal aspects of the music industry, such as the selection and protection of group names, copyright registration, music unions and performing rights societies. Also included is a paragraph-by-paragraph annotation of a standard recording agreement.

Copies of the manual are available by sending a check for $11.60 (which includes tax, postage and handling) payable to the Committee for the Arts, to the Beverly

Hills Bar Association, 300 South Beverly Drive, Beverly Hills, CA 90212. [ELR 1:19:8]