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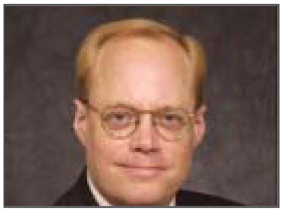

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Pharrell Williams, Robin Thicke Lose $7.4M Verdict For Marvin Gaye Song Theft--Before Taxes

A jury awarded Marvin Gaye's children $7.4 million, determining that Robin Thicke and Pharrell Williams copied Gaye's music to create Blurred Lines. It was the biggest song of 2013, earning over $16 million and counting. Rapper T.I. and the record company were cleared of infringement charges, but not Williams and Thicke. Ironically, the case started with a race to the courthouse in 2013.

That's right, Pharrell and Thicke started as *plaintiffs* in August 2013. Their suit attempted to stop Gaye's family from suing for copyright infringement. However, the suit was thrown out when Gaye's family showed the two songs were similar. The money at stake is considerable, and so are the reputation issues.

The Los Angeles Times said Blurred Lines earned $5.6 million for Thicke, $5.2 million for Pharrell, another $5 million to $6 million for the record company, and $8 million more in publishing revenue. Gaye's children, Nona, Frankie and Marvin Gaye III, initially asked for $40 million in damages, but reduced their claim to $25 million.

LOS ANGELES, CA – MARCH 05: Musician Robin Thicke is seen outside the Roybal Federal Building on March 5, 2015 in Los Angeles, California. Thicke and co-writers of the song 'Blurred Lines' are being sued by the children of singer Marvin Gaye for using elements of Gaye's song 'Got to Give it Up' in 'Blurred Lines.' (Photo by David Buchan/Getty Images)

Sales of Blurred Lines are still going strong, with the notoriety of the trial enhancing the take. That will probably spike again now with the verdict. Although no announcement has been made about an appeal, observers consider it likely. Even after an appeal, it is possible the case could be settled.

The revenue streams are big, but it is likely that the Gaye children will think about taxes when they get closer to turning the verdict into cash.

There are several large tax issues, but they start from the premise that virtually everything is taxable. That includes many lawsuit recoveries. But taxable as what, as capital gain or ordinary income? Another question is whether the Gaye children must pay tax on their gross recovery before lawyers fee, or only on their net recovery after fees.

How could they be taxed on their gross, you might ask? If the plaintiff has a contingent fee lawyer, the plaintiff is usually treated (for tax purposes) as receiving 100% of the money, even if the defendant pays the plaintiff's lawyer his contingent fee directly.

Suppose that the Gaye family settles for $7 million, and that their lawyers' fee is $3 million. You might *think* they have $4 million of income. Instead, they have $7 million of income, followed by a $3 million tax deduction. If the deduction is a miscellaneous itemized one as seems likely, the Gaye family faces numerous limitations. They may even be subject to the alternative minimum tax, AMT.

When plaintiffs complain that they are paying tax on money they never received, it is usually because of this rule. There are sometimes ways of getting around or minimizing its impact, but the tax traps can be severe. And they seem unfair.

The question whether a recovery is ordinary income or capital gain matters too. Plaintiffs would rather pay a 20% capital gain tax than a 39.6% ordinary income, even though the capital gain may face the extra 3.8% Obamacare tax. One area ripe for capital gain tax planning is intellectual property cases such as patent, copyright and trade secret cases. Royalties are ordinary income, but when an inventor or creator sells rights, it may be a capital gain.

There is a good deal of line-drawing, including questions over whether someone is a professional that can only collect ordinary income. But sometimes the standards can be forgiving. For example, in *Kucera v. Commissioner*, an inventor with 21 inventions and several patents was not a professional so was entitled to capital gain treatment. If the Gaye family hope to minimize taxes on their recovery, they will have their work cut out for them.

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