



Wood LLP

Tax Alert



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THE TAX LAWYER

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Bid On Michael Jackson Treasures, Help Estate Fight IRS Too

Numerous items that belonged to the late King of Pop or his family are up for sale. Check them out at GottaHaveRockandRoll.com. This isn't your normal estate sale. Vintage Associates reportedly obtained the property from a bankrupt collector of Michael Jackson memorabilia.

Not everything in the auction is high value. Included are Janet Jackson's old bras, master recordings of never released Jackson 5 music, business and court files, toys owned by Michael and his siblings—even La Toya Jackson's old sex toys. The online auction comes to an end on September 19. The bids for most items begin at around \$100, with the exception of the unheard Jackson 5 tapes which have a starting price of \$1,000.

With the money Mr. Jackson's estate is generating, we may not see a tax sale soon. And this sale isn't fueling the estate's tax litigation. Yet there's a huge tax dispute going through the courts. The star's efforts have continued to produce a steady stream of income, and, as always, the IRS wants its cut.

Just as in the case of a living individual, the income collected by an estate is subject to income tax, and Mr. Jackson's estate is raking it in. Although Mr. Jackson is deceased, his estate is still required to file as it collects income. That income is considerable, hundreds of millions of dollars since the star's death. Then, there are 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. The IRS would like more than his estate reported on its federal estate tax return. The IRS has valued Mr. Jackson's estate at more than \$1.1 billion, alleging that the executors significantly undervalued his property. The IRS claims that the Jackson Estate owes a whopping \$505.1 million in additional taxes and another \$196.9 million in penalties.

Currently, the federal estate tax law allows \$5.34 million per person to be passed tax-free after death. The year Jackson died, the exemption was only \$3.5 million. If Jackson had died in 2010—like billionaires George Steinbrenner and Walter Shorenstein—there was *no* federal estate tax.

The estate tax is calculated based on the value of the estate. Unlike income tax disputes, estate tax cases are often about valuing something. For estate tax, only net value is taxed. If the estate includes an asset worth \$100 million but there is \$50 million of debt, only \$50 million is taxed. Debts could be key variables here. Mr. Jackson reportedly had many debts.

Still, he owned his own music catalogue, real estate, and art. Neverland Ranch was intimately tied up with Mr. Jackson's image, making its value harder to fix. Above all else, though, the tax case between the Jackson Estate and the IRS is 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. 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.

Can a celebrity be worth more dead than alive? Mr. Jackson's recording sales and other income seemed to spike after his death. One question presented by the Jackson case is the strange connection between streams of income subject to the income tax and the valuation of one's image and likeness. The latter could be subject to the estate tax, which seems like double dipping.

Including Jackson's image and likeness as factors in his estate's value is not something on which everyone agrees. Add to that the fact that the government has argued for this so aggressively and you have a big fight. Timing in valuation disputes is key. Mr. Jackson's sales and income rose *after* his death, but was that predictable when he died?

As frequently occurs in valuation disputes, both sides may have to compromise. The IRS may be overly aggressive with its pie-in-the-sky \$434 million. The estate may have been overly aggressive in pegging the value of the rights at \$2,105. The estate is sure to argue that the meteoric rise in Mr. Jackson's fortunes after his death could not have been foreseen.

Mr. Jackson had dramatic swings in earnings and productivity, and his legal and public relations challenges may help his tax case. At the time of his death, Mr. Jackson was said to be spending more than he was making. His album production was low, his music wasn't selling as well as it had, and he was plagued by continuing controversies. Arguably, Mr. Jackson's star was falling, not rising.

What say you, IRS?

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.