Trust Me, Michael Jackson Is Still Paying Taxes

The King of Pop vs. the IRS

Dec. 30, 2013

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Michael Jackson faced many legal struggles during his storied career. He fought sex abuse charges, copyright infringements and concert contract disputes. Sadly, the King of Pop died unexpectedly on June 25, 2009. Even now, though, his estate faces one more pitched battle in court, this time about estate taxes.

Michael Jackson has actually made a lot of money since his passing. His name, image and ongoing musical success have continued to pull in considerable income for his estate. Reports suggest that the Jackson estate has collected hundreds of millions of dollars.

There was a $60 million advance for the film “This Is It” and a new recording contract worth up to $250 million. There was also the high-grossing Michael Jackson Immortal World Tour, a joint venture with Cirque du Soleil. His estate reportedly collected $170 million in 2011 and $145 million in 2012. As always, the Internal Revenue Service wants its cut.

Indeed, just as with a living individual, the income collected by an estate is subject to income tax. Accordingly, the estate has reportedly already paid over $100 million in income taxes. You might assume that after collecting all that income tax, the IRS wouldn’t ask for more. But, estate tax is another matter. The IRS and Jackson’s estate are locked in a Tax Court battle over estate taxes.[1]

The IRS claims that Mr. Jackson’s estate owes a whopping $505.1 million in estate taxes, plus $196.9 million in penalties.[2] Fortunately for the estate, the penalties are based on the taxes due. If the tax charge is struck down, the penalties should go with it.

Unlike income taxes, estate taxes are levied on property transferred from the decedent to his heirs. The tax due depends on the value of an estate as of the date of death, minus deductions. Alternatively, the estate can elect to value the assets six months after death. Executors often determine which value is lower and report that figure.

Federal estate tax law currently allows $5.25 million per person to be passed tax-free. But in 2009, the year Jackson died, the exemption was only $3.5 million. Excess assets for those who died in 2009 are taxed at up to 45 percent. As you might imagine, Jackson had significantly more than $3.5 million in assets.

Under the estate tax, only net value—assets minus liabilities—is taxed. That’s a key concept for Jackson, who reportedly had many assets but many debts too. Beyond this fundamental rule about debts, specific assets must be valued. Jackson owned a 50 percent share in a valuable Sony music catalogue, his own music catalogue, real estate and art.

And, who can forget Neverland Ranch? For most decedent's property, it's usually possible to determine the value of real estate based on other parcels, possible development use, restrictions, etc. Jackson's Neverland Ranch, on the other hand, is truly unique and is, arguably, tied to Jackson's image. These facts make its value particularly difficult to fix.

The core of the tax dispute concerns the value of the pop icon's image, likeness and intellectual properties. The IRS is said to have valued the estate's rights to Jackson's image and likeness at $434 million. The estate pins that value at $2,105 (not a typo). Clearly, both sides are exaggerating, and both will probably have to compromise.

However, the estate has a legitimate argument that the meteoric rise in Jackson's fortunes after his death couldn't have been foreseen. Future payments to the estate for Jackson's continuing sales are valued for federal estate tax purposes by the projected future worth discounted to present value. Those calculations aren't easy when the subject's earnings have fluctuated wildly.

Yet, Jackson's past legal and public relations challenges may help his estate's tax case now. When he died in 2009, Jackson was said to be spending more than he was making. His album production was low, and the value of his likeness and image was on the decline. Between sexual abuse charges, controversies over his physical appearance, gaffes with his kids and his Martin Bashir interview, Jackson's star was fading, not rising.

His estate can be expected to exploit this history. The estate might claim that the "This is It" movie was successful because of the star's death, not in spite of it. Viewed objectively before his passing, one could argue that his scheduled concert tour was a huge gamble. And, even if it had succeeded, there are degrees of success.

As you would expect, the Jackson estate employed an appraiser to value the assets, and the IRS has one too. As such, this will be a legal battle as well as a battle of the appraisers. Mr. Jackson's fortunes soared after his death, as reflected in the estate's high earnings, on which it paid income tax. But, that does not mean the estate was worth all of that money on the date of his death.

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 its federal estate tax return, these penalties could run as high as 40 percent. That only adds to the Thriller-sized dollars at stake.

Of course, most disputes end up being compromised. With the polarized valuation figures here, there is considerable room between the IRS' and the estate's numbers. But, with a treasure trove of debts, lore and gossip at its disposal, I would wager that the estate may have to compromise much less than the Service. Beat it, IRS.

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[1] *See Estate of Michael Jackson v. Commissioner* (017152-13 U.S. Tax Court).

[2] *See* Patrick Temple-West, "U.S. agency says Michael Jackson estate owes $702 million in taxes," Reuters (Aug. 23, 2013).