1 T.C. 711 (1943)

Income derived from the transfer of motion picture rights to a copyrighted play by a playwright is taxable as ordinary income, not capital gains, because the copyright is property used in the taxpayer's trade or business and subject to depreciation.

Summary

Clifford H. Goldsmith, a playwright, transferred motion picture rights to his play to Paramount Pictures. He argued that the income from this transfer should be treated as capital gains. The Tax Court disagreed, holding that the income was taxable as ordinary income because the copyright was property used in Goldsmith's trade or business as a playwright and was of a character subject to depreciation, therefore excluded from the definition of "capital asset" under Section 117 of the Revenue Act of 1938. This decision clarified the tax treatment of income derived from copyrights held by authors in their trade or business.

Facts

Clifford H. Goldsmith was a playwright who authored a play called "Enter to Learn," which he copyrighted in 1936. He later revised the play, renamed it "What a Life," and it became a successful Broadway production. In 1938, Goldsmith entered into an agreement with Paramount Pictures, Inc., to transfer the exclusive world-wide motion picture rights to his play. Goldsmith received payments from Paramount in 1938 and 1939. On his tax returns, Goldsmith reported these amounts as gains from the sale of capital assets, taking into account only 50% of the gain for income tax purposes.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Goldsmith's income tax for 1938 and 1939, arguing that the income received from Paramount was ordinary income, not capital gains. Goldsmith contested this determination before the United States Tax Court.

Issue(s)

Whether the income received by Goldsmith from the transfer of motion picture rights to his copyrighted play constitutes proceeds from the sale of a capital asset taxable at capital gains rates, or ordinary income taxable at full rates.

Holding

No, because the copyright was property used in Goldsmith's trade or business as a playwright and was of a character subject to depreciation. As such, the copyright falls under exceptions listed in Section 117(a)(1) and is not considered a capital asset.

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Court’s Reasoning

The court reasoned that under Section 117(a)(1) of the Revenue Act of 1938, the term “capital assets” does not include “property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l).” The court found that Goldsmith’s trade or business was that of an author and playwright. His copyrighted play, “Enter to Learn,” was used in his trade or business, as evidenced by the royalties he received from its Broadway production. The court referenced Article 23 (l)-3 of Regulations 101, which allows for depreciation of intangible property like copyrights when their use in the trade or business is definitely limited in duration. Although Goldsmith did not take a deduction for depreciation on his copyright, the court found that the copyright was of a character subject to depreciation, and therefore, was not a capital asset. The court cited *Fackler v. Commissioner* in support, solidifying their reasoning that income from the transfer of motion picture rights should be taxed as ordinary income.

Practical Implications

Goldsmith v. Commissioner establishes that copyrights held by authors and used in their trade or business are generally not considered capital assets for tax purposes, even if the author does not actually depreciate the copyright. This means that income from the sale or licensing of such copyrights is taxed as ordinary income, which is often a higher tax rate than capital gains rates. The case highlights the importance of understanding the exceptions to the definition of capital assets in Section 117(a)(1) and its successor statutes. It also shows that the nature of the taxpayer’s business and the use of the property in that business are critical factors in determining the tax treatment of income derived from that property. Later cases have distinguished *Goldsmith* based on factual differences, such as whether the taxpayer was in the trade or business of creating copyrighted works, or whether the asset was actually subject to depreciation.

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