What's Behind The Boom In Song Catalog Sales? (And Should I Sell Mine?)

AS PRIVATE EQUITY POURS INTO the music business, seeking a slice of streaming's steady returns, artists, producers and songwriters (which will be used interchangeably at times throughout this piece) are facing a tricky question: "Should I sell my catalog?" While artists may enjoy the expanded opportunities offered by a shifting landscape, they often grapple with how to deal with the complexities that accompany them. The opportunity to sell a song catalog is a prime example.

Daniel Weisman worked as an artist manager for over 10 years, managing artists like Mike Posner, Wale, Big Sean and Capital Cities. Born and raised in Los Angeles, Weisman is now based in Nashville, where he works for AllianceBernstein, a global research and wealth management firm that is consistently ranked No. 1 in investment research. It has $580 billion in assets under management, with $100 billion in private wealth and over $3 billion in its sports and entertainment division. Weisman's background brings a unique perspective to advising music clients on their wealth and the complexity that comes with it.

Billboard sat down with Weisman to discuss the flourishing catalog-sales market and why there has never been a more tempting time to sell as now, but it might not be for the reasons you think.

GABRIELLA MIRABELLI "Catalog sale" isn't a new concept, is it?

DANIEL WEISMAN To be sure, artists have sold their song catalogs in the past, but those acquisitions and investments were typically limited to marquee names, evergreen hits or large catalogs. One of the most high-profile acquisitions happened in the mid-1980s, but the circumstances that made it all possible happened 20 years earlier.

In the mid-1960s, Paul McCartney and John Lennon assigned their copyrights to Northern Songs, a company they formed with their manager, Brian Epstein, and publishers Dick James and Charles Silver. In 1969, Lennon and McCartney, unable to get control of Northern Songs, sold their interests in the company to ATV Music for 3.5 million pounds [$58.9 million in 2019 U.S. dollars]. According to an attorney for The Beatles who was quoted in an old *Los Angeles Times* article, they sold in order for capital gain tax benefits, rather than income. In 1985, Michael Jackson wanted to explore the untapped value of music publishing, so he purchased the publishing rights — not songwriter's rights — to 251 Beatles songs, along with 40,000 other copyrights owned by ATV Music, for $47 million [$200 million in 2019 U.S. dollars].

Also, even the biggest David Bowie fan might not remember that in 1997, retail investors had the opportunity to invest in Bowie Bonds and capitalize on his future royalty streams.

So what makes 2020 different? Why has it become the year of the catalog sale?

Publishing acquisitions, both of legendary catalogs and more recent works, are hotter than ever, for three reasons:

1. Streaming, and the data generated from streams and downloads, have made it easier to value a song's worth and project its future earnings;
2. In this low-interest-rate environment, investors are

looking for return streams that are less correlated to the stock market and have yields higher than those offered by bonds;

3. And barriers to entry into the publishing business have fallen, granting access to more buyers. Because of technology, it is easier and less expensive to administer publishing and collect royalties globally now than it was even 10 years ago. Any artist with a hit is a potential acquisition, and anybody with a checkbook and the wherewithal to collect royalties is a potential buyer.

OK. But why are catalog values so high today?

The biggest misconception is that it's because of streaming, but it's largely because of historically low interest rates: While forecasting future streaming revenue is critical to determining the value of a music catalog, there is an equally important factor — the value of receiving a dollar today compared to tomorrow. This "time value of money" concept is important in assessing not only the sale price, but also whether the money should be paid in a lump sum — a catalog sale — or over time [through] annual royalty payments.

Today, inflation and interest rates are both at historic lows. So as long as inflation remains low, the buying power of one dollar today is likely to be very similar to one dollar tomorrow. That means buyers are willing to pay more for a music catalog today than they would be if inflation and/or interest rates were higher. Add in the uncertainty and potential decay of future revenue due to changing consumer preferences, new technology or reduced royalty rates, and the case for an artist selling their catalog today becomes even more compelling.

The historic sales seem like they were mostly of big names. Why are investors now interested in buying catalogs of a wider array of artists?

In the past, acquisition bets were made on the bigger names. But imagine only buying the 30 stocks that make up the Dow Jones Industrial Average, or stock in companies whose name you recognized or products you used. You'd be missing out on a lot of opportunity. Past publishing acquisitions were similar — they left a lot of opportunity on the table. Current acquisitions have less to do with brand names and more to do with two factors: historically low interest rates and the fact that music royalties are not correlated to the capital markets. They actually aren't correlated to much of anything. The legendary publishing executive Marty Bandier once told me that music and booze are the

HOW INFLATION WORKS

One way to bring this to life is by measuring the impact of inflation over the last 40 years, broken into two 20-year periods: 1979-1998 and 1999-2018.

During the first span, inflation averaged 4.5% per year, so a dollar saved from 1979 would, in 1998, only be able to purchase $0.41 worth of goods and services. An investor buying an income stream in 1979 wouldn't place much value in the dollar that they have to wait 20 years to receive.

With inflation down to 2.2% between 1999 and 2018, the value proposition for buying cash flow becomes a lot clearer: One dollar in 1999 has, after inflation, the purchasing power of $0.65 in 2018. That's the retention of almost 50% more purchasing power than there was in the prior 20 years. In a period where inflation and interest rates are low and expected to remain that way, buyers place a higher value on the dollar they would receive in the future than they do if inflation or interest rates are high.

only two industries that flourished when people are both happy and sad.

So why did Jackson spend $47 million on ATV in 1985, when inflation was 3.56% and interest rates approached double digits?

That's a good question. And the deal almost didn't happen. Jackson, along with his attorney John Branca and accounting firm Gelfand Rennert & Feldman, spent about $1 million over 10 months with a team of 20 people auditing the books of ATV in London, Los Angeles, Toronto, Sydney, Munich and Amsterdam. Through this due diligence, they determined the deal was worth it, largely because of the sheer number of copyrights he would come to own and the fact that the Beatles publishing was not being synched, marketed and exploited.

In 1995, Jackson went on to sell 50% of the company for $100 million and in 2016, his estate sold the other half for $750 million. That is a 1,600% return, not adjusted for inflation. While that sounds like a staggering return on his investment, if Jackson had invested $47 million in the S&P 500 on Oct. 1, 1985, and reinvested any dividends, it would have been worth over $1 billion in 2016. That's an over 2,000% return, not adjusted for inflation. That's not to say Jackson's investment wasn't a good one. He was able to sell a portion of it for a huge gain early on and likely received earnings from his joint venture with Sony/ATV over the decadeslong partnership. However, this does illustrate how a basic investment strategy can compound over time if you aren't spending from your portfolio.

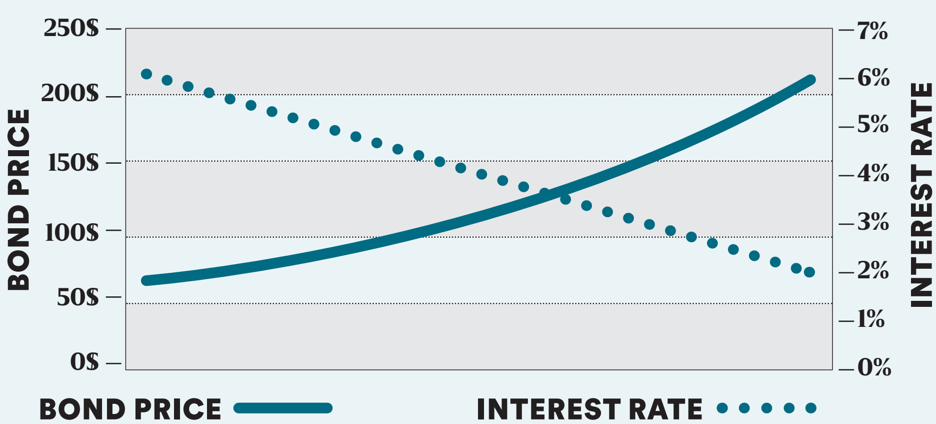
Can you compare catalog purchases to any other financial instrument and explain how they relate to interest rates?

The best thing is to compare a catalog to a bond, and the price of bonds is inversely proportional to interest rates. When interest rates go up, bond prices go down and vice versa.

Bonds also have coupons. If you buy one bond for $1,000, it comes with a coupon rate and a maturity date. If it is a 5% coupon, then you receive two payments of $25 every year until the maturity date, at which point the issuer of the bond pays you $1,000. Some people have a hard time wrapping their head around this, so it helps to remember that back in the day, there were actual coupons — each one worth $25 — that you tore off the $1,000 bond and brought to the issuer to redeem two times per year. At the end you brought the bond back to the issuer and they returned to you your principal [$1,000].

Your catalog is like a bond. You paid nothing for it because you created it. If your catalog has been paying you $500,000 per year, is projected to continue to produce around that number and then someone comes along and pays $10 million for your catalog, it's as if they purchased a 5% bond. However, a catalog differs from a bond in several ways. Once an investor has been paid $500,000 every year for 20 years, they've made back their $10 million principal, not adjusted for inflation, but they still own the catalog and it is still generating roughly $500,000 annually. They also have the option to sell that catalog for more than they paid for it, unlike bonds, which when they mature are only worth their principal — the original price.

Interest Rates Down, Bonds Up But If Rates Up, Bonds Down



Source

Why is it important for songwriters and artists to know and understand this?

It's important to understand the similarities between bonds and catalogs so you can understand how external factors beyond hits and streaming numbers can dictate the multiples that investors are willing to pay for catalogs. With information, data and measurement tools readily available, a big-name catalog that generated $10 million during five years of the aughts — the iTunes era — could be worth less than a smaller-name catalog that generated $10 million in five years during the streaming era.

OK, you lost me. Why?

A number of factors, including the evergreen nature of playlisting; the decay of a hit on streaming being far less drastic than in the download era; and the barrier of entry to listening to music being essentially nonexistent. Once you have internet and a device, it doesn't cost you anything to listen to a song on-demand, it just costs the streaming company money. It then costs you money to subscribe to a streaming service, but even then you can still listen for free on YouTube or Spotify freemium. Other factors to consider are, for instance: One song that has generated $10 million in revenue over a period of time could be worth slightly less or more than 20 songs that have generated $10 million over the same period thanks to the value of diversification and the discount placed on synch revenue.

Ah ha. Got it. Do artists' other assets — for example, paintings or TV royalties — work in the same way or is music unique?

The way music royalties accrue makes it unique in the "art as an asset" world. Investing in fine art like Picasso or Basquiat is a gamble in which purchasers hope that the value of their purchase goes up at the next auction. It could go up 100%, or it could go up 1,000%. However, someone who bought a Basquiat for $500 in the early '80s and has held on to it for 30 years hasn't made $1 off of it. Fine art doesn't generate income until it's sold, whereas music royalties are generating income 24/7.

Royalties from films or television programs are also very different from music. Film and TV royalties are dependent on numerous factors, ranging from deal negotiation to collective bargaining by unions and measurements of consumer engagement. Mechanical royalties in music are determined by the government, allowing them to be predictably formulaic. Therefore, these acquisitions are purely financial, and generally $1 of earnings from a bigger name is worth roughly the same multiple as $1 of earnings from a [smaller] name as long as there is a sufficient history of earnings.

Deals are based on financial models and basic economic principles tied to a confluence of both domestic and global economic factors including the virtual elimination of music piracy and the growing worldwide streaming industry. All that to say that right now is one of the best times in history for songwriters to [cash in] on their intellectual property.

Boil it down for me: What is actually being bought and sold?

These days, any income stream is up for grabs. An artist's or songwriter's stake in his or her compositions is typically referred to as "publishing" or "catalog." When a catalog is sold, 100% of the songwriter's copyright interest — all income and rights in each song — is typically relinquished. This would include, where applicable, writer's share, publisher's share and performance rights or royalties. On occasion, if the artist or songwriter is also a producer and has received a master royalty, then producer royalties may also be included in the deal. But there is a marketplace for mechanical royalties, SoundExchange royalties, neighboring-rights income, strictly streaming income, etc. You can sell it all or sell it piecemeal.

Do you have to sell it all, globally in all locations, or can you still keep some of it?

Well, as my friend Doug Colton — who is an attorney specializing in catalog sales — says, the beauty of catalog sales is their flexibility. They can be structured however you want them to be. One nice thing about copyrights and music royalties is that they can be sold in percentages, by territory and by duration. This allows the seller to still participate in their copyrights while taking some money off the table.

OK, say I'm an artist. Should I sell now or wait?

The catalog market is constantly changing. Traditional publishers haven't historically paid the same kinds of multiples on publishing revenue like some of the newer companies have been. However, in the last year, three or four new players have joined the party along with the major publishers and thus, traditional publishers have had to reevaluate and start taking more calculated risks. Depending on how the original publishing deal was structured, the buyer is typically acquiring as much of the publishing rights as possible, which usually means 100% of the seller's mechanical and performance royalties, including both the writer and publisher shares where applicable.

Right, but right now, in 2020, should I sell or wait?

It depends. For artists, the trade-offs aren't immediately apparent. When the catalog is sold the artist must remember two things: 1) no more assets; and 2) no more royalty payments in the mailbox.

I was an entrepreneur and I sold my creative agency. Is selling a catalog like that?
Selling a catalog is economically similar to selling a business, but unlike you, who had in-depth knowledge of your company's financial worth, many artists do not truly understand the value of what they are selling. Therefore, artists are at a distinct disadvantage when negotiating. While they might know the A&R [executive] that signed them to their original deal, they probably fail to remember that that person works for [either] a French multinational media conglomerate, Universal Music Publishing Group; a Japanese multinational conglomerate, Sony; or a Russian oligarch, Warner. The music business is truly a global copyright business, and artists who are looking to sell their catalog are going to be negotiating with sophisticated counterparties in the form of private equity, investment banks and institutional investors.

Before artists face-off with sophisticated investors or large multinational corporations, they have to be armed with the financial knowledge that provides them the wherewithal to succeed at the negotiating table.

Pretend I'm an artist. What are some things I should consider before selling a catalog?
You should honestly ask yourself two questions:

1. Do I need the money to pay for something?
2. Do I want the money to invest?

If you answered "yes" to [Question] 1, you should probably not sell your catalog. Many artists sign record and publishing deals because they need money. Very few then look back and say, "I'm really glad I signed that deal." If you are looking to sell your catalog to buy something, then you are probably making a mistake, unless what you are buying is an appreciating asset. You should not be selling your catalog if you "need" money or even if you "want" money. I should caveat that by saying that if you are planning on using the proceeds from a sale to get yourself out of debt with the IRS, then please make sure you are working with a licensed CPA on a plan.

My friend Phil Sarna, who is a great business manager, has been involved in a number of catalog sales and he says that anyone who is not taking their catalog sale proceeds and investing them into a long-term diversified asset allocation strategy is making a mistake.

To put it simply: Money is flowing into acquiring music rights as a form of investment diversification. This is the same reason why you should consider making a sale and why it is a good idea to use the proceeds from a sale to diversify your investments.

So if I answer "no" to Question 1 and "yes" to Question 2, can you walk me through my next steps?
Step one: Before selling your catalog, you should assemble a team of trusted advisers to help you evaluate your options, understand your goals and take the steps necessary to achieve them.

Who should be on that team?
An attorney. You might have an attorney already. You might have an attorney who represented you before you even made a dollar. Great, keep them onboard. However, you want to make sure that the attorney you bring in to help you when considering, and executing, the sale of your catalog is a trusted music transactional attorney who has experience in catalog sales, not someone who is simply doing contractual work all day.

An accountant or business manager. This person will audit past royalties and help you derive a realistic valuation. This person models earnings streams, projected cash flows and internal rates of return. They also are there to advise on the tax consequences of a sale.

A financial adviser, well versed in catalog sales. A critical and sometimes forgotten member of the team, the financial adviser can help by being a second set of eyes on earnings models, projected cash flows and internal rates of return, all of which are critical when considering options and offers. They also help clients by creating an asset allocation plan and wealth forecasting analysis, which models out spending needs 30-plus years in the future. Think of the financial adviser as serving as a "quarterback" for the deal, providing guidance throughout the transaction and beyond.

It's important to find an adviser that is not driven by the motivation to sell you a life insurance policy. Insurance may be an important and necessary part of your plan moving forward, but it's crucial to back into that number as needed within an overall plan. Some financial advisers have a personal financial incentive to sell life insurance or structure products. For these individuals, a significant percentage of their income is generated through commissions.

What is step two?
Step two involves due diligence and financial modeling. Part of the due diligence is understanding the value of each asset. Investors are looking at royalties as uncorrelated assets. An uncorrelated asset is something of value whose price does not have a relationship to a value or price of something else of value.

Remember how Marty Bandier said booze and music are recession-proof? Music consumption, and therefore music royalties, are generally strong regardless if the economy is up or down. In other words, the economics of music consumption are not linked to any other part of the economy. Even if people cancel their Spotify subscriptions, there is a freemium tier that generates revenue. That's not to say that what a buyer is willing to pay for a catalog isn't affected by other parts of the economy ... Investors are flocking to catalogs because of this low-interest-rate and low-inflation environment. Investors are essentially buying cash flows.

What sorts of multiples should artists be looking for on their catalogs?

There is a lot of conversation about multiples on earnings, but if you want to get an accurate valuation to take to market, you need to do a little more work.

On a very basic level, you should have an understanding of what the last five years of your earnings look like for mechanical royalties and performance royalties. Break out any synch income so you can be prepared for any potential discounts a buyer may apply to synchs. Synchs are often a one-time income boost to earnings statements, and many buyers will back synchs out of their valuations or significantly discount them as part of the valuation. After you've separated out the different income streams for the last five years, you should create average, median, floor and ceiling numbers. With those numbers, and with the help of your team of trusted advisers, you can start to get closer to an accurate number of the value of your catalog and what you can hope to sell it for.

If you have an accountant or business manager who has been tracking your income and [profit/loss statements], this shouldn't take more than a few weeks.

Who is the buyer for my catalog?

Another part of the due diligence process involves assessing the buyers in the marketplace. You should consider expanding the possible set of buyers beyond your current publisher and major music companies and offer your catalog on the open market. Like Michael Jackson's purchase of the Beatles catalog, interested buyers might not fit a traditional profile.

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WHAT'S THE REAL OPPORTUNITY FROM STREAMING ROYALTIES?

The rise of music streaming has created an exciting new revenue source in the music business. Many artists assume that the recent interest and perceived value of their catalogs are driven solely by this rise in revenue. But that's not entirely true. After the record label and streaming service take their cut, the slice of the streaming pie left for the songwriter is surprisingly thin. Generally, for every $1 of revenue generated by a streaming service, like Spotify or Apple Music, only about $0.05 goes to the artist. The breakdown is as follows:

MASTER RECORDING/ RECORD LABEL

The sound recording owner, typically the record label, gets $0.58. This covers the master recording and any corresponding master royalties that need to be paid by the label to the leading artist, featured artist and/or producer. Surprisingly, many people in the industry don't understand the difference between "master" and "publishing" and each's compensation from $1 of streaming revenue. The term "master" is a throwback to a bygone era when original recordings existed on acetate or tape and all copies were derived from that original master recording. Today, master recordings exist on hard drives and in the cloud as multitrack digital files.

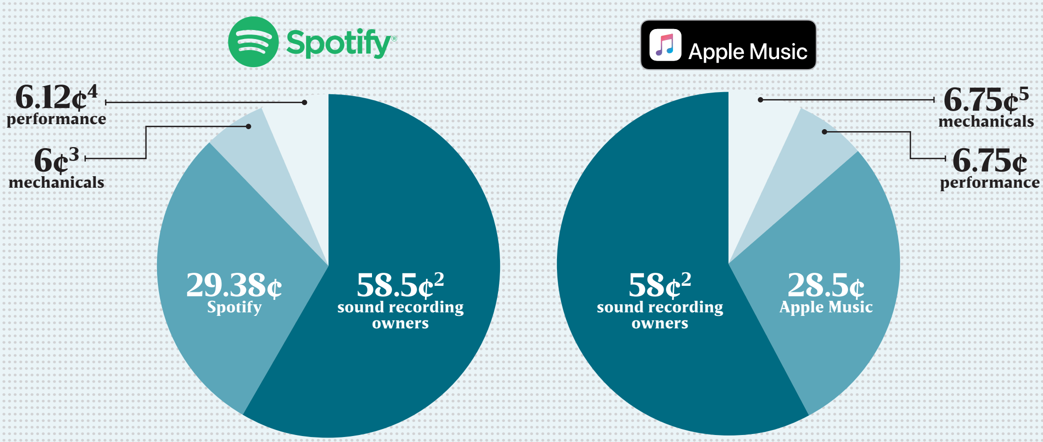
STREAMING SERVICE

Though the consumer may not care, there is a difference for the artist between streaming and downloading music. The streaming service gets $0.29 to cover its expenses, but that revenue fluctuates based on several factors, including label market share, total audience consumption and type of subscription. A million streams one month that pay $5,000 could pay just $4,500 the next month. Conversely, royalties and revenue from iTunes downloads, for example, are static — always 30%. If iTunes generates $2 million in download sales, Apple keeps $600,000. It accounts for every download the exact same way — 1 million downloads in one month pays the same amount as 1 million downloads the next month.

PUBLISHING (Mechanical Royalties)
$0.06 goes to cover mechanical royalties. The term "mechanical" is also outdated and confusing in the streaming landscape. It comes from when sheet music was printed with staggered holes so that it could be placed onto a piano roll for use in a mechanical player piano. Today, the streaming service typically has a blanket license agreement with a third-party collection agency, like Harry Fox, which takes 11.5% commission. The streaming service sends statutory notice and payment to the publisher or third party, which is typically split equally with the songwriter.

PERFORMANCE ROYALTIES (Performing Rights Organizations)
$0.06 goes to the PRO, like ASCAP, BMI and SESAC, which deducts expenses off the top, then pays out 50% to the publisher and 50% to the writer.

What Happens To A Dollar Of Revenue[1]



LEGEND
- In most cases, sound recording owners are record labels. But they also include producers, film studios, independent artists and investors.
- Mechanicals (short for mechanical royalties) are collected by publishers or a mechanical licensing administrator like The Harry Fox Agency. What publishers keep before paying out to songwriters varies. HFA charges an 11.5% commission on payments collected.
- Performance income usually flows through performing rights organizations (see footnote 4). ASCAP and BMI deduct their operating expenses off the top (approximately 16% to 18% of royalties) before paying the writer's share (50%) directly to writers and the publisher's share (50%) to publishers. Note: The percentages listed are unconfirmed estimates of operating expenses for the United States only, and these rates do not apply to direct deals with SESAC, Global Media Rights and collection societies. Some publishers also collect performance income.

NOTES
The figures mentioned only relate to U.S. revenue. Foreign amounts will vary across all aspects.
1 Depending on the type of service, music service revenue may include, among other things, monthly subscriber payments and/or advertising revenue.
2 There is no statutory right of public performance for interactive streams of sound recordings. The precise amount of revenue paid out for use of a recording depends on the sound recording owner's negotiated deal with the service. 58.5 is an approximation based on multiple data points we received.
3 Mechanical royalties, or "mechanicals," are paid to publishers and songwriters for the right to reproduce a song in a recording (vinyl, CDs, downloads and "cached" or server copies on interactive services). Unless otherwise negotiated, the rates are determined by statute. For interactive services, the Copyright Royalty Board sets an "all-in royalty pool" of 10.5% of music service revenue. Then performance royalties are deducted from the all-in royalty pool to come up with what we call the "payable royalty pool." 10.5% does not necessarily apply to all services. There is a "minimum all-in royalty pool" calculated as a percentage of the amount the service reports to pay labels (the "label payment"), which applies if the result is greater than 10.5% of service revenue. That percentage changes depending on whether the label or the service obtains the mechanical license. In practice, it is always the service, which means the all-in royalty pool is calculated as 21% of the label payment. If the label was the licensee, the all-in royalty pool will be 17.36% of the label payment. There is also a "subscriber-based floor" of 80 cents per subscriber per month, which will be used only if it results in a smaller amount than the minimum all-in royalty pool. There is an additional mechanical subscriber-based floor of 50 cents per subscriber per month that applies if the payable royalty pool is smaller after deducting performance monies (which it almost certainly is for Spotify). Note: For ad-supported interactive services, there is no subscriber-based floor and a different percentage for the minimum all-in royalty pool. Practically, this means the all-in royalty pool for Spotify's ad-supported service is the greater of (i) 10.5% of service revenue and (ii) 22% of the label payment.
4 Performance monies are paid for the right to publicly perform a song. As a song streams on an interactive service, it qualifies as a "public performance." Performance rates are negotiated directly between performing rights organizations and the services and set annually. 6% to 7% of service revenue is an approximate, unconfirmed rate paid by Spotify to ASCAP and BMI for 2016.
5 This calculation is based on direct deals between publishers and Apple. Therefore, there are no minimum all-in royalty pools or subscriber-based floors. However, if there is no direct license, the same statutory calculations as Spotify apply.

SOURCE

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Can you give a real-world example of how you walk your clients through the decision to sell or not to sell?

I recently had a wealth management client who was considering the sale of her catalog. Let's call her Patricia Popstar. She is 40 and living in California. Her income from touring covers her annual living expenses. She has also earned an average of $250,000 per year from publishing and PRO income over the last five years. Her royalty income during the aughts was less significant than it is now. One of her songs was sampled in a more recent hit and she has since seen steady royalties. She was concerned that the window might be closing on her ability to realize the biggest upside in selling her catalog. She was offered $3.21 million to sell her catalog, equal to a 12.84 times blended multiple on her $250,000 average annual income. She wanted to know if she should accept the offer.

Did she?

Here's the thing: Most people in a commission-based business, like music, might be hesitant to take advice from someone like a manager or lawyer telling them to take a deal. They might be thinking, "Of course they're saying take it, so they can take their commission and have a big payday." In Patricia's case, she wanted an unbiased third-party opinion, and I told her to consider three things:

1. TAXES

Given her state of residency, California; size of the sale, $1 million-plus; and her current needs, a sale might not make sense. It was important for her to identify her core needs.

2. INTEREST RATES

Right now, interest rates are low. The short-term, mid-term and long-term applicable federal rate [AFR] are within a half a percent of each other. That means the cost to borrow money for 30 years is almost the same as it is to borrow for 10 years. Interest rates are low, inflation is low, and bond prices are high. Because of that, investors are interested in buying Patricia's catalog for cash flow.

Remember to think of her catalog like a bond: The investor paying $3.21 million in exchange for her $250,000 per year in income is essentially buying a bond with a 7.7% coupon. That is more than 5% higher than the long-term AFR. If interest rates go up, her catalog becomes less appealing to an investor. The cost of borrowing money goes up and down over time, and right now money is cheap, so she should be getting as much as possible.

3. HER FUTURE

She should plan for the proceeds in the form of a diverse, long-term strategy. She should not use the proceeds to pay for something or a change in lifestyle. Why? Because she traded annual income for a liquidity event. That larger amount of money applied to an investment strategy, especially when she isn't spending from her portfolio — at least not until she stops touring — allows for the least amount of drag on performance.

Right. Point No. 1 was taxes: What sort of taxes do you have to pay on a catalog sale?

Ah, yes — the tax hit on hits. Well, regardless of whether Patricia's royalty income payments are received each year, or she sells them for one lump-sum cash payment, she will pay tax. The tax rate, however, will differ.

How are royalties taxed?

Royalty payments are subject to ordinary federal income taxes around 35% — which can run as high as 37% — plus state income tax and a 3.8% net investment income [NII] tax. As a resident of California, Patricia would owe 9.3% California state income tax on earnings between $107,960 and $551,476, and the rate could climb to as high as 13.3%. She was paying around 45% in taxes, but at the highest marginal rates, Patricia could be paying over 50% in federal and state income taxes on royalty income.

How is a catalog sale itself taxed?

The sale of Patricia's catalog would be taxed more favorably — subject to 20% federal long-term capital gains tax, plus 13.3% state income tax and 3.8% NII tax. Even at the highest federal and California rates, this would result in a tax rate around 37%. So, in addition to realizing the time value of money if she sells, she is also saving around 8% on taxes, or roughly $256,000. That's a year of earnings.

What did you tell her to do?

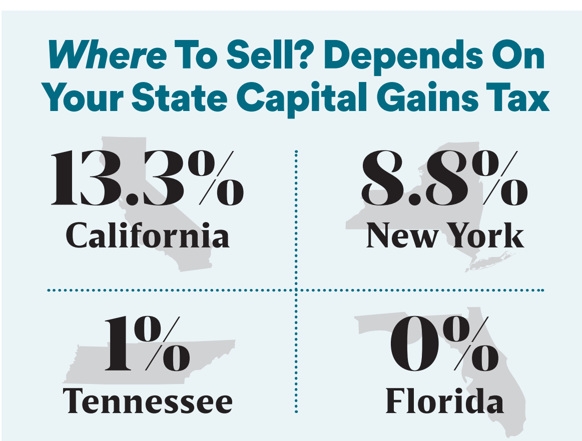
While every situation is different and I cannot give tax or legal advice, if your earnings are significant enough to motivate someone to offer to buy your catalog, generally speaking, under our current tax code, a long-term capital gains event will usually be taxed more favorably than income tax. I will leave it at that.

Does it matter where you live when you sell your catalog?
California and New York have two of the highest state tax rates, and to the extent you can control your residency, you might be able to significantly control the amount of money you pay in taxes.

You mean move locations? An artist selling a catalog can move before the sale to save on taxes?
Absolutely. I had a wealth management client who lived in New York and decided to move to Tennessee before selling their catalog in order to avoid New York's 8.8% capital gains tax. Although Tennessee has no income tax, they do have a state capital gains tax, also known as a Hall Tax, which was 6% in 2015 and has been sunsetting by 1% every year. It is currently 1% and is set to go away after 2020. He will save over 5% on his sale by moving to Tennessee in addition to avoiding state income tax on his current earnings.

Currently, Florida residents have neither a state income tax nor capital gains tax.

Always consult an attorney and CPA in both your home state and the state you're moving to before making any planning decisions. Many states require minimum residency requirements.



If you can't move locations, is there anything else you can do before selling that can help save on taxes?
Many people can't just move to avoid taxes. But there are other things that can be done to maximize tax savings on capital gains. The Tax Cuts and Jobs Act of 2017 allows you to, among many other things, reinvest realized capital gains into a qualified opportunity fund where your taxes can be delayed, reduced or, depending on the investment, eliminated altogether.

A charitable strategy can also be used to reduce capital gains, generate an income tax deduction in the year of the sale and leave funds to donate to charity — ask about a donor-advised fund.

For clients who might be subject to an estate tax — the 2020 exemption is $11.58 million per person or $23.16 million per married couple; anything above that is taxed at 40% on death — there are strategies that can be implemented to transfer and grow wealth out of their estate for the benefit of children or family.

Any last pieces of advice or thoughts you'd like to share?
Most people are not good at planning. Most people will never make the kind of money that requires planning. Most artists are not good at planning. Many artists do make the kind of money that requires planning, but few actually do any planning. A small amount of planning now can potentially save you millions over your lifetime.

Dan Weisman *(daniel.weisman@bernstein.com) is a wealth adviser who specializes in working with artists, entrepreneurs and business owners, especially as they are going through significant financial transactions. He is also a Grammy Award-nominated video producer and entrepreneur. He spent 15 years as a manager for multiplatinum global touring acts, negotiating major-label recording and publishing deals and advocating for artist rights. In addition, he has had two of his own liquidity events from businesses in which he was a shareholder, luxury shoe brand Buscemi and the Dollar Shave Club, both resulting in exit prices of over 200 times his initial investment. He is now a vice president at Bernstein Private Wealth Management, partnering with artists and other successful individuals, offering wealth strategies and planning from AllianceBernstein's global headquarters in Nashville.*

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