

BUSINESS LAW TODAY

Even After Death, Michael Jackson Has to Deal with the IRS

By [Robert W. Wood](#)

Michael Jackson was no stranger to lawyers while he was alive, reportedly spending \$20 million on his successful defense against sex abuse charges. Now, even after his death, he is still keeping lawyers busy, producing a healthy stream of income and paying lots of taxes on that income. Despite the size of the checks the IRS is receiving, however, the agency wants more. Yes, we're talking *estate* taxes.

This article takes a look at how estate tax laws are affecting the Jackson estate today. It discusses how the IRS is able to collect both income taxes and estate taxes following a person's death. The tax and valuation issues are particularly knotty where intellectual property and image rights are at play. More importantly, this article also emphasizes how the subjective nature of valuing assets can lead to messy disputes with the IRS. As we will see, these disputes can be particularly devastating to an estate with illiquid assets that are – or at least appear to be – immensely valuable.

Income Taxes

Mr. Jackson died unexpectedly on June 25, 2009, at age 50. As frequently occurs with top entertainers, the star's efforts during his lifetime have continued to produce

a steady stream of income even after his death. As always, the IRS wants its cut. First, there are income taxes, which are distinct from estate taxes.

Just as in the case of a living individual, the income collected by an estate is subject to income tax. Mr. Jackson's estate continues to rake in considerable income. Although Mr. Jackson himself is deceased and is therefore not required to continue filing income tax returns, his estate is still required to file. These are *income* tax returns, but filed by the *estate* because it is still collecting income. And that income is considerable.

Reports suggest that the Jackson Estate has collected hundreds of millions of dollars since the star's death. There was a \$60 million advance for the film "This Is It," and a new recording contract worth up to \$250 million. His estate reportedly collected \$170 million in 2011 and \$145 million in 2012. There are still two Jackson-themed Cirque du Soleil tours – Michael Jackson One in Las Vegas and the Michael Jackson Immortal World Tour.

Estate Taxes

You might think that after collecting all that income tax, the IRS would not ask for

more. But the IRS and Jackson's estate are locked in a Tax Court battle over estate taxes. See *Estate of Michael Jackson v. Commissioner* (017152-13 U.S. Tax Court). The IRS would like more than his estate reported on its federal estate tax return.

The IRS claims that the Jackson Estate owes a whopping \$505.1 million in additional taxes and another \$196.9 million in penalties. The penalties are based on the taxes due, so if the tax charge is struck down, the penalties go with it. Currently, the federal estate tax law allows \$5.25 million per person to be passed tax-free. But in 2009, the year Jackson died, the exemption amount was only \$3,500,000.

For someone who died in 2009, assets in excess of that amount are taxed at up to 45 percent. Given the considerable upheaval in the estate tax law over the last few years (e.g., see American Taxpayer Relief Act of 2012, P.L. 112-240, enacted on January 2, 2013), the Jackson Estate will pay a 45 percent rate once the valuation dispute is resolved, even though the current estate tax rate is 40 percent. If Jackson had died in 2010 – like billionaires George Steinbrenner, Dan Duncan, and Walter Shorenstein – there would be no federal estate tax at all.

Valuing the Estate

The estate tax depends on the value of the estate as of the date of death. Alternatively, the estate can elect to value the assets six months after death, something known as the alternate valuation date. Executors often determine which value is lower and report that lower figure. But apart from the choice of which of these two dates produces the lower tax, the IRS gets a share based on the value of the estate.

That brings us to valuation, the key in most estate tax disputes. Unlike income tax cases, where the amount of cash usually can't be disputed, estate tax cases usually are about valuing something. Whether it is raw land, a mountain retreat, a conservation easement, or a rare piece of art, valuation disputes can be maddening, especially when dealing with illiquid assets.

For estate tax purposes, only net value – assets minus liabilities – is subject to tax. If the estate includes an asset worth \$100 million but there is \$50 million of debt, only \$50 million is taxed. The presence and details of debts could be key variables for the estate, because Mr. Jackson reportedly had many high-value assets but many large debts too.

Beyond this fundamental rule about debts, specific assets must be valued. Jackson owned a 50 percent share in a valuable Sony music catalog, his own music catalog, real estate, and art. And don't forget Neverland Ranch. Although the law may presume that every piece of real estate is unique, it is usually possible to hash out the value of real estate based on comparable parcels, possible development use, legal restrictions, etc. Neverland Ranch may be in an especially unique category, however, because it is so intimately tied up with Mr. Jackson's image. That makes its value harder to fix.

Above all else, the tax case between the Jackson Estate and the IRS is mostly about the value of the singer's image, likeness, and intellectual properties. The value of these rights accrues to the estate, but valuation swings for assets of that variety can be huge. To give you an idea of how wild the differences in perception of valu-

ation can be, the IRS is said to have valued the estate's rights to Mr. Jackson's image and likeness at \$434 million. In contrast, the estate reportedly listed these rights on the federal estate tax return as worth only \$2,105.

As frequently occurs in valuation disputes, both sides may have to compromise. Indeed, just as the IRS may have been overly aggressive with its pie in the sky \$434 million, the estate may have been unrealistic in pegging the value of the rights at \$2,105. Judges in tax cases – particularly in the U.S. Tax Court where the Jackson Estate case is pending – often complain to both parties that their valuation claims need to be reasonable.

Timing the Valuation

Yet it can be hard to compromise polarized figures. Such valuation disputes often boil down to a battle of the experts, each side arguing for an aggressive number. In this case, the estate is sure to argue that the meteoric rise in Mr. Jackson's fortunes after his death could not have been foreseen.

Rights to receive future payments must be valued for federal estate tax purposes. Their value is the projected future worth (or the aggregate of the future payment stream) discounted to present value. Reminding us of David Bowie bonds – asset-backed securities issued by musician David Bowie that used current and future revenue from recordings made before 1990 as collateral – the IRS asks what a third party would pay today for the right to receive those payments in the future.

Often, such calculations can be figured based on average annual earnings. However, that is difficult if not impossible when the subject's earnings have fluctuated wildly rather than follow a predictable path. Curiously, Mr. Jackson did have dramatic swings in earnings and productivity.

Mr. Jackson's past legal and public relations challenges may actually materially help his estate's tax case. At the time of his death, Mr. Jackson was said to be spending more than he was making. In 2006, the *New York Times* reported that Mr. Jackson had churned through hundreds of millions of

dollars of loans and lines of credit. His album production was low and wasn't selling in the fashion of "Beat It" and "Thriller."

Then there were the repeated negative impacts on his image and likeness. There were the sexual abuse charges, his physical appearance controversies, gaffes with his kids, and his Martin Beshears interview. There were also drug abuse rumors, and more.

In short, Mr. Jackson's star was fading, not rising. The value of his likeness and image was on the decline. His estate's tax lawyers can be expected to exploit that history now, presumably with facts and figures.

For example, they may argue that the "This is It" movie released after Mr. Jackson's death was popular because of the star's sad death, not in spite of it. Viewed at the time of his death, his scheduled concert tour can be presented as – and probably was – a huge gamble. And even if it had succeeded, there are degrees of success.

Indeed, when one looks at the history and thinks like an odds-maker, it is conceivable that the market response to Mr. Jackson would have been tepid. In a dispute of this nature, all of that translates into dollars and cents. Placing a value on the star's projected earnings may involve more art than science, but someone must do it if the estate is to be closed and the IRS is to be on its way.

As you would expect, the Jackson Estate employed an appraiser, and the IRS has too. But this will be both a legal battle as well as a battle of the appraisers. The estate can be expected to contend that Mr. Jackson's earning power and the value of his brand was low as of the date of his death. His fortunes soared after his death, as reflected in the estate's high earnings, on which it has to pay income tax. But that does not mean the estate was worth all of that money viewed on the date of his death.

Of course, valuation is subjective. Because estate tax matters so often hinge on valuation, there are special IRS penalties. If the estate is found to have misrepresented the value of items on the federal estate tax return, penalties could run as high as 40 percent. That only adds to the Thriller-sized dollars at stake.

There may be many lessons from Mr. Jackson's lifelong fame and from his family dysfunction and other difficulties. But there are also tax and estate planning lessons here. The Jacksons' case illustrates the severe financial burdens that surviving family members may face when the IRS unleashes the Federal Estate Tax on an estate with valuable illiquid assets.

Clearly, not every estate has to worry about valuation issues surrounding unique assets like Neverland Ranch, let alone the notoriety of its recently deceased owner. Still, the fundamental problems at the core of the Jackson dispute could lead to unanticipated tax bills, interest, and penalties for any estate involving assets that are difficult to value. And that could impact many far less famous people and even some who are not famous at all.

There can also be timing mismatches, where beneficiaries are already enjoying assets but the estate faces a tax audit and ensuing dispute. Collecting money and assets from beneficiaries is never as easy once they have it. In some cases, the IRS is forced to pursue beneficiaries as transferees of the estate. The tax code allows for such liability with a kind of "taxes follow the assets" notion.

Conclusion

It is too soon to say whether the IRS or the Jackson Estate will win in the valuation of the estate. Most such disputes end up being compromised. But with all of the controversy surrounding Mr. Jackson at the time of his death, the alleged damage it had caused to his image, and all of the related gossip that will likely be exploited by the estate, I would put my money on the estate.

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