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Prince's Estate And The Countless Challenges Ahead

Law360, New York (May 11, 2016, 10:53 AM ET) -- Hearing that Prince may have died without a will or other estate planning in place is disturbing, but not particularly surprising, to those familiar with estate planning. Despite the numerous problems that can be caused by not having properly planned one's estate, far too many people are in that boat. Hopefully, the reports that Prince was among those shipmates will prove to be inaccurate for the sake of what he worked so hard to create during his life and for those family members, friends or entities whom he may have preferred to benefit from those labors following his death.

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By all accounts, Prince was a gifted person. Not only was he an extremely creative and talented musician, he was also known to be a gifted producer, business person and negotiator. It has been reported that he went through numerous agents, advisers and attorneys during his lifetime and often preferred to negotiate his music and other business deals himself.[1] This not an uncommon trait among intelligent, successful people. Many people who have achieved substantial success in one or more fields often become convinced that they will handle all matters more capably than others. While this may sometimes be true, it is a dangerous conviction to hold in an increasingly complex world.

Estate planning is an unknown and unappealing topic for many people. Often, the greatest challenges related to it are learning and appreciating what issues and obstacles are involved in it. The old adage, "You don't know what you don't know," is important to bear in mind in this area. Did Prince know and appreciate what might happen to his estate upon his passing without any planning? There are people who do not have any great level of concern about what happens to what they have or created after they are gone. For them, the focus is on life while they are living it, and not on what becomes of their things after they die. This is more common among people, like Prince, who do not have spouses, children or other dependent family members.

Perhaps he knew very well who would receive his assets upon his death without any planning and was comfortable with that distribution plan. Every state has laws governing intestate succession. "Intestate" is a term that refers to someone who dies without a last will and testament. Prince may well have been familiar with the relevant laws of intestate succession in Minnesota, and wherever else he owned and stored physical possessions. He may have discerned that those laws were suitable to him. Since he had no close dependents, or so we are told, he also may not have cared that there would be a substantial loss of his assets to estate taxes. There are certainly people who believe that if they are leaving unexpected, unearned money to someone else, it should not be too troubling to the recipient to endure taxation and perhaps increased administrative and legal process as a condition of receiving it. Maybe that is the way Prince thought about this topic.

On the other hand, perhaps he did not know what options were available to him to preserve his assets, including his closely guarded musical works, to reduce the potential taxation of them and pass them to the people or entities of his choosing. Maybe he did not seek, or even spurned, professional advice of this nature. If so, he may not have been made aware of the potential perils in this regard.

Of course there is a middle ground here as well. Perhaps Prince understood and appreciated the challenges of planning his estate, but thought that he had plenty of time to attend to that or was not ready to tackle the challenges of that process. This is a very popular mindset among all people, including many of the most successful people. Surveys reveal that more than 50 percent of baby boomers, such as Prince, do not have a will.[2]

Whatever his thoughts about this topic may have been, his estate is now going to go through the federal and state estate taxation processes and the probate administration process and then be divided among potentially six siblings,[3] and perhaps without the benefit of any established planning documents. That could lead to dividing and selling many of his prized possessions and musical treasure troves.

Before his estate can distribute his assets to his heirs, it will first have to satisfy its estate tax obligations. The U.S. estate tax is a tax on the right to transfer the value of someone's assets after their death. Since Prince was a U.S. citizen, the estate tax will be imposed upon his worldwide assets. It will be determined by obtaining the fair market value of all of his assets as of the date of his death, deducting all relevant expenses and exemptions, and then applying the applicable tax rate. Under federal law, the estate of anyone with assets in excess of $5.45 million who dies in 2016 is subject to the estate tax.[4] This will almost certainly impact Prince's estate, which had been estimated to be worth $300 million before he died.[5] The federal tax rate imposed upon the value of his assets in excess of $5.45 million will be 40 percent.[6]

Unfortunately for his heirs, Prince was domiciled in a state that also imposes a state estate tax. Minnesota's estate tax will most likely be imposed upon all or a substantial portion of Prince's estate. However, Minnesota is unable to tax any real estate or tangible personal property that he owned outside the borders of Minnesota. The exemption from Minnesota's estate tax for people dying in 2016 is $1.6 million. The tax rates imposed range from 10 percent to 16 percent of the amount of his estate that is in excess of the exemption.[7]

Between the two estate tax regimes, Prince's estate may have to pay in excess of one-half of the fair market value of his net estate to the IRS and the Minnesota Department of Revenue. For estate tax purposes, "fair market value" is defined as: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."[8]

The assets that Prince owned when he died will most likely be valued as of the date of his death.[9] Unfortunately for Prince's estate, that does not mean that any future income earned by those assets will not be taxed. On the contrary, the right to receive income in the future is a valuable right for estate tax purposes. The taxable value of that right is determined based upon what a reasonable, unrelated third party would pay at the time of Prince's death for the right to receive those earnings into the future. The method of deriving the taxable value of such an income stream involves projecting what that income stream may be over an acceptable period of time and then discounting it to present dollars. If any of his income-producing assets are held in business entities, there will likely also be additional opportunities to discount the value of the underlying assets for tax purposes depending upon how those entities are owned and controlled and their marketability. The period of time to be used for projecting the earnings and the rate of the discounts to apply to them are some of the potential issues that may be disputed by the estate and the IRS in valuing his income-producing assets.

The issue then becomes, what assets did Prince own at the end of his life that will be subject to these taxes. As an accomplished artist and producer, Prince's estate will contain substantial assets and some of an unusual variety. Like most people, his taxable estate will include his home (Paisley Park), any other real estate that he owned, his automobiles, his personal belongings, collections and other tangible personal property, his business interests, stocks, bonds, bank accounts and brokerage accounts. Unlike most people, his taxable estate will likely also include his royalties from previously published music, unreleased musical recordings, unrecorded written music, other property that may be found in his rumored "vault,"[10] the value of his intellectual property interests, which may include the value of his right of publicity, unique musical instruments and recording equipment.

The valuation of some of those less common property interests presents a significant challenge and much room for debate. This can be observed in the ongoing battle between the estate of Michael Jackson and the IRS, where the IRS has reportedly assessed the value of his estate at more than 150 times the amount of his estate's valuation of it: 1.125 billion vs. a bit more than $7 million.[11]

One interesting battlefield in that case, which will be important for Prince's estate as well, is the valuation of Michael Jackson's post-mortem right of publicity. The right of publicity is the right to control the use of one's identity, including his or her name, voice, image and likeness. It is based upon state law, not federal law.[12] The post-mortem marketability of a deceased celebrity's identity is increasing with technological advancements that can generate virtual versions of them for commercial use. Yet it is far from certain which celebrities will be marketable after death and which will not.[13] Of those that are marketable, the extent and duration of that marketability are also unknown.

In the estate of Michael Jackson matter, the estate reportedly valued his post-death publicity rights at a mere $2,105, partially due to his tarnished image and the alleged uncertainty just before his death as to whether there was continuing demand for his image and likeness.[14] The IRS, on the other hand, valued his post-mortem publicity rights at $434 million.[15] Both positions may well be extremes, but the case points out the substantial room for debate and disagreement regarding this issue.

The status of Minnesota's law surrounding the right of publicity is uncertain. Minnesota does not currently have a statutory right of publicity, and its own state courts have not yet ruled on the nature and extent of the common law right in that state.[16] The heirs of Prince's estate will be particularly interested in whether Minnesota will recognize the post-mortem continuance of a celebrity's right of publicity. There is no clear legal authority on that issue in Minnesota at this time.[17] If it is not recognized, the estate and its heirs could possibly lose the right to benefit from the commercialization of his name and likeness. At the same time, if there was no right to transfer the right of publicity at death, the IRS could theoretically lose out on a big estate tax payday as well.

In the wake of Prince's death, the Minnesota Legislature is reportedly considering new legislation to end this potential controversy by codifying the right of publicity and extend its protections to a deceased celebrity's heirs.[18] There are only two weeks remaining in its current legislative session, so it is possible that this could happen very soon. Not surprisingly, the legislation is being sponsored by the law firm representing the special administrator of Prince's estate.[19]

If this effort fails, there are several states with expansive, "umbrella" right to publicity laws that may well afford an opportunity for the estate (and the IRS) to gain benefit from Prince's publicity right into the future. The state of Indiana for instance, protects the interests of celebrities "regardless of a personality's domicile, residence, or citizenship."[20] As a result, even if Prince had very little connection with that state, his heirs may be able to enforce his right of publicity through Indiana's laws. Those laws are also very broad in defining what constitutes a violation and who is subject to the state's jurisdiction.[21]

For an iconic artist like Prince, his musical works, video works, image and likeness, voice, name and glyph may produce untold millions of dollars for many years to come. Then again, they may not. What would you pay for them as of the date he died? It will be interesting to see how the issue turns out both for his heirs and for the precedent that may be set for estate taxation purposes.

—By Paul F. Riekhof, Joseph Greenwald & Laake PA

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[1] http://wealthmanagement.com/people/lack-will-makes-prince-enigma-death-too?NL=WM-27&Issue=WM-27_20160430_WM-27_954&sfvc4enews=42&cl=article_2&utm_rid=CPG09000005742188&utm_campaign=5833&utm_medium=email&elq2=501aaaf7a6504ac5b910c0c5a4bc4acd; htt
esq/princes-legal-legacy-contract-fights-886521

[2] http://www.marketwired.com/press-release/digital-limbo-rocket-lawyer-uncovers-how-americans-are-arent-protecting-their-digital-2011658.htm; http://www.nextavenue.org/americans-ostrich-approach-estate-planning/

[3] http://www.cnn.com/2016/05/02/entertainment/prince-estate/

[4] https://www.law.cornell.edu/uscode/text/26/2010; https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Estate-Tax

[5] http://www.celebritynetworth.com/richest-celebrities/singers/prince-net-worth/

[6] https://www.law.cornell.edu/uscode/text/26/2001

[7] https://www.revisor.mn.gov/statutes/?id=291.03&year=2015

[8] Treasury Regulation §20.2031-1

[9] An election could be made to value them as of six months after his date of death. This election could only be made if it would result in a reduction of the overall estate tax burden.

[10] http://www.theguardian.com/music/2015/mar/19/i-would-hide-4-u-whats-in-princes-secret-vault

[11] http://articles.latimes.com/2014/feb/07/local/la-me-jackson-taxes-20140208

[12] Zacchini v. Scripps-Howard Broad. Co., 433 U.S. 562, 566, 97 S. Ct. 2849, 2853, 53 L. Ed. 2d 965 (1977)

[13] http://www.forbes.com/pictures/mjd45eijfi/top-earning-dead-celebri/

[14] http://www.forbes.com/sites/janetnovack/2016/04/25/could-prince-estate-end-up-following-michael-jacksons-into-tax-court/#268e060f4bbb

[15] Id.

[16] http://www.rightofpublicityroadmap.com/law/minnesota

[17] Id.

[18] http://kstp.com/politics/minnesota-legislation-artists-rights-prince-death/4131484/

[19] Id.

[20] IN ST 32-36-1-1

[21] IN ST 32-36-1-1, et. seq.