

Larry's Tax Law

Estate of Michael Jackson v. Commissioner of Internal Revenue

By Larry Brant on 3.5.14 | Posted in Tax Procedure

The Estate of Michael Jackson is battling it out with the IRS in a dispute over the value of the late pop star's estate. To borrow the titles from two of Michael Jackson's hit songs, the Service is alleging the estate is "Bad" in that it substantially understated the value of the decedent's assets, while the estate is telling the Service that it is wrong and it should simply "Beat It."

What is the battle about? The answer is simple: Lots of money! The Service asserts the understatement results in the estate owing taxes of over \$500 million more than actually reported on the estate's tax return, plus almost \$200 million in penalties. If the Service is correct, the State of California will likely have its hand out, asking the estate for a significant amount of additional taxes, plus penalties.

According to the petition filed by the estate in the United States Tax Court, representatives of the estate placed a date of death value on the decedent's property at a little over \$7 million. The IRS, on the other hand, asserts the value was closer to \$1.125 billion dollars. If the Service is correct, the estate was undervalued by more than 160 times.

Estates are not often subjected to a substantial valuation understatement penalty. The reason is obvious. The Code is very generous in this regard. The understatement of value must be significant for a penalty to apply. First, a penalty cannot be triggered unless the underpayment of tax exceeds \$5,000. Next, there must be a "substantial understatement of value" for a penalty to apply. IRC § 6662(g)(1) provides a substantial estate tax valuation understatement occurs if the value of property on the return is 65% or less of the correct value. Pursuant to IRC § 6662(a), the resulting penalty is 20% of the tax underpayment. If, however, the value of the property on the return is 40% or less of the correct value, the penalty is increased to 40% of the tax underpayment. IRC § 6662(h)(2)(C).

So, the threshold for a penalty of this nature is high. The resulting tax must exceed \$5,000 and the understatement of value itself must be more than 35%. In cases where the understatement of value is more than 60%, the penalty doubles. Consequently, in this case, if the Service's values are correct, the 40% penalty is applicable.

The bulk of the Service's fight with Michael Jackson's estate appears to center around the value of Michael Jackson's image, the estate's intellectual property rights to certain songs, including some of the Beatles song catalog which Michael Jackson acquired prior to his death, and an interest in a trust. The estate valued the image at a little over two thousand dollars, while the Service's experts put the value at over \$434 million. The estate valued the estate's interest in the musical collection at zero. The IRS, on the other hand, valued this asset at around \$469 million. Last, the estate valued its interest in the trust at around \$2 million, but the Service asserts its actual value is closer to \$61 million.

Other items in dispute include: (a) stocks and bonds which the Service values at \$64.4 million more than the estate reported on the return; (b) Jackson 5 master recordings which the Service values at over \$34 million more than the estate reported on the return; and (c) three Rolls Royces and a Bentley which the Service values at about \$160,000 more than the estate reported on the return.

This will be an interesting case for at least two reasons: (1) the valuation issues, including valuation of a person's likeness, are interesting and will result in a battle of the experts; and (2) application of the 40% valuation understatement penalty is not terribly common.

Stay tuned! The decision of the U.S. Tax Court will likely be an interesting read.

Tags: Michael Jackson Estate, Tax Penalties, United States Tax Court