# Mary Poppins Tax: a Spoonful of Sugar Helps the Revenue Go Down?

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## Introduction

Tom Hanks may be starring in the forthcoming biographical drama that centres on the production of Disney's *Mary Poppins*, but it was the trustees of the will of the author of the original books who were centre stage at the recent First-tier Tribunal decision.[1] The tribunal judges were required to decide how, for tax purposes, the royalties paid after the author's death from the stage musical *Mary Poppins*, which opened in the west end of London at the end of 2004, were to be treated.

Whilst even your most cheerful chimney sweep is likely to be daunted by the prospect of a two-day hearing in respect of trusts and tax issues, this particular decision was further complicated by the fact that, after the death of PL Travers, her trustees had assigned the right to put productions of *Mary Poppins* on stage, which had previously been dealt with by a copyright licence. The question for the tribunal was whether the royalties were to be regarded as income or capital and, if the former, had that income been accumulated so that it wasn't just taxable at the basic rate (broadly 20 per cent) but at the higher rate applicable to trusts (up to 45 per cent). Somewhat confusingly, even if the royalties were capital for trust law purposes, they would be subject to income tax, albeit at the basic rate.

## The script

PL Travers published six *Mary Poppins* children's books between 1934 and 1982. In 1960, she and a family company entered into an agreement with Walt Disney Productions under which they agreed to grant Walt Disney Productions an assignment of the right to make motion picture adaptations of any of the *Mary Poppins* books. The hugely successful Disney film was released in 1964.

In May 1994, PL Travers entered into another agreement, this time with Cameron Mackintosh Ltd (CML) (and another), with a view to staging a *Mary Poppins* musical. PL Travers died in 1996, having never seen the musical get past the preliminary stage of Sir Cameron Mackintosh obtaining approval from the Walt Disney organisation (whose consent to the stage show was required).

In her will, PL Travers left her literary estate (including the copyright in *Mary Poppins*) upon a settlement, the beneficiaries of which were her descendants and a charity she had set up. Under the terms of the settlement, the trustees were to pay out the income of the settlement for 80 years, after which time they were to distribute the capital among certain beneficiaries absolutely.

Disney's approval to CML putting on the stage show was given in 2004, at which time another agreement (which amended the 1994 Agreement) was executed between the trustees and CML. As part of that 2004 agreement, the trustees assigned the right to put the *Mary Poppins* story on stage to CML, effectively enlarging the 1994 Licence into an absolute entitlement. This extension was in exchange for receiving a royalty stream which would be based on a percentage of the profits of the show.

[1] *Trustees of PL Travers Will Trust v HMRC* [2013] UKFTT 436 (TC).

## Copyright and tax

Copyright in literary or artistic works will last for the life of the creator plus 70 further years from the year of the author's death. The general rule is that the author of a copyright work is the first owner of the copyright. However, where a copyright owner grants a licence, that licence will then be, broadly, binding on every successor to the copyright owner (including trustees of a settlement).

There were several tax years at stake for the tribunal to consider and, given the income tax re-write that took place in the early 2000s, there were two different pieces of legislation to consider. However, the relevant provisions were materially the same and essentially provided that any income arising to trustees of a settlement would be taxable. The rate at which the income would be taxable depended upon whether the income was to be accumulated. If so, it would be taxed at the higher rate applicable to trusts (i.e. 45 per cent). If, however, the income wasn't accumulated income, and fell outside of the statutory provisions in respect of such income, it would be taxable at the basic rate (i.e. 20 per cent).

## HMRC assessment

The trustees had submitted tax returns on the basis that the royalties derived from the musical were capital in trust law terms and therefore were to be added to the trust fund rather than distributed. They therefore took the view that the royalties (which were not, the trustees believed, "accumulated income" for tax purposes) were liable to income tax at the basic rate. The trustees prepared the trust's tax returns accordingly and disclosed the decisions that had been made.

In 2007, HMRC enquired into the returns and concluded that the payments were subject to tax at the higher rate applying to trusts as the royalty payments were accumulated income. The appeal heard by the tribunal was against HMRC's decision in respect of the tax treatment from 2004/05–2008/09.

## Facts before the tribunal

The tribunal was faced with a lack of case law in respect of royalties, trusts and tax. Many of the cases referred to during the appeal were Scottish and most of those made reference to mineral rights. The tribunal was asked to consider a number of authorities in which the settlor had not specified whether the fruits of exploitation of the minerals were to be enjoyed by the life tenant (i.e. the party entitled to enjoy the trust property for a limited period) or were to be preserved for the remainderman (i.e. the party entitled to have the trust property passed to him at the end of the specified limited period).

In several of the cases, trustees had opened new mines or granted new mining rights over additional mineral deposits. In such cases, the trusts' receipts from those "new" sources were capital and were to be preserved for the remainderman. The case law held that, broadly, the settlor could specify which beneficiaries were to enjoy the receipts but, in default of any such express provision, the settlor will be taken to have intended that the life tenant should receive the receipts from mines that had already been worked on or leased before the settlement but any "new" receipts which were created after the settlement was established were to be preserved for the remainderman.

HMRC suggested that PL Travers had "opened the mine" (at least when the 1994 rights were granted to CML, if not when she first published the *Mary Poppins* books) and it was irrelevant that those companies had not worked those rights during her lifetime. The trustees disagreed, and instead sought to compare the situation to cases where it had been held that the income to which the beneficiaries were entitled did not include any income produced by mines which had been opened after the settlor's death.

Putting to one side the difficulty in comparing the production of minerals from mines and the royalty stream deriving from the production of a musical, the cases presented were trust not tax cases and solely sought to deal with situations where the relevant will had been silent as to which category of beneficiaries was entitled to the receipts. It seemed to be "plainly right" to the tribunal that, in circumstances where land containing untouched minerals was settled upon a life interest trust, the minerals would form part of the trust property that is to be preserved for the remainderman. Where trustees were to turn those minerals into cash, the remainder man's interest in the trust would be eroded if the cash were applied as income and paid to the life tenant.

Having considered the intricate terms of PL Travers' will, the tribunal concluded that the trustees had been directed to preserve the royalties for distribution in 2076 (i.e. 80 years after her death). The next question for the tribunal to consider was therefore whether when making this direction, PL Travers had directed an accumulation of income as set out in the relevant legislation. The trustees submitted that there was not an accumulation as the royalties were not "income" in the trust law sense and/or they were not being "accumulated" in the trust law sense because they were, in essence, being stored up to replace the wasting asset represented by copyright that would expire in 2066. HMRC submitted that the royalties were income that was being accumulated.

## Tribunal decision

The tribunal concluded that that the trustees' case largely succeeded. At the time of PL Travers' death, the 1994 agreement had given CML a *licence* of certain stage show musical rights arising out of the *Mary Poppins* copyright. The underlying right remained with PL Travers and that portion of her copyright was passed into her estate on her death. The subsequent execution by the trustees of

the 2004 agreement, in short, brought about an *assignment* to CML of the right to perform or licence others to perform acts that would otherwise be restricted by PL Travers' copyright.

PL Travers' trustees had therefore, according to the tribunal, in pursuance of their duty to maximise the value of the trust property in accordance with PL Travers' wishes, themselves disposed of portions of her copyright that had come to them at the time of her death. What they had done resulted in an assignment of the relevant portions of copyright with the result that they no longer belonged to the trustees but, from 2004, were replaced by a stream of receipts that was correctly analysed as the proceeds of the disposal of property. As a result, the post-2004 proceeds retained their capital nature in the eyes of the law of trusts. The question whether there was accumulated income was therefore irrelevant and the basic rate of tax was applicable.

The pre-2004 royalties, however, were to be treated differently. Upon PL Travers' death, her rights passed to her estate. The licence with CML had already prevented PL Travers from using the copyright in any way other than receiving royalties pursuant to the 1994 Agreement. The will did not, according the tribunal, direct the trustees to preserve the royalties from CML prior to the assignment as income for trust law purposes. As a result, on the tribunal's analysis, those royalties were a stream of payments generated by property (i.e. the relevant portions of copyright) settled on and, in relation to the period prior to the assignment, remaining with the trustees. This was sufficient for the tribunal to characterise these royalties as income.

Provided the tribunal was correct in its decision so far, the question of whether the income was accumulated income for tax purposes was only relevant to royalties received prior to the 2004 Assignment.

The tribunal accepted that copyright is a wasting asset in the same way as a leasehold asset or other time-limited form of property right. The trustees submitted that, given that the will contained a direction to preserve 91 per cent of the royalties for PL Travers' descendants (with the remaining 9 per cent going to charity), reasonable provision had been made for the wasting of the intangible assets.

However, the tribunal concluded that the wasting nature of the copyrights did not save the terms of the will from being a direction to accumulate. There was no reason why the 91 per cent preservation was equivalent to the market value over the 70-year period (to the contrary, the market value would almost certainly be less than that amount). The tribunal concluded that, on the information available, it could see no indication that PL Travers was attempting to emulate other settlors who had sought to direct that monies be available at the end of a wasting asset's life to replace that asset.

The tribunal therefore allowed the appeal in part. The pre-2004 royalties were income which was taxable at the rate applicable to trust (the higher rate) whereas the post-2004 royalties were more analogous with the proceeds from the disposal of property. Those later royalties therefore retained a capital nature for trust purposes and were taxable at 20 per cent.

## Thoughts

It is rare to come across a case which covers as much new ground as this particular decision. The fact that the tribunal judges had to refer to a line of Scottish cases about mineral rights highlights how unusual it was to be faced with a case that concerned intellectual property rights that had been passed to a trust on death.

Undoubtedly the executors of other literary estates will be cautious before carrying out assignments and granting new rights following the death of the author as this may have a bearing upon the tax rates applicable to the monies received from that asset. This case therefore serves as a warning, not only to those creating a copyright during their life as to how best to deal with royalties arising from the use of that right after their death, but also to trustees who have been tasked with dealing with deceased authors' copyrights.

As is often the case with tax and trusts, this decision highlights the need to get professional advice on how to structure the use of intellectual property rights at the outset, particularly when planning for death. Failure to do so risks making a muddle of the situation and, before you can say supercalifragilisticexpialidocious, you may have a bigger tax liability than you had expected—something even Mary Poppins herself would have struggled to smile at.

[1] *Cartoon Network Inc v OHIM* (T-285/12) October 2, 2013.