



The Franchise Valuations Reporter

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Damages, Valuations and CyberCrime

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Welcome to the premier issue of our newsletter focusing on issues unique to our practice that we don't think are addressed anywhere else. We examine valuation and damages, cyber crime, expert testimony and tax nexus –the issues we know best, that matter to our clients - franchise executives and the consultants, attorneys and other professionals who advise them. We hope you find information that warns, informs and benefits you.

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Valuation Decisions

WARNING: IMPAIRMENT OF INTANGIBLE PROPERTY

Owners, particularly venture capital firms, of franchise companies that have been acquired within the past decade will have to do in-depth inspections of the booked value of their intangible property taking into account the world economic meltdown during the last quarter of 2008. In light of the fact that IP often makes up more than 70% of the value of franchise companies, it is very likely that many acquired franchise companies will have to take substantial write downs for impairment of IP to conform with FASB 141 and 142. This may have a dramatic impact on both the balance sheet and the earnings statement.

Valuation Formulae Determined in Buy-Sell Agreements

This is an area of importance to any closely-held franchise company. It is surely a best practice for such entities to have Buy-Sell agreements in place to deal with the “3 Ds”: death, disability and disaffection. A main purpose of these agreements is to fix a value for the enterprise in advance and to specify how to pay any contemplated redemption. The case law on this issue is fact specific and often conflicting.

Bommer Revocable Trust v. Commissioner, TC Memo 1997-380, 74 TCM 358, where the Tax Court would not accept a valuation determined by a buy-sell agreement

Estate of Blount v. Commissioner, TC Memo 2004-116, 87 TCM 1316 where the Eleventh Circuit upheld a buy-sell agreement valuation (with a modification

that the buy-sell obligation itself be computed as a corporate liability)

Estate of True v. Comm'r, 390 F3d 1210 (CA 10 2004) affirming TC Memo 2001-167, 82 TCM 105, where the Tenth Circuit affirmed the Tax Court which had refused to

give any credence to a valuation determined under a buy-sell agreement.

Estate of Amlie v. Commissioner, TC Memo 2006-76, 91 TCM 1029, where the Tax Court found a valuation in a buy-sell agreement binding (among other things).

CyberCrime

BBC Prediction of Dramatic Increase in Cyber-Crime

According to the BBC, with the economic downturn affecting every corner of the globe, it is expected that incidences of hacking and computer mischief by hi-tech criminals over the next 12 months will increase dramatically. In contrast to many ordinary people, hi-tech criminals are likely to see opportunities to prosper rather than suffer in the downturn. "Crime tends to rise when you have more unemployment," said Mikko Hypponen, chief research officer at F-Secure. "If you look, in general, where the attacks are coming from you can find social reasons behind them," he said.

Easy money

Layoffs of many people familiar with net technology may tempt more into crime, he said, simply because their chances of being caught are slim. Equally, he said, the punishments for those that are caught are not harsh. Some security firms fear that making people redundant could also trigger a wave of crime as aggrieved workers strike back at their employers. This could mean that the intellectual property that a company relies on to keep going, such as its customer database, is copied and walks out of the door when employees pack up and leave. "The damage that insiders can do should not be underestimated. It can take just a few

minutes for an entire database that has taken years to build to be copied to a CD or USB stick," said Adam Bosnian, a spokesman for Cyber-Ark. "With a faltering economy companies need to be especially vigilant about protecting their most sensitive data against nervous or disgruntled employees," he said.

YOU SHOULD BE FRIGHTENED! Links to Recent Articles on Cyber-Crime

TJX settles with MasterCard for \$24 million
<http://www.scmagazineus.com/TJX-settles-with-MasterCard-for-24-million/article/108671/>

Horizon 300,000 members unencrypted data on stolen laptop
<http://www.scmagazineus.com/Horizon-300000-members-unencrypted-data-on-stolen-laptop/article/104737/>

Discount retail website Geeks.com hacked
<http://www.scmagazineus.com/Discount-retail-website-Geekscom-hacked/article/100508/>

Florida woman accused of deleting \$2.5 million in data (Insider Threat)
<http://www.scmagazineus.com/Florida-woman-accused-of-deleting-25-million-in-data/article/104575/>

IC3 report: Internet crime up to \$240 million in 2007
<http://www.scmagazineus.com/IC3-report-Internet-crime-up-to-240-million-in-2007/article/108706/>

Data Breaches Up Almost 50 Percent, Affecting Records of 35.7 Million People

<http://www.washingtonpost.com/wp-dyn/content/article/2009/01/05/AR2009010503046.html?hpid=moreheadlines>

FTC May require new Identity Theft Programs
<http://www.franchise.org/Franchise-News-Detail.aspx?id=43488#two>

Daubert Decisions

CCH has published a study prepared by Franchise Valuations, Ltd. on expert testimony, focusing on *Daubert* and *Frye* challenges to the testimony of financial experts for the period 2004 through 2008. Copies of the study are available on request to 212.689-0400.

Also the American Antitrust Institute just posted on its website a new working paper on *Daubert* challenges to antitrust experts at <http://www.antitrustinstitute.org/>

PricewaterhouseCoopers also publishes a compendium of *Daubert* cases.

Nexus Notes

New Mexico --Sales and Use Tax: U.S. Supreme Court Asked Whether Non-Sales Acts of Third Party Can Create Nexus

Texas-based Dell Computer, an Internet- and mail-order retailer of computers has asked the U.S. Supreme Court whether New Mexico may impose its gross receipts tax on the seller's sales into the state based solely on the activities of a third-party contractor that provides post-sale services to New Mexico buyers. The New Mexico Court of Appeals held that the third-party contractor's activities helped the seller establish and maintain a market in New Mexico. Therefore, the seller, through its relationship with the contractor and the contractor's activities in New Mexico, had a substantial nexus with the state and, consequently, the Department's imposition of gross receipts tax did not violate the Commerce Clause.

Maryland --Corporate Income Tax: Subsidiaries had Nexus Through Parent Company

Two subsidiary corporations that did not do business in Maryland and did not own tangible property in Maryland, but were subsidiaries of an out-of-state parent company that did business in Maryland, were liable for Maryland corporate income tax because they lacked real economic substance as separate business entities and constitutional nexus existed. The parent company entered into a license agreement authorizing the subsidiary to license the use of the parent trademarks in exchange for 100% of the subsidiary's stock and the sub collected royalty payments. The Court noted that the royalties were loaned back to the parent and determined these were not arm's length market transactions. Therefore, the subsidiaries lacked real economic substance and as such, there was nexus with Maryland.

Additions to Tax

For Connecticut corporation business tax purposes, a corporation must add back to its federal taxable income all federally deducted interest expenses and costs, as well as any expenses and costs directly or indirectly attributable to "intangible property" incurred with respect to transactions with specified parties related, through ownership interests, to the corporation.

Indiana --Sales and Use Tax: Delivery and Installation Created Nexus

Sales of boat docks and lifts by a nonresident taxpayer to Indiana customers were subject to sales tax because the taxpayer's delivery and installation of the items established substantial nexus. Though the taxpayer did not engage representatives in Indiana and did not store or display goods within the state, deliveries to Indiana customers were made using the taxpayer's own vehicles, and the taxpayer's employees installed the boat docks and lifts.

For more information, please visit:

<http://www.franchisevaluations.com>

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