PERSPECTIVE

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MJ's Estate Case A Thriller

By Robert W. Wood

Michael Jackson was no stranger to lawyers while he was alive, spending a reported $20 million on his successful defense against sex abuse charges. Even after his death, he is keeping lawyers busy, and he could even make some important tax law. The King of Pop died unexpectedly on June 25, 2009. Despite his death, he's made a lot of money since then.

As always, the Internal Revenue Service wants its cut of both income and estate taxes. The estate has reportedly already paid over $100 million in taxes, but the IRS wants more.

The IRS claims that Jackson's estate owes a whopping $505.1 million in taxes plus $196.9 million in penalties. See Reuters, "U.S. agency says Michael Jackson estate owes $702 million in taxes," by Patrick Temple-West, (Aug. 23, 2013). The penalties are based on the taxes due, so if the tax charge is struck down, the penalties go with it. However, apart from the disputed tax sum, it's not as if the IRS isn't already making out well.

After all, Jackson's estate is raking in considerable income, and that means income taxes. Although Jackson is deceased and is therefore not required to keep filing income tax returns, his estate still has to file. These are *income* tax returns, but filed by the *estate* because it is still collecting income.

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.

Just as in the case of a living individual, the income collected by an estate is subject to income tax. 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 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. Executors often determine which value is lower and report that figure. But on one of these two dates, the IRS gets a share based on the value of the estate.

The federal estate tax law now allows $5.25 million per person to be passed tax-free. But in 2009, the year Jackson died, the exemption was $3,500,000. Excess assets for those who died in 2009 are taxed at up to 45 percent. As you might imagine, Jackson had significantly more than $3,500,000 in assets.

Although the Jackson estate will have to pay a 45 percent estate tax once the valuation dispute is resolved, the estate tax rate in 2013 is now 40 percent, not 45 percent. And if Jackson had died in 2010 — like billionaires George Steinbrenner, Dan Duncan and Walter Shorenstein — there was no federal estate tax at all. Talk about good timing.

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 don't forget Neverland Ranch. Every piece of real estate may be unique, but it's usually possible to hash out the value of real estate based on other parcels, possible development use, restrictions, etc. Yet Neverland Ranch is especially unique, and is arguably all tied up with Jackson's image, good or bad.

Much of the tax dispute concerns the value of the singer's image, likeness and intellectual properties, and valuation swings for such assets can be huge. The IRS is said to have valued the estate's rights to Jackson's image and likeness at $434 million, the estate reportedly at only $2,105. As frequently occurs in valuation disputes, both sides may have to compromise. However, the estate is sure to argue that the meteoric rise in Jackson's fortunes after his death could not have been foreseen.

Rights to receive future payments are valued for federal estate tax purposes by the projected future worth discounted to present value. Reminding us of David Bowie Bonds, the IRS asks what a third party would pay today for the right to receive those payments in the future. Such calculations can be figured based on average annual earnings, but that's tough when the subject's earnings have fluctuated wildly. Indeed, Jackson's past legal and public relations challenges may materially help his tax case.

At the time of his death, 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, his physical appearance controversies, gaffes with his kids, his Martin Beshears interview, and drug abuse rumors, Jackson's star was fading, not rising. His tax lawyers can be expected to exploit that history now. The estate may argue that the "This is It" movie was popular *because* of the star's death, not in spite of it, and that his scheduled concert tour was a huge gamble.

The estate's advisers employed an appraiser, and the estate can be expected to contend that Jackson's earning power and the value of his brand was low as of his death. His 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 viewed 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, penalties could run as high as 40 percent. That only adds to the Thriller-sized dollars at stake.

It is too soon to say whether the IRS or the Jackson estate will win. Most such disputes end up being compromised. But with the dollars at stake and the treasure trove of assets, lore and gossip to be exploited, I would put my money on the estate. Beat it, IRS.

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