LEGAL AFFAIRS

International Tax Planning for Artists in the Entertainment Industry (Part 1)

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I. International Income Tax Planning

A. Overview

Today, films and television co-productions are routinely being financed jointly by investors from two or more countries; motion pictures are being filmed in several countries; and the international distribution of films is being undertaken by a number of independent distributors (as well as by the major studios). Therefore, tax planning for important artists is often international tax planning. (In this article, the term "artists" includes athletes as well as other performers, writers, directors and producers.)

Not long ago, the work of tax practitioners representing artists and athletes focused on reviewing tax shelters, dealing with the investment tax credit on films - an important incentive for an independent television production, as well as for tax shelters and setting up loan-out companies with pension and medical plans.

Today, for many practitioners, the focus is shifting to the international arena, and also to estate planning since death taxes now have a maximum federal rate of 55%, whereas the maximum federal income tax rate is only 28%.

Recent tax legislation, together with lowered income tax rates, have made most motion picture tax shelters unsound investments for individuals. Recent tax legislation has also reduced the size of permissible pension contributions to a point where pensions provide only modest benefits to very successful artists and athletes. Further, the investment tax credit has been repealed. However, on a daily basis, we must plan for: (i) American artists going abroad to work and live, often for extended periods of time; (ii) foreign artists coming to the United States to work, and sometimes to invest and to live; and (iii) producers and distributors making and distributing films across national boundaries. Lawyers often find it advantageous to establish European offices in order to better serve their clients. (In January, Loeb and Loeb will open an office in Rome.) Therefore, tax advisors will have to work out the tax problems relating to the international practice of law, as well as the tax problems of their clients.

Planning to avoid multiple taxation (and on occasion being able to avoid even single taxation) in the international arena is a three-dimensional game of chess.

Because our topic is tax planning for artists and athletes, we are deliberately excluding the very complex tax planning problems involved in international motion picture production and distribution.

B. Planning for Foreign Artists Coming to the United States

1. Foreign Actors, Actresses and Athletes

a. Tax Treaties With Artists and Athletes Clauses

The United States has an extensive network of international bilateral tax treaties with other countries around the world. This system of treaties facilitates the growth of the global economy by allowing foreign businesses, with only modest planning, to minimize the impact of federal income taxes until they establish a substantial presence in the United States. (Generally, this substantial presence is referred to as a " permanent establishment.")

However, it is usually irrelevant whether or not the United States has a tax treaty with an actor's or actress' home country because most of our tax treaties contain "artists and athletes" clauses which preclude tax treaty protection for performers earning substantial amounts of money. (See, for example, Article 17 of the United Kingdom/United States income tax treaty. Some countries, such as France, treat film directors as performers and deny them tax treaty protection.) Some United States tax treaties with artists and athletes clauses will still protect earnings of up to $10,000 to $15,000 per year (generally inclusive of expense reimbursements), so as to avoid withholding on lesser cast members working for foreign companies or sometimes as "independent contractors".

If the artist will unavoidably be taxed in the United States (either because he resides in a country without a U.S. tax treaty, or because the applicable treaty has an artists and athletes clause), tax counsel should consider whether the artist will obtain a credit for all or a part of the United States tax in his home country. If there will not be full credit for the United States tax, then tax counsel should try to obtain maximum deductions in the United States so as to reduce United States income taxes. Also, in some cases, part of the artist's compensation can be allocated to non-U.S. services, or to non-performing services which can be protected by treaties.

b. Older Treaties Without Artists and Athletes Clauses

Most of our tax treaties now have "artists and athletes" clauses. However, a few tax treaties (e.g., the United States tax treaties with Switzerland, the Netherlands and Ireland) do not contain "artists and athletes" clauses and, hence, these treaties still provide protection to performers who reside in those countries and who work for the specified type of foreign company which has no U.S. permanent establishment. But see, Ingemar Johansson v. United States, 336 F.2d 809 (5th Cir. 1964), where the Court of Appeals held that a boxer who claimed to be a Swiss resident employed by a Swiss corporation was not entitled to the benefit of the United States/Swiss tax treaty on the grounds that, in reality, he was not a bona fide Swiss resident, and further that he was not a bona fide employee of a Swiss Corporation.n1

Even where an applicable tax treaty does not contain an artists and athletes clause, treaty benefits for services are generally only available if the foreign person is providing services as an employee of a foreign corporation with no U.S. permanent establishment, or, in the case of our newer treaties, as an independent contractor.

In its two 1974 "Lend-A-Star" rulings (Rev. Rul. 74-330, 1974-2 CB 278 and Rev. Rul. 74- 331, 1974-2 CB 281), the Internal Revenue Service ("IRS") takes the position that actors and actresses who are furnished by their foreign loan-out companies to a United States production company will usually be deemed to be employees of the United States production company that utilizes their services and, therefore, ineligible for tax treaty protection and hence subject to withholding under IRC Sec. 3401 and 3402 (or, if they are independent contractors without tax treaty protection, under IRC Secs. 1441 and 1442). The IRS views actors and their foreign loan-out companies as merely the actor's booking agent, rather than his employer.(2)

If the United States production company withholds on a payment to a foreign loan-out company notwithstanding the company's tax treaty protection, it would be difficult for the foreign artist to individually claim credit for the tax on his personal return in his home country. However, since the theory of the withholding is that it is merely a method of collecting tax on the compensation of the artist (i.e., under the applicable treaty, the company is not subject to U.S. tax, and the "Lend-A-Star" rulings say that the loan-out company is merely the artist's "booking agent"), it might be possible to obtain a ruling that the tax is imposed on the artist and that the withholding agent should issue the withholding forms in the name of the individual artist to reflect this. England does this when an American star works in the U.K. through a loan- out company - i.e., it permits the issuance of withholding forms in the name of the individual artist rather than in the name of the loan-out company.

These "Lend-A-Star" rulings have not been tested in the courts and they could possibly be invalid since they may conflict with our treaty obligations.n3 However, these rulings have been cross-referenced and cited in Treas. Reg. Sec. 1.1441-4(a)(1) and in IRS Publication 515. The major studios generally follow these rulings and withhold on payments to foreign loan-out corporations in order to avoid the unlitigated and, therefore, uncertain risk of liability for failing to withhold. Once there is withholding, the foreign artist must file a refund claim and either litigate the issue, or possibly work out a compromise with the IRS since the IRS has also been hesitant to take this issue to court.

Independent production companies are sometimes more willing to take the position that these "Lend-A-Star" rulings and the above- mentioned Treasury Regulation and IRS Publication 515 that cite them with approval are invalid, and to pay the artist's foreign loan-out company without withholding if the company has tax treaty protection and files Form 1001, or if it files Form 4224. (But see, footnote 5, below, regarding the use of this Form 4224 by certain service companies.) However, the independent production company which does not withhold is likely to insist on an indemnity which is fully secured by bank deposits for several years.

It may be possible for an important star to be treated as an independent contractor and not as an employee for purposes of the tax treaties provided that the contract properly reflects the independent status of the star. See, Rev. Rul. 87- 41, 1987-1 CB 296 relating to the differences between an employee and an independent contractor. This is only advantageous if the artist has the benefit of a tax treaty that protects independent services and that has no Artists and Athletes clause. Band members and others who do not receive substantial fees may be able to use this approach even if there is an artists and athletes clause since these clauses often are inapplicable to earnings up to a specified amount [ranging from $3,000 to about $20,000, often inclusive of expenses]. When there is such a treaty, if Form 8233 is filed at least 10 days in advance of the payment and if the IRS doesn't object, the production company can safely pay the foreign star, free of withholding.

In conclusion, the ideal situation is for an artist to work as an independent contractor if the applicable treaty covers such independent services and if the artist is properly treated as an independent contractor. The second choice (if the performing artist has tax treaty protection as an employee and if the United States party paying the foreign artist is willing to pay free of withholding based on an indemnity) is for the foreign artist to work as an employee of a foreign loan-out corporation. (Of course, if there will be no net profit after expenses, or if the artist will obtain full credit for the U.S.

tax in his home country, then there is no reason to use a foreign corporation or to give the payor of the compensation an indemnity to induce him not to withhold U.S. tax.) Using a tax indemnity in this way is an aggressive approach, as it is contrary to the published position of the IRS. The foreign artist would be required to file a U.S. tax return and show the excluded compensation as required by TD 8262, approved on July 19, 1989, adopting Temporary Treas. Reg. Sec. 301.6114-IT. If withholding cannot be avoided, the artist must weigh his chances of success of sustaining tax treaty protection in a refund claim (or working out a compromise with the IRS) versus using a domestic corporation so as to obtain the benefits of a medical plan, a pension plan and probably more deductions than he could persuade the IRS to allow in a withholding agreement for the foreign loanout corporation. In deciding whether to use a foreign corporation, the amount of tax involved must be weighed against the legal and other costs in arranging a withholding agreement and in pursuing a refund claim, the risk of failure and the added visibility involved in first negotiating a withholding agreement to take business expenses into account and then filing a refund claim.

If withholding cannot be avoided, and if the artist intends to still use a foreign corporation and file a refund claim to recover the withholding, then the foreign artist should plan his relationship with his loan-out company so that there is a reasonable chance of success in court under the tests discussed in footnote 2, above.

It will usually be possible for a foreign corporation to negotiate a withholding agreement with the IRS to take legitimate business expenses into account, and still preserve the artist's ability to file a refund claim based on the treaty. A refund claim may well be granted where, for example, an Irish resident is loaned out by an Irish corporation and where the Irish treaty has no "artists and athletes" clause. The chances of success in pursuing a refund claim are much less, for example, when an artist who is resident in the Bahamas is furnished by a Netherlands corporation so that the refund claim is based solely on the treaty protection for the "industrial and commercial profits" of the Netherlands corporation.

Finally, if the foreign artist decides to use a United States loan-out company and forego tax treaty protection, that corporation should act as the artist's sponsor for immigration purposes if withholding on payments to that corporation is to be avoided. If the production company is the sponsor, the IRS will send a notice to the production company to withhold on payments to that loanout company.

The IRS has taken the position in its manual that withholding agents should withhold on payments to even domestic loan-out companies of foreign artists, although this is not often done at present, except in the case of the most important touring singers or bands. See, footnote 10, below.

Note that law and accounting firms should be wary of making payments on behalf of clients to foreign entertainers or foreign loan-out companies through their clients' trust accounts without first considering the legal issues involved, since these firms can be considered to be withholding agents and hence liable for failure to withhold.

2. Foreign Singers and Musicians

a. United States Tax Exemption for Foreign Touring Companies

For most touring groups (i.e., all except the very most successful groups), the most practical approach is to use a U.S. corporation, preferably one owned by an

American. Usually the IRS won't tell the venues to withhold on payments to such a U.S. corporation unless a major touring star is involved, and, after deducting expenses, commissions and "per diems," most tours will be lucky to break even.

The major stars have a different problem. There is a real risk that the IRS will instruct the venues to withhold, even on payments to a U.S. company, if there is no advance ruling or withholding agreement. Further, the tour of a major star is likely to generate substantial profits.

If you are dealing with an important star and if that artist is one of the very few such stars who are residents of a country (e.g., Ireland, the Netherlands or Switzerland) which has a tax treaty with the United States that does not contain an artists and athletes clause, then the foreign company producing the show and the artist may both be able to avoid United States federal income tax.n4

If it is eligible, the foreign touring corporation should file Form 1001 with the promoter or other party making the payment,n5 in order to claim treaty benefits and avoid withholding under IRC Sec. 1441. This form is valid for three successive calendar years. See, Treas. Reg. Sec. 1.1441-6(c)(2).

An artist who wishes to use a tax treaty to avoid taxes imposed by the Internal Revenue Code must now attach to his federal income tax return a statement that complies with recently adopted Temporary Regulation Section 301.6114- IT, TD 8262, 54 FR 37451 (9/11/89).

The foreign corporation producing a foreign artist's entire stage show is not merely furnishing personal services in the way that a loan-out company furnishes the services of an actor.n6 Rather, it hires a number of people and presents an entire production and, hence, its profits should be protected from United States taxation under applicable tax treaties as "industrial and commercial profits" which are exempt from federal income taxation so long as the foreign corporation has no United States permanent establishment. See, e.g., Article 7 of the United States/United Kingdom income tax treaty. The scenery and equipment of such a company should not ordinarily constitute a permanent establishment that will allow the United States to tax the company.

The corporation making such a payment must file Form 1042 and 1042S with respect to the payment. Form 1042 "Annual Withholding Tax Return for U.S. Source Income of Foreign Persons" is due on March 15 for all payments subject to withholding under IRC Sec. 1441 and made during the preceding calendar year whether or not exempt under a treaty. Form 1042S must be filed with respect to each payee, even if exemption was claimed by the payee through a Form 1001.

Although there should arguably be no withholding on the payment to the company putting on an entire show if it has no permanent U.S. establishment, if the star individually has no treaty protection (e.g., because of an artists and athletes clauses), the IRS is most likely to require withholding, at least on that part of the foreign company's profits that is attributable to the services of the star.n7 Most of the private letter rulings that preclude withholding deal with symphonies and non-profit theatre groups, but it is possible that a ruling would be obtained for a touring show if the corporation is owned by the producer rather than by the star and if there are assurances that there will be withholding on the salary paid to the star.

The star who is employed by a foreign company with no permanent establishment in the U.S. will be protected if the applicable tax treaty, like the Swiss, Netherlands and Irish treaties, has no artists and athletes clause.

The foreign corporation may seek a private letter ruling in advance to avoid the risk of withholding,n8 and private letter rulings may be available for a company producing an entire touring show (especially if it is not owned by the artist, such as a non-profit symphony, theatre or dance company) because it is not a personal service company that merely furnishes the services of an artist. See the rulings of this type cited in footnote 7 above. But see page 3 of IRS Publication 515 regarding withholding on payments for services to certain Personal Holding Companies, since this could apply to some touring companies when the principal artist in the show owns at least 25% of the shares of the company and when there is no other important artist in the show. See Treas. Reg. Sec. 1.543- 1 (b)(8)(ii).

Sometimes the IRS sends notices to the promoter to withhold when a highly publicized foreign artist comes to the United States (whether he uses a foreign corporation or a domestic corporation). The theory of the IRS in sending such notices is that the promoter does not have sufficient facts to know whether the claimed tax treaty exemption is, in fact, applicable, for the reasons described in footnote 8, above (e.g., whether the artist is, in fact, a resident of the treaty country and a true employee of the foreign corporation, and whether the artist will be present in the United States for 183 or more days during the year). The IRS takes the position that the foreign corporation should either obtain an advance ruling, or allow withholding and then file a refund claim so that the IRS will have an opportunity to review the facts and determine whether the tax treaty is applicable.n9

If the promoter withholds 30% of the gross income, the withholding will often be more than 100% of the net income. Therefore, if a private letter ruling cannot be obtained and if the treaty doesn't protect independent services, then it may be advisable for the corporation to enter into a Central Withholding Agreement with the IRS so that there will be withholding only on the net income. See, Treas. Reg. Sec. 1.1441-4(b)(3) and IRM Sec. 56(10)2.5 regarding Central Withholding Agreements. Both foreign and domestic corporations can avoid withholding by entering into such agreements with the IRS. See, Revenue Procedure 89-47, 1989-33 IRB 29 (8/14/89) for procedures to obtain such Central Withholding Agreements.

If reputable U.S. accountants are involved, the IRS will usually allow the total payment to flow to the foreign or domestic corporation if a budget is approved by the IRS and if there are assurances that the net income will be paid out to the artist subject to withholding (or possibly free of withholding if the corporation is foreign and if one of the few treaties without an artists and athletes clause is applicable).

The foreign singer might present his show as an individual if one of the very few tax treaties that has no artists and athletes clause and that protects independent services is applicable. In such rare cases, possibly a partnership (e.g., one comprised of a rock group), can also obtain the protection available for independent services. Withholding might then be avoided if Form 8233 is filed ten days in advance of the first payment. See the text preceding footnote 11. Of course, it would be important to carry adequate insurance because there would be a greater risk of personal liability if a corporation is not used.

Note that if the foreign musician also writes music, or if he licenses his name and likeness for merchandising, the royalty provisions of the applicable treaty may be effective in reducing or avoiding United States tax on the royalty income generated. Counsel should also consider whether the composer's home country will allow the use of an "off-shore" structure (e.g., a company formed in the Netherlands) to own literary or musical compositions and to license the use of his name and likeness so that tax on royalties can be minimized in the artist's home country, as well as in the United States.

b. Planning for Individual Artists (i.e., not touring artists)

In most cases, a foreign performing artist will not have tax treaty protection in the United States because of the artists and athletes clause in most of our tax treaties and hence they will be subject to U.S. tax. If the artist can obtain credit in his home country for the federal and state tax, he can merely come to the U.S. as an employee of the American production company.

If the actor cannot obtain credit in his home country for the United States tax, he will want to minimize the

United States tax. He should consider using a United States corporation to avoid withholding on his gross income.n10 The United States corporation could adopt a pension plan and a medical plan (if there are not other employees who would be expensive to cover), and pay other fees, commissions and expenses which will substantially reduce the income that will be paid out as wages subject to United States income tax.

A much better result can be achieved by filing Form 8233 in duplicate with the withholding agent if an artist can claim tax treaty protection as an independent contractor, but there are very few treaties that have no artists and athletes clause and that protect independent services. If the withholding agent acts in good faith and has no reason to believe that the artist is ineligible for treaty benefits, the withholding agent should avoid the risk of liability by filing one copy of this form with the IRS at least ten days in advance of the payment to the artist. If an actor can qualify for tax treaty protection as an independent contractor, this is advantageous because a United States company can safely make the payment to him as described above without withholding. (Form 8233 may also be available to a musical group that tours in the United States as a partnership.)

If the actor is an employee of a foreign corporation, the withholding agent can only obtain similar protection by requesting a private letter ruling. See the discussion of such loan-out situations in C.1., below. Note that the withholding agent must attach a copy of Form 8233 to Form 1042S that is filed on or before March 15 with respect to payments to that artist during the preceding calendar year.n11

c. Social Security Taxes

If the artist is resident in a country that has a social security "totalization agreement" with the United States, the artist may be able to avoid paying FICA and FUTA taxes in the United States, if he is an employee of a foreign corporation. See, Rev. Proc. 84-54, 1984-2 CB 489 regarding the use of such totalization agreements. See also, the discussion of totalization agreements in footnote 15, below. As November 30, 1988, the United States had totalization agreements with Belgium, Canada, France, Germany, Italy, Norway, Spain, Sweden, Switzerland and the United Kingdom, and such agreements are under negotiation with Australia, Austria, Brazil and Ireland. Some of these agreements require that the artist be employed by a corporation formed in his country of residence (as contrasted to allowing him to be employed by a corporation formed in any other country). Also, some of the agreements allow an American artist to avoid the other country's social security taxes if he works as an independent contractor, but it may be necessary that he regularly works as an independent contractor in the United States in order to properly be entitled to this protection.

If the artist is to be employed by a United States company, social security taxes will ordinarily be imposed and the artist should go to the social security administration with his passport and visa which shows that he is authorized to work here, and he will be given a social security number. (This can be done by mail, but using the mail is a very slow process and usually it is best to obtain the social security number in person.) Even if the artist is employed by a foreign company, FICA taxes are supposed to be paid, but I question whether this is often done in practice. See IRC Sec. 3121(b) and the regulations thereunder. If a non-resident alien artist works in the United States as an independent contractor, self employment tax is not imposed, even without a totalization agreement. IRC Sec. 1401(a). See also, 340 T.M., Non-resident Individuals - U.S. Income Taxation, at A-48.

d. State and Foreign Withholding Tax Issues

Some states require withholding of state tax on touring singers and musicians. Federal tax treaties do not preclude the imposition of state taxes. Wisconsin, Illinois, California and Massachusetts (and often Ohio) enforce tax withholding. In some states (e.g., Wisconsin and Massachusetts) the corporation should submit a budget of projected income and expenses so that withholding will be made only on net income, rather than on gross income. Canada and England also allow a budget to be filed and, if the budget is approved, they pen-nit withholding to be made on estimated net income, rather than on gross income. This approach is similar to our Central Withholding Agreement. Although the tax rate is higher if the artist chooses net withholding in England or Canada, still the actual tax will often be lower.

3. Foreign Producers and Directors

a. Treaty Benefits

Artists and athletes clauses are interpreted by the United States and by most other countries to apply only to performers - not to writers, producers, directors and other "behind the scenes" personnel. (However, some countries, such as France, treat directors as artists so you should check in each instance.) Unlike actors, important writers, producers and directors can usually be treated by the IRS as independent contractors, especially if contracts are properly prepared. (Counsel should consider whether liability is limited to Workers Compensation if the artist is loaned-out or works as an independent contractor. It may be wise to provide that the artist is a "Special Employee" for purposes of Workers Compensation, even though the effects of such provisions have not been determined by the courts. Many liability policies of production companies have a "loaned employee" endorsement to protect loaned employees, and the artist's counsel should be sure that such a rider is included in the liability policy.)

If the United States tax treaty with the artist's home country protects independent services, such artists will not need to worry about the above "Lend-A-Star" rulings.n12 The IRS may be unwilling to grant a private letter ruling in a loan-out arrangement, but, as discussed in B.3., above, an independent contractor may avoid withholding by filing Form 8233. See, Treas. Reg. Secs. 1.1441- 4(b)(1)(iv) and 1.1441-4(b)(2). Unfortunately, some of the older United States tax treaties (such as the

Swiss and Irish treaties) do not prevent the imposition of tax on artists providing independent services.

Of course, if the artist will obtain full credit in his home country for the United States tax, then planning to avoid U.S. tax is unnecessary.

If full credit will not be obtained for the United States tax, then in those cases where a tax treaty provides protection for employees but not for independent contractors, the writer, producer or director might perform any United States services as an employee of his foreign company, if the production company will accept an indemnity and not withhold under the "Lend- A-Star" rulings, discussed in II.A.2., above. If the withholding agent will not accept an indemnity and will insist on withholding, the artist should consider: (1) whether to obtain an agreement to reduce withholding so that it is imposed only in the corporation's net income; or (2) whether to use a United States corporation to reduce taxes by obtaining more liberal deductions. If a foreign corporation is to be used, the artist must be prepared to file a refund claim to recover the withholding. Note that the IRS may try to compel withholding even when a domestic corporation is used. See, footnote 10, above. This is not often done if the loan-out company acts as the sponsor of a producer or director for immigration purposes. As between these two alternatives, each situation must be decided on its own facts.

The risk of withholding on a United States loan-out company is greatly increased if the studio applies for the artist's visa as his "employer" because the Immigration and Naturalization Service ("INS") will then advise the IRS that the studio is the employer, and the IRS will send a notice to the studio, as the employer, to withhold on payments to the loan-out company. Therefore, the artist's loan-out company should apply to INS as the artist's sponsor and employer to bring the artist into the

United States. A knowledgeable immigration attorney who works regularly with entertainers and who has the cooperation of the studio should be able to have the loan-out company of an important artist approved as the artist's sponsor.

If the foreign writer, producer or director decides that he has a good argument to support his claim to tax treaty benefits as an employee of a foreign corporation, and if he is willing to file a refund claim and attempt to recover any tax that may be withheld, there are some actions he can take to reduce the risk that a court will apply the "Lend-A-Star" rulings to his situation:

(a) The foreign company can provide various employees and production services and not merely loan the artist's services. See the rulings cited in footnote 7 above.

(b) The writer, producer or director should, if possible, use a company that he does not own. He should have no interest in the company's profits (possibly a discretionary bonus would be allowed). He should have a continuing relationship with the same loan-out company, and not come to the United States shortly after starting to use the company. (If the producer or director is to receive a profit participation or ownership interest in the film, it might be best if such profits are not earned by the same loan- out company that receives his fixed fee. For example, the profits might be earned by the artist individually as an executive producer, largely for foreign services, and he might receive the fixed fee through the loan-out corporation for directing the film in the United States. Each case must be considered on its facts, but separate planning should be done for such profits.)

(c) The artist individually should avoid having a United States office or other permanent establishment if he is an independent contractor. The artist must also avoid having his foreign corporation maintain a United States office or other United States permanent establishment if he is claiming treaty tax exemption as an employee of that corporation. See, George Simenon, 44 T.C. 820 (1965). If a producer or director is employed by a United States permanent establishment of a foreign corporation, he is treated in the same way as if he were employed by a United States corporation for purposes of the above tax treaty provisions, and hence he would be ineligible for treaty protection.

(d) The loan-out company should be well capitalized so that it bears some risk under the employment agreement, which should be for a period of several years, and the artist should have no veto for the use of his services.

(e) See the IRS criteria for a valid loan-out arrangement as set forth in footnote 2, above.

b. No Treaty Benefits

Planning for a writer, producer or director coming to the United States without tax treaty protection ordinarily involves (i) obtaining the maximum benefit from deductions by using a domestic corporation, and (ii) allocating as much of the client's compensation as possible to work done abroad or to the use of the artist's name and likeness abroad, or to the sale of the writer's story to the company using his services.

On the other hand, occasionally artists (e.g., artists from France and Sweden) are very happy to pay United States tax at 28% because they do not merely obtain a tax credit in their home country for the United States 28% tax. Rather, by paying a 28% United States tax, they will, under French and Swedish tax law, be entitled to completely avoid the much higher tax in their home country! However, France will impose a very low rate of tax on the gain from the sale of an artist's copyright held for more than two years, so a French artist will want to avoid United States tax on such profits and to pay United States tax only on income from services. In each case, the best approach can only be found by the cooperative efforts of U.S. and foreign tax advisors.

4. Planning for Foreign Artists Establishing United States Residence

a. Early Planning Essential

If a foreign artist who comes to the United States might become a tax resident of the United States,n13 it is important that tax planning be done by telephone between the tax advisor in his home country and United States tax counsel before the artist comes to the United States.

A United States resident is taxed on his worldwide income (including some types of income earned by controlled foreign corporations). The first year of an artist's

United States residence generally starts on the day of that year when he first comes to the United States, and planning can best be done before the start of his United States residence.

b. Residency Test

An artist will be a United States resident if the number of days the artist is present in the United States during the current year, plus 1/3 of the days he was present during the preceding year, plus 1/6 of the days he was present during the second preceding year equals or exceeds 183 days.n14 If the artist is in the United States annually at least 122 days, he will be a resident (unless he has closer connections to another country as described below) because 122 + 122/3 + 122/6 = 183. Note that the above physical presence text does not apply to some professional athletes. See, Prop. Treas. Reg. Sec. 301.7701(b)-3.

If an artist is present in the United States for less than 183 days during the current taxable year (without regard to the two prior years), but he has closer connections to another country, he will be a nonresident of the United States. See, IRC Sec. 7701(b). However, in the absence of the treaty protection, if an artist is in the United States for over 183 days in one taxable year or has a green card, he will be a United States resident, even if he has closer connections to another country. But if the artist's "closer connections" are to another country with which the United States has a tax treaty and if he uses that treaty to reduce United States tax on at least one item of income, then, even if he is present here for 183 or more days during the year in question, the provisions of the applicable tax treaty can still cause the artist to be a nonresident of the United States under the IRC for purposes of income taxes. See, INTL-56-86, 1987-2 CB 948, setting forth Prop. Treas. Reg. Sec. 301.7701(b)-7.

c. Income First, Residency Second

If the artist is going to become a United States resident, then income and capital gains should be accelerated before the artist comes to the United States, possibly by related party transactions, provided that it will not result in tax or undue expense in the artist's other country of residence. See, the authorities cited in Prentice-Hall Federal Taxes, Para. 14,468 with regard to the circumstances under which the IRS will recognize related party transactions. On the other hand, built-in losses should not ordinarily be recognized until after the artist moves to the United States. See, Rev. Rul. 80-17, 1980-1 CB 45 with regard to expropriation losses. Certain expenses should be deferred and paid after the artist comes to the United States, unless the expense will produce a greater tax benefit in his home country. See, generally, Prentice-Hall Federal Taxes Para.30,248 relating to sources of income and change of residence status. See, also, IRC Sec. 7701(b)(10) and Treas. Reg. Sec. 1.871-13 regarding the possibility of deferring the receipt of foreign source income until after an artist terminates his U.S. residence.

d. Estate/Gift Tax Issues

If an artist is going to become a United States citizen or otherwise domiciled in the United States, gift and estate tax planning, as well as income tax planning, should be done before he becomes domiciled here. (See, Part II of this article regarding estate planning.)

For non-domiciled persons, it is advisable for investments in United States corporate securities to be originally made through a foreign corporation so as to avoid United States death taxes on United States situs property. If such securities are not originally bought by a foreign corporation, a contribution of appreciated securities to a foreign corporation would be subject to an excise tax under IRC Sec. 1491 if the artist is resident here for income tax purposes (because income tax treaties don't protect against excise taxes), but a sale of the securities to a foreign corporation might avoid United States income tax if there is an applicable income tax treaty because a sale of appreciated securities generates income that is often protected by treaty - it does not cause an excise tax to be imposed.

NOTES

1. The United States tax treaties with Switzerland and Ireland require that the performer be employed by a

Swiss (or Irish) corporation. However, the United States/Netherlands tax treaty only requires that the Dutch performer be employed by a non-United States corporation. Also, the definition of "resident" in the Swiss treaty is less favorable to the taxpayer than is the case in most tax treaties. it is imperative that the applicable tax treaty provisions be carefully reviewed because there are important differences among the various United States tax treaties.

2. These "Lend-A-Star" rulings say that the IRS would accept the foreign loan-out company as the artist's true employer if: (1) the artist has no ownership interest in the loan-out company; (2) the artist will receive only a fixed salary and has no interest in the profits of the loan-out company, (3) the artist has a continuing work relationship with the loan-out company, (4) the artist has imposed no restrictions on the loan-out company's use of

his services and the artist has no veto right over engagements, (5) the artist is subject to the control and direction of the loan-out company as to the time, place and manner of performance, (6) the loan-out company assumes the financial risk of the artist's performance, and (7) the services performed by the artist are part of the regular business of the corporation. See also, Rev. Rul. 87-91, 1987-1 C.B. 296; and Rev. Rul. 75-41, 1975-1 C.B. 323 which discuss the tests of whether a person is an employee of a loan-out company. However, it would be very unusual for a loan-out arrangement to meet all of the above tests. It, therefore, would be almost impossible to obtain a favorable ruling on a loan-out situation if all these tests must be met. However, the IRS might respect a loan-out arrangement on a refund claim if the artist is a resident of the country where the corporation is formed, even if some of these tests are not met. Nevertheless, in planning a loan-out arrangement, counsel should meet as many of these tests as possible so that, if the matter should ever be litigated, the artist's position will be as strong as possible.

3. The last paragraph of the Technical Explanation of Article 17 of the current United States/United Kingdom income tax treaty cites these rulings, but gives no indication as to their validity or why the "artists and athletes" clause was needed (except for independent contractors and the few musicians and dancers who are typically employees of an unrelated party) if the rulings are valid. See also, Treas. Reg. sec. 31.3401(a)(6)-1(e), 1.1441-6(c) and 1.1441-4(b) which appear to be contrary to these rulings. The fact that these rulings have not been tested in court for fifteen years after they were issued indicates that the IRS has not been anxious to have them tested, since they are quite effective without a judicial decision and gradually the "artists and athletes"

clauses in our newer tax treaties are dealing with this situation.

4. As discussed in B.4, below, United States income tax treaties do not generally prevent the imposition of state income taxes on payments to foreign entertainers or their loan-out companies.

5. If the foreign company is doing business in the United States, it would file Form 4224 instead of Form 1001, but the foreign company must be doing business here without having a "permanent establishment"; otherwise, the corporation and its employees will not have tax treaty protection. See, however, the instructions to Form 4224 and also page 3 of IRS Publication 515 (Rev. Nov. 1988) for limitations on the ability of certain personal services companies to use Form 4224 to avoid withholding. See Casanova Company, 87 T.C. 214

(1986), regarding the effect of filing such forms after the due date.

6. Treas. Reg. Sec.1.1441-6(c)(1) provides that Form 1001 cannot be used to reduce withholding on income from personal services. Compare the authorities cited in footnote 7, below, (where the income of companies furnishing an entire show was exempt from withholding) with Form 8233 and the authorities cited in footnote 12, below, allowing tax exemption payments to persons providing independent services where the treaty provided for such exemption.

7. See Rev. Rut. 67-321, 1967-2 C.B. 470; PLR 8336071 (June 9, 1983); PLR 8138043 (June 23, 1981); PLR 8117177 (January 30, 1981); PLR 8033056 (May 21, 1980); PLR 7937060 (June 14, 1979); PLR 7934046 (May 23, 1979); PLR 7917105 (January 26, 1979); PLR

7850037 (September 14, 1978); PLR 7843004 (July 17, 1978); and PLR 7841020 (July 13, 1978). These rulings deal with cases when the foreign company produces an entire show and claims exemption for its "industrial and commercial profits". However, see the authorities cited in footnotes 8 and 10, and see also page 3 of IRS Publication 515 relating to withholding on payments to certain Personal Holding Companies.

8. IRS Publication 515 (Rev. Nov. 1988), at page 4, provides the following with regard to withholding on gate receipts from certain events:

"Special events and promotion. Unless you have been specifically advised otherwise by letter from the Internal Revenue Service, you must withhold tax at the full 30% rate for payments that represent gate receipts (or television or other receipts) from rock music festivals, boxing promotions, and other entertainment or sporting events made to a nonresident alien or foreign corporation. One reason for this is that the partial or complete exemption provided by certain tax treaties usually is based upon factors not generally determinable until after the close of the tax year. Also, when an alien's services are provided by a foreign corporation, the qualification for tax treaty benefits may not be easily determined because of the need to resolve other issues such as: (1) The existence of an agency relationship rather than a bona fide employer-employee relationship. (2) The status of a foreign corporation as engaged or not engaged in trade or business in the United States, and (3) The possibility that business arrangements may amount to an assignment of income.

The required letter is issued by the Assistant Commissioner (International), 950 L'Enfant Plaza South, S.W., Washington, D.C. 20024, Attention: IN: F:C:5l."

9. See Rev. Proc. 72-3, 1972-1 C.B. 698, describing the procedures followed by the IRS in issuing rulings; See generally, Harvey P. Dale, "Withholding Tax on Payments to Foreign Persons" 36 Tax Law Review 49 (1980).

10. See IRM Sec.6(10)2.4(6) stating that there should be withholding on payments to domestic, as well as foreign, loan-out companies of foreign artists. This is not yet widely followed, but practitioners should remain aware of developments in this area. In any event, this provision of the Internal Revenue Service Manual should not be applicable to a corporation that hires a band and produces a touring show since this is not a loan-out corporation.

11. There is some risk that the IRS will respond negatively to Form 8233 during the ten day period, for

example, by saying that the actor is, in fact, an employee and not an independent contractor, or that the actor is not, in fact, a resident of the country where he claims to be a resident. Conceivably the IRS, on audit, could challenge the reliance on Form 8233 and seek withholding on the grounds that an actor clearly is not an independent contractor although such an attack by the IRS would be surprising.

12. See, PLR 8614021 (December 31, 1985); PLR 8521062 (February 26, 1985); PLR 8426060 (March 27, 1984); PLR 8339012 (June 23, 1983); PLR 8249047 (September 8, 1982); PLR 8137115 (June 18, 1981); PLR 7918093 (January 31, 1979); ail allowing treaty protection for film and stage directors who were found to be independent contractors so that the "Lend-A-Star" rulings were not applicable.

13. See, IRC Sec.7701(b) relating to the definition of residence for aliens holding "green cards" or present in the United States for the required number of days during the year in question based on a weighted rolling three-year average, as discussed in D.2, below.

14. For the exact method of counting the number of days presence that will cause a foreign person to be taxed as a resident, see IRC Sec.7701(b)(1)(A)(ii).

Bruce Stiglitz is a partner in the Los Angeles office of the law firm of Loeb and Loeb. The author wishes to express his appreciation to Paul A. Sczudlo of Loeb and Loeb for his valuable input regarding these international tax issues. [ELR 11:6:3]

RECENT CASES

Romance novelist's use of material from historical work did not constitute copyright infringement

Irena Narell's 1981 book "Our City: The Jews of San Francisco," described Jewish immigration from Europe to California and the social history of the immigrant families.

In 1984, G.P.Putnam's Sons published "Illusions of Love," written by Cynthia Freeman. Freeman's novel recounted the saga of a young man from a large, wealthy Jewish family Portions of the novel were based on historical events described in Narell's book, and Freeman admitted that she consulted "Our City" when writing the novel.

Narell's copyright infringement action cited instances of copying by Freeman amounting to over 300 words. A

Federal District Court granted Freeman's motion for summary judgment on the alternative grounds that there was no substantial similarity between the two works and that Freeman was entitled to a fair use defense- A Federal Court of Appeals has affirmed the District Court's decision. Judge Farris noted that Freeman primarily used unprotected factual information from Narell's book, and a few ordinary phrases and stock scenes which did not contain protectable original expression.

The court's finding that no protected expression was copied was a sufficient basis for affirming the District Court decision, stated Judge Farris, who nevertheless proceeded to consider the issues of substantial similarity and fair use.

The court determined that the basic elements of the two works, viewed as a whole, did not resemble one another although both works, to a limited extent, referred to similar themes. Neither the mood, pace, or sequence of the two works were alike, and, again, evidence showing the duplication of historical facts and ordinary phrases did not raise a triable issue of fact.

Furthermore, Narell's book was a historical work, not a romance novel, and did not resemble the basic concept, theme, or mood of "Illusions of Love." The similarities between the two works were found neither quantitatively nor qualitatively significant, and because no reasonable reader could conclude that the works were substantially similar, the District Court properly granted summary judgment on the issue of substantial similarity.

After reviewing the statutory fair use factors, Judge Farris affirmed the grant of summary judgment on this issue as well.

The court concluded by observing that "Freeman used Narell's work to provide context for her novel, just as storytellers throughout time have used history as source material for works of imagination." Freeman did not copy substantial protected portions of ""Our City," and "Illusions of Love" will not likely affect the marketability of the historical work.

Federal Court of Appeals Judge Hall, in a special concurrence, stated that summary judgment was properly granted because Freeman did not copy protected expression. Judge Hall believed that it was unnecessary to reach the issues of substantial similarity and fair use.

Narell v. Freeman, 872 F.2d 907 (9th Cir. 1989) [ELR 11:6:13]

Claims based on alleged oral joint venture to develop screenplay are barred by New York's statute of frauds

A New York trial court has ruled that the statute of frauds barred any claims arising out of an alleged oral joint venture to develop and produce a screenplay entitled "See Jane Run."

The screenplay related the experiences of an individual (identified only as Watson) during the 1962 Cuban missile crisis. Watson denied that she entered into a joint venture with certain parties (identified only as Kantor), and argued that even assuming the truth of the allegations in the complaint, the action was barred by the statute of frauds as the purported agreement could not be performed within one year.

The court noted that New York law provides that where either party might rightfully terminate a contract at any time, the contract would be capable of completion within one year and not governed by the statute of frauds.

In the instant case, the parties allegedly agreed that the joint venture could be terminated either by mutual agreement or at Kantor's option - Watson did not have the right to terminate the agreement. Judge Sherman stated that "where the plaintiff retains the sole power to terminate the agreement, the statute of fraud[s] does not become inapplicable as the right to terminate is illusory from the defendant's point of view since his liability endures indefinitely..." The fact that the parties allegedly could mutually agree to terminate the joint venture also was "of no importance," stated Judge Sherman, "as a mutual agreement to terminate is not performance of the contract but rather the destruction of the contract. Only where the contract is terminable at will does the statute become inapplicable..."

Furthermore, since Watson was to share any compensation received from the exploitation of her screenplay, this rendered the agreement open-ended, with Watson's liability being " eternal." The agreement, accordingly, could not be performed within a year and was subject to the statute of frauds, except for the cause of action alleging quantum meruit for the reasonable value of the services rendered to Watson.

Kantor v. Watson, New York Law Journal, p. 22, col. 1 (N.Y.Cnty., July 11, 1989) [ELR 11:6:13]

Production executive may pursue claims against Sandollar Productions alleging breach of oral employment contract and fraud

In June 1986, Sandollar Productions, Gallin Morey Associates, and Albert S. Gallin agreed to pay $150,000 to Robert Cortes Productions to develop motion picture properties. The oral agreement was guaranteed for a one year period, but in October 1986, Sandollar terminated Cortes' employment.

A Los Angeles trial court granted summary judgment to the Sandollar parties, finding that Cortes' breach of contract claim was barred by the statute of frauds. The court also granted summary judgment to Sandollar on the remaining causes of action alleging fraud, tortious breach of the covenant of good faith and fair dealing, and conspiracy.

On appeal, the Sandollar parties noted that the provision for terminating the agreement (a provision contained in a draft agreement approved by Sandollar's attorney, but not signed by the parties) stated: "This agreement may be terminated by [Sandollar Productions], without any further obligation to [Cortes], in the event of the death or permanent incapacity of Cortes or a material breach of this agreement by .[Cortes] not cured within a reasonable period of time following written notice."

Section 1624 of the California Civil Code provides in part that "The following contracts are invalid, unless they, or some note or memorandum thereof, are in writing and subscribed by the party to be charged or by the party's agent: [Para] (a) An agreement that by its terms is not to be performed within a year from the making thereof." According to Sandollar, the trial court properly applied the statute in finding that the termination contingencies in the agreement may have provided excuses for nonperformance, but did not make the agreement one capable of performance within a year.

California Court of Appeal Presiding Judge Lillie cited the case of Foley v. Interactive Data Corp., 47 Cal.3d 654 (1988), for the principle that if, pursuant to the terms of the agreement, plaintiff could have terminated his employment within [one year], or defendant could have discharged plaintiff for cause," the contract would not fall within the statute of frauds.

Judge Lillie rejected Sandollar's argument that Foley dealt with employment agreements with indefinite terms, and did not apply to the instant case which involved an agreement for a definite term. The court found no basis for distinguishing between an agreement for an indefinite term which contains provisions for termination within one year, and one for a definite term which contains the same provisions for termination within one year, for "the effect (performance within one year) is the same."

Furthermore, stated the court, Foley did not limit the type of condition which the parties agree may result in a termination of an agreement. Sandollar entered into an agreement which by its express terms "contemplate[d] its termination in the event of certain occurrences and cannot in good faith complain now about such terms and attempt to treat them as if they are not in fact part of the agreement." The agreement in issue was not one that "by its terms is not to be performed within a year from the making thereof," and thus, again, was not subject to the statute of frauds.

The trial court's rulings granting summary judgment to Sandollar with respect to Cortes' tort claims also were reversed. Cortes claimed that he detrimentally relied on Sandollar's offer of employment in turning down a job offer from RKO - a reasonable inference from Cortes' testimony, stated Judge Lillie, was that the promise of a one year guaranteed position was an element of Cortes' negotiations with Sandollar, and the element upon which Cortes relied in turning down the RKO position. The evidence was sufficient to create a triable issue of fact as to whether Cortes detrimentally relied upon Sandollar's alleged fraudulent misrepresentation. It should be noted that in a footnote comment, Judge Lillie mentioned that were the court to address the issue of the writing requirement of the statute of frauds, the court would conclude that the writings in the instant case satisfied the requirement of the statute.

Robert Cortes Productions, Inc. v. Sandollar Productions, Inc., Case No. B036354 (Ca.Ct.App., Sep. 21, 1989) [ELR 11:6:14]

Holder of television rights to Laurel and Hardy silent films may proceed with claim that Hal Roach Studios lacks valid copyrights in films

In 1985, a Federal District Court in California entered a declaratory judgment against Richard Feiner and Feiner & Co.; the court found that the license agreement between Feiner and Hal Roach, Inc. (the predecessor in interest of Hal Roach Studios) with respect to the television rights to a number of Laurel and Hardy silent films would expire on September 27, 1986.

A Federal Court of Appeals recently ruled that Feiner may proceed with his claim challenging the validity of Roach's copyrights in the films.

The court first found that the District Court erred in entering judgment against Richard Feiner, individually. Judge Reinhardt next ruled that Feiner's cause of action to reform the agreement based on mutual mistake was barred by the statute of limitations.

In turning to Feiner & Co.'s argument that Hal Roach Studios did not own valid copyrights to the Laurel and Hardy works, Judge Stephen Reinhardt noted that although the validity of the copyrights would not affect the claim that the license agreement expired on a certain date, the issue was material to the outcome of the declaratory relief action. If the copyrights were invalid, stated the court, the expiration date of the license agreement would be "of no practical consequence" - there would be no actual case or controversy between Feiner & Co. and Hal Roach Studios, and no basis for a judicial declaration as to the expiration date of the license agreement.

Judge Reinhardt concluded that Feiner & Co.'s counterclaim seeking a declaration that Hal Roach Studios lacked valid copyrights to the films that were the subject of the licensing agreement presented a justiciable controversy suitable for declaratory relief, and remanded the matter for further proceedings.

Hal Roach Studios, Inc. v. Richard Feiner and Company, Inc., Case No. 87-6146 (9th Cir., Aug. 28, 1989) [ELR 11:6:15]

Ruling granting producer of "The Newlywed Game" 100% of statutory cable television royalties is upheld

Barris Industries, the producer of "The Newlywed Game" was entitled to receive 100% of the statutory cable royalty fees derived from the secondary transmission of the program by cable rebroadcast, a Federal Court of Appeals has ruled.

In upholding a District Court ruling (ELR 7:12:11), Chief Judge Goodwin set forth the relevant provisions of Barris' contract with distributor Worldvision Enterprises. Barris agreed to pay Worldvision thirty percent of "gross receipts"; the definition of gross receipts did not refer to statutory cable royalties, i.e., the fees obtained under compulsory licenses when cable television companies retransmit non-network television such as "The Newlywed Game" beyond the range of broadcast television.

The Copyright Act of 1976 became effective in 1978, after the signing of the Barris- Worldvision contract. Worldvision claimed that it was entitled to all or a portion of the statutory cable royalties under the Act as the distributor of the program, or, alternatively, on the basis of an alleged agreement by Barris to split the royalties.

The court found that the parties' contract unambiguously limited Worldvision's compensation to thirty percent of the amounts received under license agreements negotiated by the company. The District Court correctly found that the contract was not reasonably susceptible to Worldvision's claim that the parties agreed to divide statutory cable royalties as part of gross receipts, concluded Judge Goodwin.

Barris Industries, Inc. v. Worldvision Enterprises, Inc,., Case No. 87-5726 (9th Cir., June 1, 1989) [ELR 11:6:15]

Video company's fraud claim against author of "Callenetics" is not preempted by Copyright Act

Valente-Kritzer Video claimed that in 1985, Callan Pinckney entered an oral agreement granting the company an exclusive license to sell the home video rights in Pinckney's book "Callenetics." According to Valente-Kritzer, the parties agreed that if the company secured a producer, Pinckney would transfer to Valente- Kritzer the right to co-produce, distribute, and sell the videocassette. Pinckney also purportedly agreed to an equal division of royalty income.

Valente-Kritzer arranged to have MCA Home Video produce the video. After MCA and Pinckney produced the video, Valente-Kritzer produced a lawsuit claiming breach of contract, tortious breach of contract and fraud.

A Federal District Court in California found that the Copyright Act of 1976 preempted Valente-Kritzer's claims, and granted summary judgment to Pinckney.

Federal Court of Appeals Judge Sneed first rejected Valente-Kritzer's breach of contract claim on the ground that section 204(a) of the Copyright Act requires that a contract transferring an exclusive license in a copyrighted work be in writing. A letter accompanying a draft agreement did not constitute a memorialization of the oral agreement, stated the court, citing Mellencamp v. Riva Music Ltd., 698 F.Supp. 1154 (S.D.N.Y. 1988; ELR 10:10:15). Judge Sneed then noted that the right to sue for tortious breach of contract under state law in this case was equivalent to suing for breach of contract for the failure to transfer exclusive rights under section 106 of the Copyright Act, and also was properly dismissed.

However, Valente-Kritzer's fraud claim was not preempted, concluded the court, for the company alleged " the element of misrepresentation that distinguishes this claim from one based on copyright." Valente-Kritzer claimed that Pinckney intentionally misrepresented its intent to perform the contract; this claim was not substantially equivalent to a claim for copyright infringement, and the ruling granting summary judgment to Pinckney with respect to the fraud claim was reversed.

Valente-Kritzer Video v. Pinckney, Case No. 88- 6247 (9th Cir., Aug. 4, 1989) [ELR 11:6:15]

Antitrust dispute between National Football League and players results in further rulings, including finding that league is not subject to antitrust liability with respect to college draft prior to expiration of collective bargaining agreement

In the third of a series of opinions in the antitrust action brought by professional football players against the National Football League (see ELR 10:4:15; 10:9:17), Federal District Court Judge David Doty has held that the college draft provision of the 1982 collective bargaining agreement did not improperly affect individuals who were not parties to the agreement, i.e., college football players. Even though some of the players suing the league were not yet members of the collective bargaining unit when some of their rights were negotiated, fundamental principles of labor law required them to be bound by terms previously "traded out," stated Judge Doty. The college draft provision of the agreement was found to have been the result of good faith arms length bargaining, and summary judgment therefore was available to the league as to the question of whether the league was exempt from an antitrust challenge to the provision up until the expiration of the agreement.

Neither party requested the court to make a finding as to impasse on the college draft provision; Judge Doty, accordingly, did not address the issue of whether the labor exemption for the provision survived the expiration of the agreement, and refrained, as requested by the league, from extending the provision until 1992.

Judge Doty next found that impasse had not been reached on the player contract issue, agreed to permit the players more time to conduct discovery, and denied the league's motion for summary judgment on all (emphasis by the court) of the players' claims regarding the contract.

The court, noting that impasse was not found until June 17, 1988 on the right of first refusal/compensation system of the 1982 collective bargaining agreement, granted summary judgment to the league on all pre-June]7th damages claims respecting those provisions of the agreement.

Judge Doty concluded by finding that the players' complaint sufficiently alleged concerted activity on the part of team owners so as to warrant granting, conditionally, the players' motion for class certification as to a subclass with respect to damages arising from restraints on veteran player movement, and a subclass with respect to the college draft, both as to damages and injunctive relief; the qualifications for the subclasses were set forth, but the court did not address the merits of the claims raised.

Powell v. National Football League, 711 F.Supp. 959 (D.Minn. 1989) [ELR 11:6:16]

Texas statute exempting religious periodicals from sales tax is ruled unconstitutional by U.S. Supreme Court

The United States Supreme Court has ruled unconstitutional a Texas statute exempting from the state sales tax "[p]eriodicals that are published or distributed by a religious faith and that consist wholly of writings promulgating the teaching of the faith and books that consist wholly of writings sacred to a religious faith." The court found that the exemption violated the establishment clause of the First Amendment, and did not reach the question of whether the exemption violated free press rights as well.

When Texas Monthly, a general interest magazine, challenged the exemption, a trial court struck down the tax as applied to nonreligious periodicals, and ordered the state to refund the sales taxes of about $150,000 paid by Texas Monthly. A Texas appellate court reversed the trial court's ruling.

In reversing the appellate court decision, Justice Brennan observed that it was "difficult to view Texas' narrow exemption as anything but state sponsorship of religious belief..." The exemption did not have a secular objective, and " effectively" endorsed religious belief, noted Justice Brennan. Furthermore, it was not shown that the payment of a sales tax by subscribers to religious periodicals or buyers of religious books would offend their religious beliefs or inhibit religious activity. Imposing the tax on religious publications did not appear to the court to be a "covert attempt to curtail religious activity," and would not subject religious organizations to an undue burden. The matter, accordingly, was remanded for further proceedings.

Justice White, concurring in the judgment, stated that the sales tax exemption improperly discriminated among publications on the basis of content in violation of the press clause of the First Amendment, and would have reversed the appellate court's judgment on the basis of Arkansas Writer's Project v. Ragland, 481 U.S. 221 (1987; ELR 9:3:12).

Justice Blackmun, with whom Justice O'Connor joined, concurred in the court's judgment, but would have focused on the narrowness of the issue decided, i.e., that a tax exemption limited to (emphasis by Justice Blackmun) the sale of religious literature by religious organizations violated the establishment clause. Texas, "by confining the tax exemption exclusively to the sale of religious publications .... engaged in preferential support for the communication of religious messages," stated Justice Blackmun who noted that although some forms of accommodating religion are constitutionally permissible, the exemption in the instant case "surely is not."

Justice Scalia, joined in dissent by Chief Justice Rehnquist and Justice Kennedy, first noted that the religious tax exemptions of the type invalidated by the majority "permeate the state and federal codes, and have done so for many years." Justice Scalia found no basis in the constitution, the decisions of the Supreme Court or "the traditions of our people" for disapproving this "longstanding and widespread practice." After an extensive discussion of the viability of the exemption under the establishment clause, Justice Scalia also expressed the view that the statute did not violate the press clause, declaring it "impossible to believe that the State is constitutionally prohibited from taxing 'Texas Monthly magazine more heavily than the Holy Bible."

Texas Monthly, Inc. v. Bullock, Case No. 87- 1234 (U.S.Sup.Ct., Feb. 21, 1989) [ELR 11:6:16]

Dallas dance hall restrictions are upheld by U.S. Supreme Court

A Dallas ordinance restricting admission to certain dance halls to 14 through 18 year olds did not infringe the First Amendment rights of the youths to associate with persons outside that age group, the United States Supreme Court has ruled.

Charles M. Stanglin, the operator of the Twilight Skating Rink in Dallas, claimed that the age and hour restrictions of the ordinance violated his substantive due process and equal protection rights under the United States and Texas Constitutions, and unconstitutionally infringed the free association rights of persons between the ages of 14 and 18.

The Texas Court of Appeals upheld the section of the ordinance limiting the hours of operation of the dance halls to between 1:00 P.M. and midnight daily when school is not in session, but struck down the age restriction.

In reversing the Court of Appeals' decision, Chief Justice Rehnquist stated that the dance opportunities which were restricted by the ordinance did not involve "the sort of expressive association that the First Amendment has been held to protect." The teenage patrons of the dance halls were not members of any organized association, and the United States Constitution, in Chief Justice Rehnquist's view, does not recognize "a generalized right of 'social association' that includes chance encounters in dance halls."

Dallas city officials could have reasonably concluded that limiting dance hall contacts between young teenagers and adults would " make less likely illicit or undesirable juvenile involvement with alcohol, illegal drugs, and promiscuous sex." Although teenagers and adults may roller skate together, skating "involves less physical contact than dancing," observed Chief Justice Rehnquist - the differences between the two activities did not have to be striking in order to survive rational basis scrutiny, and the matter thus was remanded for further proceedings consistent with the court's opinion.

Justice Stevens, with whom Justice Blackmun joined, concurred in the court's opinion, but stated that the critical issue raised involved substantive due process rather than the First Amendment right of association. Justice Stevens agreed, however, that the city adequately justified the ordinance's "modest impairment of the liberty of teenagers."

City of Dallas v. Stanglin, Case No. 87-1848 (U.S.Sup.Ct., April 3, 1989) [ELR 11:6:17]

Cable television program service may obtain damages, but not injunctive relief, in action claiming breach of affiliation contract

In September 1986, the USA Network agreed to provide cable television programming to Jones Intercable, Inc., the operator of 94 cable systems in 21 states. In August 1988, after receiving notice of a USA rate increase, Jones announced that it was replacing USA on the majority of its systems by Turner Network Television. (Jones, according to news reports, holds a small interest in Turner stock.)

USA sued Jones for breach of the affiliation contract, and sought an order enjoining Jones from terminating USA pending the outcome of the action.

A Federal District Court in New York denied USA's motion for a preliminary injunction. Judge Kenneth Conboy found that Jones' termination of USA would not "devastate or threaten the very existence" of USA's business. USA claimed that Jones' actions would impair USA's status in the industry among other cable systems operators, advertisers, and program suppliers. USA's complaint, as described by Judge Conboy, portrayed "a commercial domino theory whereby a relatively small, compensable contract breach will gradually but inevitably lead to its irreversible descent to second-rate industry status."

The court stated that it was convinced "neither of the fact nor the immeasurability of the so-called ripple effect damages," characterizing USA's claims concerning the consequences of Jones' actions (beyond the immediate loss of fees and proportional advertising revenues) "if not wholly remote and speculative, vastly exaggerated." USA was aware that its rate increases might result in affiliate cancellations pursuant to contractual termination options, and the company could not reasonably assume that its affiliate base would remain completely stable over time.

Judge Conboy cited the case of Gennaro v. Rosenfield, 600 F.Supp. 485 (S.D.N.Y. 1984; ELR 7:6:10) in which the court denied choreographer Peter Gennaro's motion for a preliminary injunction to prevent a producer, allegedly in violation of his contract with Gennaro, from hiring a different choreographer for the Broadway production of "Singin' in the Rain." Although agreeing that the apparent replacement of Gennaro might damage his reputation in the theatrical community, the court in Gennaro noted other factors which were likely to reduce the effect of the producer's actions on the choreographer's professional standing.

In the instant proceeding, given USA's "track record, projections of future growth, status in the industry, and the relatively minor portion of its business represented by Jones," it was unlikely, stated the court, that Jones' actions would tarnish USA's image. Indeed, noted Judge Conboy, certain aspects of Jones' conduct made it more likely that the company's "reputation of reliability, as well as for honorable business conduct, may be tarnished rather than USA's."

Judge Conboy concluded by pointing out that USA's direct contract damages were not insubstantial, and that the company would be able to recover a "significant portion" of its ripple effect damages if they occurred. Injunctive relief could not compel Jones to withdraw its criticism of USA or restore to USA "the intangible degree of leverage it may or may not have lost as a result of Jones' highly publicized actions and statements." In all, USA's damages over the life of the affiliation contract could be calculated with reasonable certainty, and the company's remedy at law therefore was adequate.

With respect to the question of whether USA was likely to succeed on the merits of the company's claim, the court noted that Jones did not exercise its contractual option to terminate according to the literal terms of the affiliation contract, and that USA might establish that the contract still was in effect. Nonetheless, declared Judge Conboy, in the absence of irreparable injury, USA was limited to its remedy at law.

USA Network v. Jones Inter(.able, Inc., 704 F.Supp. 488 (S.D.N.Y. 1989) [ELR 11:6:18]

San Diego regains 1988 America's Cup trophy; appeals court rules that San Diego's catamaran did not violate yacht design requirements of the Deed of Gift creating the race

A New York appellate court has ruled that the San Diego Yacht Club's catamaran was an eligible yacht, that it was the winner of the two races held on September 7 and 9, 1988 for the America's Cup, and that San Diego, as the winner of the two races, was entitled to the America's Cup in accordance with the terms and conditions of the Deed of Gift of October 24, 1887.

In a 30 page opinion reversing the decision of a New York trial court, Judge Joseph P. Sullivan recounted the history of the prestigious trophy. The America's Cup, which was first won by the yacht America in a race around the Isle of Wight in August 185 1, was the corpus of a charitable trust created in the 19th century under New York law. Under the terms of the deed, the holder of the America's Cup acts as the sole trustee of the charitable trust, and is succeeded by the party who successfully challenges the trustee in a race for the trophy. The New York Yacht Club served as the trustee until 1983, when Australia 11, the entry of the Royal Perth Yacht Club defeated the vessel Liberty. In 1987, San Diego's vessel, Stars & Stripes '87, defeated the Royal Perth entry, Kookaburra III.

The deed specifies the permissible length for the competing vessels and sets forth the guidelines for a valid challenge. With respect to boat design, the deed states only that a challenger may race against any "yacht or vessel" between forty-four and ninety feet on the load water-line. Judge Sullivan pointed out that the deed does not bar the use of a multi- hulled vessel or require the trustee to defend in a vessel having the same number of hulls as the challenger, "nor is there any express mandate that the competing vessels be identical or even substantially similar."

San Diego planned to conduct its first defense of the America's Cup in 1990 or 1991 in 12 meter yachts, and yacht clubs "all around the world," noted Judge Sullivan, began preparing to compete. However, in July 1987, the Mercury Bay Boating Club issued a challenge to San Diego demanding a match less than a year later; Mercury Bay proposed to sail in a yacht measuring 90 feet on the load water-line, the largest length permitted under the Deed of Gift. San Diego announced that the terms of the challenge were unacceptable.

In September 1987, Mercury Bay brought a lawsuit seeking a declaration of the validity of its challenge, and a preliminary injunction to prohibit San Diego from considering any other challenges. San Diego asked the court to permit the traditional elimination series of races in order to further the purpose of the America's Cup donors, i.e., fostering "friendly competition between foreign countries."

The court found that Mercury Bay's notice of challenge was valid. When San Diego subsequently announced its decision to race in a multihull yacht, Mercury Bay sought to hold San Diego in contempt. Mercury Bay argued that the use of a catamaran would deny the yacht club, in violation of the court's earlier order, the "match" contemplated by the deed.

In July 1988, the trial court denied Mercury Bay's motion. The court stated that while "[n]othing in this decision should be interpreted as indicating that multihulled boats are either permitted or barred under the America's Cup," the parties should proceed with the races and reserve any protest until after completing the races.

In early September 1988, San Diego's catamaran, Stars and Stripes, defeated Mercury Bay's monohull, New Zealand, two races to none.

When Mercury Bay returned to court, Judge Carmen Ciparick found that San Diego had violated "the spirit of the Deed" by attempting to retain the America's Cup at all costs so that it could host a competition on its own terms. Judge Ciparick, stating that the use of the catamaran "deviated from the intent of the donors" that the competing vessels be "somewhat evenly matched," disqualified San Diego's yacht, and directed San Diego to transfer the trophy to Mercury Bay.

On appeal, Judge Sullivan questioned the trial court's finding that the competing vessels were required to be "somewhat evenly matched," noting that such a rule was neither expressed in, nor inferable from, the language of the Deed of Gift. The deed requires a challenger to give ten months notice to the defending club and provides that such notice include the "name, rig, owner, and four specified dimensions of the challenging vessel: load water-line, water-line beam, maximum beam, and draft." Nothing in the deed suggests, stated Judge Sullivan, that the specifications limited the defender's selection of its boat. Under the deed, the competing vessels must both be "yachts or vessels," "propelled by sails only;" if single-masted, they must measure, again, between forty-four and ninety feet on the load water-line. The reference in the deed to "friendly competition between foreign countries" imposed no affirmative obligation on the trustee to use any particular type of vessel.

The trial court also had found that because the challenger must notify the defender of four specified dimensions of the challenging vessel, the defender thus was required to conform its boat to the challenger's. Judge Sullivan found no such intent, viewing the notice provisions as a means to give the trustee sufficient time to build a defending vessel, not to require the vessel to meet the challenger's specifications.

Judge Sullivan went on to emphasize that the deed did not contain any design restraints. The provision that the defender may race "any one yacht or vessel constructed in the country of the Club holding the Cup" used "perhaps the most expansive term conceivable for any water-borne vehicle." And Judge Ciparick's views as to the "inherent" inequality of monohulls and multihulls reflected a "marked departure" from the court's own findings on the same issue in its prerace decision on the contempt motion.

It also was observed that a letter written by George L. Schuyler, one of the donors of the America's Cup, indicated that the word "match" was intended to refer to a competition between two contestants, rather than having one challenger face a "fleet" of vessels - there was, stated Judge Sullivan, "no hint of any intention on his part to require likeness or similarity between the competing vessels." Schuyler specifically explained the dimension clause; the explanation, which was "wholly ignored" by the trial court, served to "negate any notion that the giving of the four dimensions would enable, much less require, the defender to produce a 'somewhat evenly matched' boat."

The court next stated that reading a somewhat evenly matched" requirement into the deed would establish a completely unworkable standard, and would "foster" judicial involvement in the question of boat eligibility."

Judge Sullivan concluded that even if the Deed of Gift were to be construed so as to bar the use of a catamaran in an America's Cup race against a monohull, the remedy of forfeiture was unwarranted. Mercury Bay itself, noted the court, had demanded an unrestricted design rule, without any agreement on a class or rating rule, or any system for handicapping or equalizing the competitors beyond the water-line length limitations set forth in the deed. And the trial court, in rejecting Mercury Bay's contempt motion, "gave no hint of its views on the use of a catamaran," although suggesting that San Diego "proceeded at its own peril" if it competed in such a boat.

In all, it was "inappropriate" for the court, after the race, to "engraft" onto the deed a rule " so elusive as to preclude a finding of contempt eight months earlier."

San Diego had sought the approval of the New York Attorney General at each stage of the proceedings and was careful to assure that its actions were consistent with the deed and its fiduciary responsibilities. At the very least, stated Judge Sullivan, San Diego should have been permitted to rerun the race with a monohull.

Furthermore, Mercury Bay insisted on a match only a year after San Diego won the America's Cup, despite the fact that the matches traditionally have been held three or four years apart. San Diego was required to design and build a yacht that was "more complex, more expensive, and riskier" than those that had previously been used, when San Diego had planned to compete in 12 meter yachts. And Mercury Bay was able to force San Diego into a one-on-one match, when San Diego wanted to continue the tradition of a multinational challenger competition.

Judge Sullivan observed that "for 140 years, challengers and defenders alike have spent fortunes and expanded immeasurable effort to gain any speed advantage, however slight, to enhance their chances for victory. That is the very essence of America's Cup competition ... to compel the trustee to accept constraints upon the competition that are not specified in the trust agreement, without the mutual consent of both challenger and defender, would itself contravene the competitive scheme contemplated by the Deed of Gift." San Diego, accordingly, was entitled to the America's cup.

In a concurring opinion, Judge Israel Rubin pointed out that there is "often a marked divergence in what may be deemed sporting and what a court will uphold as legal." The overall thrust of the Deed of Gift was that the contestants compete with the fastest boats on the water. Judge Rubin agreed with the dissent in that the victory of Stars and Stripes was " virtually ensured," but did not agree with the proposition that the America's Cup competition "is now, if it ever was, a paradigm of good sportsmanship." The race is open to "a yacht or vessel propelled by sails only" and conforming to the load waterline length requirements, and this provision, stated Judge Rubin, specified the eligibility requirements for a challenging vessel.

Mercury Bay may present a new challenge to San Diego with a new boat, for "between true yachtsmen, victory is pursued on the water and not in the courtroom."

Judge Bentley Kassal, in dissent, stated that San Diego violated "a sense of fair play and ... honest rivalry" when it entered a catamaran in the America's Cup race. Judge Kassal would have found such a "gross mismatch" impermissible under the deed, stating that the condition upon which the trophy was donated was the goal of fostering friendly competition. San Diego was aware that the eligibility of the catamaran had not been determined, and knew of the risk. of disqualification and forfeiture. Judge Kassal stated that the 1988 America's Cup races were " manifestly unfair in every sense. True sportsmanship and the integrity of this great sport demand far more, as does the very Deed of Gift by which this competition has been sponsored for over a century."

Mercury Bay Boating Club Inc. v. San Diego Yacht Club, Case No.37382 (N.Y.App., Sept. 19, 1989) [ELR 11:6:19]

Briefly Noted:

ASCAP-Songwriter Arbitration.

"Jingle" writer Steve Karmen challenged an ASCAP decision to allocate three percent of a "use credit" per performance to jingle writers. In accordance with ASCAP's Articles of Association, the dispute was heard by a Board of Review; the Board rejected Karmen's claim, and a panel of arbitrators affirmed the decision of the Board. Karmen filed an action in state court to vacate the decision of the panel. However, the Federal District Court in New York, pursuant to its continuing jurisdiction of a consent judgment originally entered in March 1950, and subsequently amended, eventually considered Karmen's claim that the procedure followed by the panel violated his rights under the due process clause. Federal District Court Judge William C. Conner first found that Karmen "failed to demonstrate any state action which would trigger the applicability of the due process clause." The fact that the court approved the consent decree, which required ASCAP to establish a grievance procedure, did not create any state action, nor did the fact that Karmen consented to the process in his membership agreement with ASCAP. Judge Conner nevertheless granted, in part, Karmen's application to vacate the arbitration award; the court remanded the matter to the panel for reconsideration of Karmen's claim, "with the understanding that it has the authority to re- evaluate the factual findings of the Board and to re-ceive any evidence that was improperly excluded in the proceedings before the Board."

United States v. American Society of Composers, Authors and Publishers, 708 F.Supp. 95 (S.D.N.Y. 1989) [ELR 11:6:21]

Copyright Infringement/"U Got the Look."

Prince's song "U Got the Look" did not infringe a copyrighted work, entitled "What's Cooking in This

Book," written by the singer's half-sister Lorna L. Nelson, a Federal Court of Appeals has ruled. The court held that the District Court did not err in dismissing the action on the basis of its finding that there was no substantial similarity between the lyrics of the songs.

Nelson v. PRN Productions, Inc., 873 F.2d 1141 (8th Cir. 1989) [ELR 11:6:21]

Copyright Infringement/Jurisdiction.

When Ulpio Minucci sued Farouk Agrama for copyright infringement and several pendent state claims, a Federal District Court in California dismissed the pendent claims without prejudice. Minucci filed the dismissed claims in state court, whereupon Agrama moved to stay Minucci's federal copyright action pending the resolution of the state court claims. A Federal District Court ruling granting the stay has been reversed. Federal Court of Appeals Judge David R. Thompson stated that Minucci's copyright claim (which was not further described by the court) was within the exclusive jurisdiction of the federal courts, and remanded the matter for further proceedings on the merits of the case.

Minucci v. Agrama, 868 F.2d 11 13 (9th Cir. 1989) [ELR 11:6:21]

Athlete's Investments.

In 1984-1985, professional football player Jeffrey Fuller invested in two real estate limited partnerships. Fuller defaulted after making ten payments due under certain promissory notes, and the partnerships foreclosed upon and resold his interests. After crediting to Fuller the amounts realized on the sale, there remained a deficiency on both accounts. (According to news reports, the amount of the judgments was "believed to total under $100,000"). A New York trial court, in granting summary judgment to the partnerships on their deficiency judgments, first found that Fuller was a suitable investor who had represented that he possessed the necessary experience to evaluate the investments. And a written disclaimer was sufficient to preclude a finding of fraud in the inducement. However, noted Judge Shirley Fingerhood, professional security and financial analysts had questioned whether the sales of Fuller's interests were arms length transactions and whether a higher price could have been obtained by the partnerships. A hearing was required to determine the propriety of the sale, concluded the court.

Bossier Plaza Associates Limited Partnership v. Fuller, New York Law Journal, p. 17, col. 6 (N.Y. Cnty., July 21, 1989) [ELR 11:6:21]

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[ELR 11:6:23]