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INTELLECTUAL PROPERTY

Intellectual property is a specifically recognized subset of intangible assets, which includes patents, copyrights, rights of publicity, trademarks, trade secrets and know-how. These assets share many of the same legal attributes, and present unique taxation and valuation issues. Because patents, copyrights and trademarks are specifically protected by federal or state statutes,[1] they have a defined legal life, which is often longer than their remaining useful life. In contrast, the descendability of a right of publicity is governed solely by state law, with some states recognizing a post-mortem right under common law and other states recognizing a post-mortem right by specific statute. Unlike the value of other intangible assets, the value of intellectual property is usually quite speculative because of its illiquid nature. In most cases, there is a lack of a predictable stream of income and the assets are subject to sharp fluctuations in value. Before focusing on the valuation issues relating to intellectual property, it is important to have a better understanding of how these assets are protected, exploited and transferred. Given that a decedent's estate is less likely to include trademarks, trade secrets or know-how, the scope of this outline is limited to an analysis of patents, copyrights and a decedent's right of publicity.

A. Patents

1. Definition and Background

A patent is a government grant that protects an inventor's right in an invention for a limited period of time. A patent can be obtained for "any new and useful process, new machine, manufacture or composition of matter, or any new or useful improvement thereof."[2] The inventor has no legal rights in the invention and cannot exclude others from exploiting it until the patent is actually granted by the U.S. Patent and Trademark Office.[3] Once the patent is granted, the patentee has the exclusive right to

make use or sell the invention for 20 years.[4] Because there is no right of renewal for patents, the invention enters the public domain after the expiration date.

2. Valuation

Of the three generally accepted approaches to valuing intangible assets - cost, market and income – the income approach is most commonly used to value patents. Simply put, the approach measures value by the present worth of the future income that will be derived from the use of the patent during its remaining economic life.

B. Copyrights

1. Definition and Background

Whereas the basic property concept of patent law is novelty and innovation, the underlying purpose of copyright law is encourage creativity and originality of expression. Copyright protection is authorized by the Constitution, which gives Congress the power: "To promote the progress of Science and useful Arts, by securing for limited Times to Authors... the exclusive Right to their respective Writings..."[5] The general social benefit to providing creative individuals with economic control over the exploitation of their works is explained in The Copyright Handbook as follows:

> The primary purpose of copyright... is not to enrich authors; rather, it is to promote the progress of science and the useful art - that is, human knowledge. To pursue this goal, copyright encourages authors in their creative efforts by giving them a mini-monopoly

over their works-termed a copyright. But this monopoly is limited when it appears to conflict with overriding public interest in encouraging creation of new intellectual and artistic works generally.[6]

To be protected, a work "must be an original work of authorship fixed in a tangible medium of expression."[7] Copyrightable works include literary works, musical works, dramatic works, pantomimes, choreographic works, [pictorial,] graphic and sculptural works, motion pictures and other audio visual works, sound recordings and architectural works.[8] The owner of a copyright actually owns a bundle of exclusive rights which includes the right to reproduce the copyrighted work, to prepare derivative works, to distribute and display copies of the work and to perform the work publicly.[9] Initial ownership of a copyright vests in the creator,[10] unless the work is a "work made for hire" (typically a work created by an employee within the scope of his or her employment),[11] in which case the copyright is owned by the employer.[12]

2. Duration of Copyright Protection

The Copyright Clause of the Constitution provides for federal copyright protection for a limited period of time. After expiration of the copyright term, the work goes into the public domain.

The duration of copyright protection is governed by the Copyright Law of 1976, as amended (the "1976 Copyright Act"), which became effective on January 1, 1978.[13] The 1976 Copyright Act replaced the Copyright Act of 1909[14] and generally preempted the common law of copyright. Under the

1909 Copyright Act, copyright protection could only be secured by publication with notice of copyright, or, if a work was unpublished, by registration. Under the 1976 Copyright Act, a work is automatically protected when it is created, and therefore registration is not a condition of copyright protection. There are still several advantages to registering - - most importantly, registration is a condition precedent to the filing of an infringement action.[15] The 1976 Copyright Act contains differing sets of rules for the duration of copyright protection depending on whether a work was created before January 1, 1978 or on or after that date.

a. Works Created and Published or Registered Before January 1, 1978

As stated above, statutory copyright protection prior to 1978 was obtained on the date a work was published with a copyright notice, or, in the case of certain unpublished works, on the date of registration. In either case, under Section 24 of the 1909 Copyright Act, the duration of the copyright protection continued for an initial term of 28 years, and could be renewed for an additional term of 28 years, for total copyright protection of 56 years.[16] The 1976 Copyright Act extended the renewal term of pre-1978 copyrights (other than those works already in the public domain) for an additional 19 years. In 1998, the Sonny Bono Copyright Term Extension Act ("CTEA")[17] further extended the renewal term for an additional 20 years. Thus, under current law, pre-1978 works are now protected for a total of 95 years.

Termination Rights

For pre-1978 works, the 1976 Copyright Act allows the copyright owner (or his or her heirs) to terminate all grants, licenses or assignments of rights (executed prior to January 1, 1978 by the author or by his or her heirs) for a five-year period beginning at the end of 56 years from the date the copyright was originally secured or beginning on January 1, 1978, whichever is later.[18] In order to effectively terminate a grant, license or assignment, written notice of termination must be sent to the person to whom the grant was made at least 2 years and no more than 10 years from the date that termination could be effected.[19] If you miss the opportunity to terminate at the end of 56 years, you have another chance at the end of 75 years to recapture the final 20 years of copyright by filing a notice of termination no later than 78 years from the date of the original copyright.[20] If the copyright owner is deceased, the 1976 Copyright Act permits the termination rights to be exercised by the surviving spouse, children and grandchildren or, if none, by the executor, administrator, personal representative or trustee.[21]

The rationale for granting authors and their families a non-waivable right of termination after a certain number of years has been explained by one commentator as follows:

> These often overlooked, but powerful rights, exist, in part, because young writers, musicians and artists, often sign away their copyrights for little or no money early in their

careers. For example, in 1938 Jerry Siegel and Joe Schuster, two young men from Cleveland, Ohio, signed over all of their rights to the *Superman* character to DC Comics for $130.00 and vague promises of future work. To address this, and similar economic injustices, Congress gave authors (and their heirs) a second chance to strike better financial deals. As a result, starting in 1999, Siegel's heirs recaptured his rights to the *Superman* character.[22]

b. Works Created On or After January 1, 1978

Under the 1976 Copyright Act, as modified by CTEA, works created on or after January 1, 1978 are automatically protected from the moment of their creation for the author's life plus an additional 70 years after the author's death.[23] There is no renewal term after the expiration of the original term. However, grants and assignments of these works can be terminated by the author (or if the author is deceased, by his or her spouse, children and grandchildren, on a per stirpes basis).[24] If there is no spouse or issue, the termination right passes to the author's executor, administrator, personal representative or trustee.[25] Termination can be effected during a five-year period beginning 35 years after the grant was made.[26] As with pre-1978 works, notice of termination must be given not less than 2 or more than 10 years from the intended termination date.[27] However, unlike the recapture rules for pre-1978 copyrights grants, the 35-year rule only applies to grants made by the author, so an author's surviving spouse or children could only terminate assignments that were made by the author.

c. Works Made For Hire

For works made for hire, as well as anonymous and pseudonymous works, the duration of the copyright is 95 years from publication or 120 years from creation, whichever is shorter.

3. Valuation

To differing degrees, all the generally accepted approaches to valuing intangible assets could be applied to the analysis of copyrights. The cost approach bases value on the current costs of replacing the property in question. Since copyrights cannot be legally recreated, the cost approach is not the best suited to valuing copyrights. For this reason, the market approach and the income approach are more often used with regard to copyright valuation. The market approach bases value on the price that the property would fetch on the market if it were sold, and focuses on sales of comparable property in determining value. Because copyrights are routinely assigned and/or licensed, there is usually sufficient data (if publicly disclosed) upon which to calculate value. Under the income approach, the value of the copyright would be determined by taking the present value of the projected future income stream over the expected remaining useful life of the copyright.

The value of a copyright for estate tax purposes will necessarily be affected by licensing agreements that the creator entered into before the date of death. If the creator's estate includes a copyright termination interest, this will also factor into the overall valuation of the copyright.

In Pascal v. Commissioner,[28] the Tax Court addressed the fair market value of a decedent's option to produce a musical play and the rights to produce a motion picture based on the musical play. Gabriel Pascal was a motion picture producer and director who was most well known in Europe. In 1937, Pascal produced a motion picture based on George Bernard Shaw's "Pygmalion" which was a financial and critical success, and went on to win an Academy Award in 1938. In 1952, Pascal was granted the exclusive worldwide rights to produce a musical stage production of "Pygmalion" together with the right to produce a motion picture based on the stage play.[29] Prior to his death in 1954, Pascal had entered into negotiations with various lyricists or composers and producers regarding the exploitation of his rights, but he had not entered into any actual agreements.[30]

After Pascal's death, the temporary administrator of his estate entered into an agreement with Frederick Loewe, Alan J. Lerner and Herman Levin, whereby they received the rights of the estate and agreed to make a musical version of the play.[31] The play was subsequently produced under the name of "My Fair Lady" and opened in New York on March 15, 1956.[32] The show was a runaway success and Pascal's estate collected over $600,000 from the stage play and record albums. In 1962, the rights for a motion picture version of the play were sold to Warner Brothers for a guaranteed minimum of $5,500,000 plus 47-1/2% of the gross over $20,000,000 of the motion picture receipts.[33] Of this amount, Pascal's

estate was entitled to receive 16% of the motion picture proceeds, or a guaranteed minimum of at least $880,000.[34]

Because it was advantageous for the Estate to have a higher basis for income tax purposes, the Estate argued that the value of Pascal's rights should be $1,140,000 as opposed to the $200,000 value that the IRS had assigned.[35] The Tax Court sided with the IRS and held that post-death facts could not be considered in valuing property as of the date of death.[36] Because Pascal had not entered into any formal agreements to produce "My Fair Lady" at the time of his death, the extraordinary success and profitability of the musical play and motion picture that were ultimately produced could not be considered.[37]

C. Right of Publicity

1. Definition and Background

The right of publicity is the right of an individual to control the commercial exploitation of his or her name and likeness.[38] While the right is clearly recognized during the individual's lifetime, states have differed on the issue of whether the right of publicity is descendible. Much of the debate has centered on whether the right of publicity is properly characterized as a property right, which can be transferred at death, or as a privacy right that is personal to its owner and therefore terminates upon his or her death. At least 23 states recognize a post-mortem right of publicity under common law or have enacted legislation explicitly providing for a right of publicity that survives death for a limited term of

years. Under prevailing conflicts of law principles, the existence of a post-mortem right of publicity should be determined by the domicile of the decedent, but courts may not always follow this rule.

2. Valuation

If a right of publicity is descendible under state law, it may represent a significant wealth transfer to the decedent's beneficiaries. Of course, the question then becomes how to value the right for estate tax purposes. Like other forms of intellectual property, the right of publicity presents difficult valuation issues because of the speculative and illiquid nature of the right.

The estate tax value of the right of publicity was litigated in Estate of Andrews v. United States.[39] V.C. Andrews was an internationally known best-selling author who had become known for her works in the "children in jeopardy" genre.[40] Andrews died in 1986 just weeks after signing a lucrative new publishing contract which would provide her with a $3,000,000 advance for writing two books.[41] Shortly after Andrews' death, her agent began exploring the idea of using a ghostwriter to author future books using the V.C. Andrews name. The agent had found an obscure author of horror stories whom she believed could mimic Andrews' writing style, plot construction and character development.[42] From the Estate's perspective, the project was a risky one because if the first ghostwritten book was unsuccessful, it could hurt future sales of the books that Andrews had published during her lifetime.[43] However, after the ghostwriter produced an outline and several pages of ghostwritten text

for the first book, the Estate agreed to a modification of the pre-death contract which permitted the ghostwriter to proceed with the project.[44] The first ghostwritten book, "Garden of Shadows," was released in 1987 and was a tremendous commercial success, as were the other ghostwritten books that followed.

Since traditional practice suggested that a decedent's right of publicity was valueless for estate tax purposes, the Executors of the Estate did not report Andrews' name as a taxable asset on the Federal estate tax return.[45] The IRS disagreed, however, and issued a notice of deficiency valuing Andrews' name at $1,244,910.84.[46] The IRS summarized its finding as follows:

> The name, V.C. Andrews, and her likeness have measurable value based on the prior earnings of decedent and the contract signed by her shortly before her death. The value of the name and likeness were determined after valuing the potential novels that could be produced as written by her, deducting the amounts payable to the agent and amounts attributable to other factors involved in the production and marketing of the work, and discounting for the contingent nature of the work.[47]

In a case of first impression, the U.S. District Court for the Eastern District of Virginia focused on several factors in valuing Andrews' name. First, it was noted that Andrews had achieved an unparalleled level of success in her chosen genre and that her most recent book was a best seller at the time of her death.[48] Furthermore, Andrews had developed a distinctive writing style and there were common themes running through her works that could be replicated.[49] In assessing the value of Andrews' name, the

District Court considered the publishing contract that Andrews signed shortly before her death "because its existence and the possibilities it presented were reasonably knowable on the date of death to the buyer and seller in the hypothetical transaction...."[50] The District Court supported its approach by citing prior case law which held that the sales price of property sold near death is persuasive evidence of the property's value when there has been no material change in circumstances between the time of sale and the time of death.[51] Whereas the IRS took the position that the value of all ghostwritten books should be considered, the Court limited its consideration to the first book because the parties could not have foreseen at the time of Andrews' death that the first book would be successful and that multiple books would follow.[52] Based on the pre-death contract, the Court valued the first ghostwritten book at $1,550,000 (approximately 1/2 of the $3,000,000 advance provided under the pre-death contract for two books), deducted the expenses, and applied a 33% risk discount factor to arrive at a value of $703,500 for Andrews' name.[53]

In light of the decision in the Andrews' case, it seems clear that the right of publicity is an asset that is subject to estate taxes, at least in states that have created an enforceable and descendible publicity right.[54] But the method by which the right should be valued is a far more difficult issue. As discussed above in the context of valuing copyrights, the three most common valuation approaches are cost, market and income. The cost method, which bases value on the current costs of replacing the property

in question, does not lend itself well to valuing a right of publicity because there is really no way to calculate the amount that an individual has "invested" in creating his or her personality.

The income method would be appropriate, but only if there is an existing revenue stream from the exploitation of a right of publicity at the time of death. Unlike copyrights which are typically exploited during an author's lifetime, a celebrity's right of publicity may not be exploited prior to death, so there may not be any data upon which to calculate value.

In applying the market approach to the value of a deceased personality's right of publicity, an appraiser could look to the value of endorsement contracts and sponsorship agreements entered into by an adequately similar personality. In Andrews, the Court was able to rely on the market approach because the name of V.C. Andrews appealed to a very specific and limited market, and there was in effect a sale of V.C. Andrews' name upon her death. But in many cases the market approach will not be helpful because a celebrity's appeal can be so unique and widespread that it is difficult to find sales of comparable property.

In valuing a right of publicity, the IRS would take the position that the asset should be valued at its highest and best use. However, because the estate tax is an excise tax on the privilege of transferring property, the value must be determined by measuring what the testator transfers to the estate beneficiaries. Therefore, it is possible for a testator to devise an

estate plan that decreases the value of the right of publicity by placing restrictions on its use and exploitation.

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[1] Trade secrets and know-how are usually protected by private contracts.
[2] 35 U.S.C. §101 et seq.
[3] Id.
[4] 35 U.S.C. §154
[5] Article I, §8 cl. 8
[6] Jassin and Schechter, The Copyright Permission and Libel Handbook
[7] 17 U.S.C. §102
[8] 17 U.S.C. §102
[9] 17 U.S.C. §106
[10] 17 U.S.C. §201(a)
[11] 17.U.S.C. §101
[12] 17 U.S.C. §201(b)
[13] Act of October 19, 1976, P.L. 94-553, 90 Stat. 2541
[14] 35 Stat. 1075, 17 O.S.C. §1 et. seq. (1976 ed.)
[15] 17 U.S.C. §411, 412
[16] 17 U.S.C. §24 (1976 ed.)
[17] P.L. 105-298
[18] 17 U.S.C. 304(c)(3)
[19] 17 U.S.C. 304(c)(4)
[20] 17 U.S.C. §304(d)
[21] 17 U.S.C. §304(c)(2)
[22] Jassin, Copyright Termination: How Authors (and their Heirs) Can Recapture Their Pre-1978 Copyrights
[23] 17 U.S.C. §302(a)
[24] P.L. 94-553 §101; H.R. Rep 1479, 94th Cong., 2d Sess. (1976)
[25] 17 U.S.C. §203(a)(2)(D), as added by CTEA, effective October 27, 1998
[26] 17 U.S.C. §203(a)(3)
[27] 17 U.S.C. §203(a)(4)(A)
[28] 22 T.C. Memo (CCH) 1766 (1963)
[29] Id.
[30] Id.
[31] Id.
[32] Id.
[33] Id.
[34] Id.
[35] Id.
[36] Id.
[37] Id.
[38] See Zacchini v. Scripps-Howard Broadcasting Co., 433 U.S. 562, 575-78 (1977)
[39] 850 F.Supp. 1279 (E.D. Va 1994)
[40] Id. at 1281
[41] Id. at 1282
[42] Id. at 1283
[43] Id.
[44] Id. at 1283
[45] Id. at 1281
[46] Id.
[47] Id. at 1286
[48] Id. at 1289-1290
[49] Id.
[50] Id. at 1292

[51] Id., citing Love v. Commissioner, 57 T.C.M. 1989-479 (CCH), 1989 WL 99436 aff'd, 923 F. 2d 335 (4th Cir. 1991)
[52] Id. at 1293
[53] Id. at 1295
[54] Note: Federal Estate Tax and the Right of Publicity: Taxing Estates for Celebrity Value, 108 Harvard Law Review 683 (Jan. 1995)