



# The Franchise Valuations Reporter



## Our Expertise

Within the franchise, distribution and dealership context, we are experts in:

- Damages, Valuations & Expert Testimony
- Finance, Accounting and Tax
- Cyber Security



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## Have a Question About Succession Planning for Franchise Owners?

Call us for a free, confidential consultation. And we're always interested in your comments about the newsletter.

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## We Write the Book

**Franchise Regulation and Damages**, the only treatise that covers damages in franchise disputes and valuations of franchises, is updated 3 times a year.

For more details, to see a Table of Contents or to place an order, go to the Wolters Kluwer Law & Business web page [here](#).

## Foreign Buyers and Owners of Franchisors: Beware

### *The Personal Holding Company Tax Is a Trap for the Unwary*

Many foreigners are buying US franchisors as a good investment and a safe bet. But because of the withholding rules that apply to non-resident aliens, they often hold their purchases in C corporations rather than LLCs. However, if five or fewer people own more than 50% of the stock and it is a C corporation; and if at least 60% of the corporation's adjusted gross income is "personal holding company income" (basically passive receipts like royalties<sup>[1]</sup>), then it can be classified as a Personal Holding Company and subject to the PHC tax - a penalty tax equal to 15% of the undistributed PHC income.

Hotel operators must be especially careful as "rent" from room rentals may be treated as personal holding company income, too.

For more on the tax treatment of passive royalty income in the franchise context, [see this chapter from the Bloomberg BNA Tax Management Portfolio I write](#).

[1]The term "royalties" (other than mineral, oil, or gas royalties or certain copyright royalties) includes amounts received for the privilege of using patents, copyrights, secret processes and formulas, goodwill, trademarks, trade brands, **franchises**, and other like property. Regs. §1.543-1(b)(3) (emphasis added).

## Franchisor as Employer or Joint Employer: 3 Cases

### *Decision for Franchisor - McDonald's Not an Employer*

Because a plaintiff did not plead that McDonald's USA was involved in or had authority over her attempted employment relationship with a franchisee that allegedly discriminated against her based on age and race in rejecting her job application, a federal district court in Montgomery, Alabama, dismissed the franchisor from her suit.[1]

The plaintiff, a 70-year-old Caucasian woman, applied to work at a McDonald's in Montgomery. Before applying, she spoke to the store owner, who said she would be happy to help her get a job. When the plaintiff visited the location, the African-American manager told her that they were hiring and that she needed "a pleasant and friendly face on the front." The plaintiff completed the application as instructed and was informed she would be called sometime the next week to set up an orientation. However, she didn't receive a call.

### *Decision for Franchisor - Jack in the Box Was Not Joint Employer with Franchisee*

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The information provided in this newsletter is for informational purposes only and should not be construed as legal or expert advice which can only be obtained from appropriate professionals. Franchise Valuations, Ltd. and Franchise Technology Risk Management provide such expert advice on the topics addressed herein.

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The Jack in the Box fast-food restaurant franchisor was not liable for the minimum wage and overtime claims (asserted under Oregon laws and the Fair Labor Standards Act) of employees of franchisees which had previously been corporate-owned restaurants, ruled a federal district court in Portland, Oregon.[2]

The Court held that the franchisor was not a joint employer of the employees since it did not have the power to hire and fire franchisee employees, and did not control their day-to-day work activities. Applying the "economic reality" factors outlined by the Ninth Circuit in *Bonnette v. Cal. Health and Welfare Agency*, the franchisor established that it did not have the power to hire and fire franchisee employees and it was not responsible for or involved in franchise employee work schedules, hours of employment, salaries, insurance, fringe benefits, or hours of work.

Although the franchisee was required to use Jack in the Box's payroll system, such ministerial functions were held to be insufficient to support the plaintiffs' argument that the franchisor controlled labor relations, the court said. Taking the circumstances of Jack in the Box's relationship with the franchisee as a whole, the employees failed to establish as a matter of law that Jack in the Box was their joint employer.

### ***Decision Against Franchisor Unemployment Insurance - Franchisor as Employer of Franchisee***

A New York Appellate Court has held that substantial evidence supported a ruling by the New York Unemployment Insurance Appeal Board that a janitorial cleaning service franchisee was the employee of his franchisor, Jan-Pro Cleaning Systems, and as such, the franchisor was liable for unpaid unemployment insurance contributions on behalf of the so-called franchisee.[3] The ruling by the Board was affirmed which meant that the franchisor was liable for contributions of remuneration paid to all other franchisees.

Under the New York unemployment insurance statute, an employment relationship exists when the employer exercises control over the results produced or the means used to achieve the results, with control over the means being the more important factor. Here, the evidence demonstrated that Jan-Pro assigned the franchisee a specific geographic territory and required new franchisees to undergo initial mandatory training, which was paid for by Jan-Pro. Franchisees were also required to operate the business in accordance with the procedures set forth by Jan-Pro. To that end, franchisees had to use Jan-Pro-sanctioned equipment, supplies, products and business forms.

More importantly, Jan-Pro helped resolve any complaints between a customer and a franchisee and retained the right to discontinue a franchisee's services to any client any time. The franchise agreement also gave Jan-Pro the sole right to invoice and collect from the franchisee's customer accounts. While the franchise agreement designated the franchisee as an independent contractor, such terms were held not to be dispositive.

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[1] *Beckley v. McDonald's USA, LLC*, February 7, 2017, Albritton, W. Civil Action No.: 2:16-cv-00054-WHA (WO)

[2]*Gessele v. Jack in the Box, Inc.*, D. Ore., CCH Business Franchise Guide ¶15,887

[3]*In the Matter of Baez*, N.Y. Sup. Ct., App. Div., CCH Business Franchise Guide ¶15,878

## Valuations

### *Credentials: Another Set of Initials for the Alphabet Soup*

According to the AICPA Business Valuation Committee, "CPAs and financial professionals can start working now on the training requirements for the CEIV credential." The new credential is Certified in Entity and Intangible Valuations™ (CEIV™), and it focuses on business entities and intangible assets. There are already nine separate self-certifying qualifications. How long until they get to the one hundred mark? One wonders if this is just a marketing ploy.

<u>Year</u>	<u>Credentia</u> <u>Instituted</u>	<u>Certifying Organization</u>	<u>Credential Name</u>
1978		Institute of Business Appraisers (IBA)	Certified Business Appraisers (CBA)
1981		American Society of Appraisers (ASA)	Accredited Senior Appraiser (ASA)
1981		American Society of Appraisers (ASA)	Accredited Member (AM)
1991		National Association of Certified Valuators and Analysts (NACVA)	Certified Valuation Analyst (CVA)
1997		American Institute of Certified Public Accountants (AICPA)	Accredited in Business Valuation (ABV)
1999		National Association of Certified Valuators and Analysts (NACVA)	Accredited Valuation Analyst (AVA)
2000		National Association of Certified Valuators and Analysts (NACVA)	Certified Forensic Financial Analyst (CFFA)
2006		National Association of Certified Valuators and Analysts (NACVA)	Accredited in Business Appraisal Review (ABAR)
2008		American Institute of Certified Public Accountants (AICPA)	Certified in Financial Forensics (CFF)

### *New Proposed 2704 Regulations to Limit Minority Discounts Would Hit Franchises Hard*

At a December 1 public hearing at the IRS, there were several speakers from the franchise world, including Keith Miller, a Subway franchisee and chair of the Coalition of Franchisee Associations (CFA), and Rob Branca, a Dunkin' Donuts franchisee and vice chair of the CFA who claimed that the proposed Section 2704 regs would have a particularly bad effect on franchises. The

CFA represents 41,000 franchisees at 86,000 locations employing about 1.4 million people.

The argument made was that franchises operate under extremely restrictive rules set forth in the franchise agreement. For example, not all franchises automatically renew, so their value "goes down every day," and there are many restrictions on the sales of franchises. To ignore these restrictions, as the proposed regs would require, would hit franchises especially hard.

## Tax Reform: Maybe and Maybe Not

### *What About All the Pass Through Entities?*

Robert J. Samuelson, in a [Washington Post article](#), describes some hurdles that may have to be addressed before the new administration makes income taxes vanish. He writes:

Tax "reform," starting with taxes on business, seems to be on everyone's agenda, and it may be a place where the incoming Trump administration and its Democratic critics find common ground. But it's still going to be a slog, and one reason is so-called pass-through businesses whose taxes are levied at personal income tax rates.

Pass-through businesses come in three varieties: sole proprietorships (firms with one owner); partnerships (including limited partnerships and LLCs); and "S" corporations, which are corporations receiving pass-through tax treatment. He points out how ubiquitous they are with data from a new report from the Tax Foundation and offers some findings from the report:

- More than 90 percent of businesses in America are pass-through enterprises. In 2014, that was 28.3 million out of 30.8 million business establishments.
- Pass-through firms account for more than half of U.S. private-sector employment. In 2014, the number of workers at these firms totaled 73 million, compared with 54 million at C corporations.
- The total profits of pass-through firms have surpassed the profits of C corporations. In 2012, the net income was \$1.6 trillion for pass-through firms and \$1.1 trillion for C corporations.

## Cybersecurity: Massive Hack at Arby's

### *Apparently Franchisee Owned Stores Not Affected*

Arby's has suffered a massive data breach at "hundreds" of its restaurants. However, according to reports only the company-owned sites (1,000 of the more than 3,300 units) are compromised. Nevertheless, more than 355,000 of its customers' credit and debit cards have reportedly come into the hands of hackers who placed malware on the payment systems of corporate stores. Krebs on Security reported that the first clues of the carnage appeared in an alert issued by a large credit-union service organization called PSCU. Arby's claims it reported the attack immediately and has brought in a team of security experts, just like Wendy's did after suffering a similarly huge breach last year.