The Bankler Report

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INTRODUCTION

David Bowie—who died of cancer on January 20, 2016 at the age of 69—was not only a rock star of music, but also a rock star of tax planning. The following is a brief summary of his tax and financial planning strategies.

Tax Exile

In 2015, an International Consortium of Investigative Journalists (ICIJ) made public documents from HSBC's Swiss private banking arm, which named dozens of celebrities, including David Bowie. He acknowledged that he had been a Swiss resident since 1976, when his first wife, Angela, who had been educated in a private school there, flew to Switzerland, hired a Swiss lawyer, and negotiated legal residence for them. The bottom line was a tax rate approaching 10%! Prior to that, David had emigrated from England (which had an 83% marginal tax rate) to California.

In 1992, he married the model Iman. While the couple lived primarily in England and the United States, Bowie reportedly established legal residency for tax purposes in Ireland by purchasing a 640-acre estate near Dublin.

Since 1969, the Irish tax code has exempted royalty earnings of musicians, writers, and other artists from income tax. That provision is credited with attracting writers like Irvine Welsh, DBC Pierre, and Frederick Forsyth to move to Ireland. It also helped persuade local artists like U2, Enya, and Seamus Heaney to remain there. When Ireland began capping the annual exemption in 2007, some artists (including U2) responded by relocating their music publishing businesses to the Netherlands.

Bowie Bonds

Undoubtedly, Bowie's greatest tax planning exercise made him a major player on Wall Street. On January 31, 1997, $55 million worth of "Bowie Bonds" were issued. They were the first major securitization of intellectual property rights. These bonds were secured by Bowie's back catalog. It consisted of future music royalties on recordings of about 300 songs recorded before 1990 and his exclusive IP rights, which had been copyrighted. Transferring these to a special purpose vehicle (SPV) and issuing the bonds enabled Bowie to raise a large amount of money without requiring him to divest ownership of those IP rights. Upon full payment of the bonds, the copyrights would revert back to Bowie. A group of investors led by Prudential Financial acquired the bonds in a private placement.

Utilizing this structure provided Bowie with both asset protection and tax deferrals. For U.S. bankruptcy purposes, the transfer of copyrights from Bowie to the SPV was structured as a "true sale," so that the copyrights would not be included in Bowie's estate should he become insolvent. Nonetheless, for U.S. tax law purposes, the transfer was structured as a loan or financing rather than as a sale, rendering it a nontaxable event.

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New Financing Method

The success of the Bowie Bonds opened up a whole new avenue of financing for entertainers (and other owners of intellectual property): securitizing future royalty income. This method of financing promises the IP owner greater liquidity and increased diversification and offers the financiers a higher rate of return.

The bondholders benefit from the bankruptcy-remote nature of the SPV. As a result, no liens can attach to the IP rights in the SPV if the IP owner becomes insolvent, is sued, or gets divorced.

In addition to offering more efficient risk sharing, the structure offers compelling tax benefits. Even if the IP owner is a U.S. resident, he can monetize the value of his IP while deferring all taxes until the royalties are actually earned. The IP owner may also be able to deduct the interest paid on the bonds if he is deemed to be engaged in a trade or business and the loan proceeds are used for a business purpose. Alternatively, if he uses the loan proceeds to generate investment income, he may deduct the interest on the bonds up to the amount of that investment income. Finally, if the royalty stream exceeds the interest and principal payments made to amortize the loan, the IP owner can use the excess to pay the income taxes on the royalty payments.

Also attractive to domestic entertainers is the benefit of better estate planning. Securitizing royalty income can provide sufficient funds for the estate of a deceased entertainer to pay estate taxes without having to sell the IP rights. Moreover, once the IP rights pass to an heir, taxes on any appreciation during the term of the loan would not just be deferred but might even be wiped out by a step-up in basis.

The issuance of Bowie Bonds was rightly seen as cutting-edge, and the investment banker who set it up claims to have created similar deals for other artists, including James Brown, Ashford & Simpson, and Marvin Gaye.

There are multiple ways to monetize assets and investments without incurring taxes that would be due if that asset were simply sold. Contact us should you have any questions or if we can assist in solving a potential problem.

(Note: Information for this report was compiled from Tax Notes articles)

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