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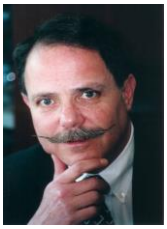
The Franchise Valuations Reporter

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.

Franchisor Recognition of Up Front Franchise Fees

Special Kudos to Aaron Chaitovsky of Citrin Cooperman and His Work on Behalf of the IFA

The history of the rules with respect to revenue recognition by franchisors of up-front franchise fees has received a lot of attention of late. It is ever-changing. Originally franchisors used to book the franchise fees as revenue when received because the franchise agreements labeled them fully earned and non-refundable when received. That did not sit well with the Financial Accounting Standards Board (FASB) and the SEC which sanctioned certain franchisors. The original iteration of the rule, FASB 45, (years ago) held that generally franchisors could not treat up front franchise fees as revenue until they had performed all their obligations under the franchise agreement and generally not until the franchised unit opened. Then the title of the authority was changed to FASB ASC 952-605-25-1 through 25-3 basically following the same rules.

More recently came an upcoming change embodied in ASC 606, *Revenue From Contracts With Customers*[1] issued jointly by the FASB and IASB on May 28, 2014, which mandated that franchisors can't book the franchise fee when the Unit opens but has to take it into income ratably over the term of the franchise agreement. This change was originally effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016, for public entities. On August 12, 2015, the FASB issued an amendment which deferred the effective date for one year for public and nonpublic entities reporting under U.S. GAAP. Therefore, **for public business entities**, certain not-for-profit entities, and certain employee benefit plans, the effective date for ASC 606 is annual reporting periods (including interim reporting periods within those periods) **beginning after December 15, 2017**. The effective date for all other entities is annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019.

But now thanks to the great persuasive powers of Aaron Chaitovsky and others, the FASB has agreed with Citrin Cooperman's argument that the initial franchise fee received by franchisors can have within it completed specific performance obligations and therefore there could very well be justification to recognize a portion of the fee prior to the opening of a location under certain circumstances. This is in complete contradiction with what the Big 4 firms have interpreted and written in their white papers, as well as what the large national firms have been quoted as advising. For the most part, they have all concluded and recommended to their clients that the simplest way to adopt 606 is to just defer the entire fee.

But the FASB held a town hall meeting on November 29, 2017 (after numerous meetings and e-mails and conversations with the IFA's task force led by Chaitovsky), at which time they discussed the issue and the vice chair of the FASB, Jim Kroeker, accepted Aaron's argument that some portions of the initial franchise fee can be recognized on receipt. For franchisors who need to allocate the portions of the franchise fee which may be currently recognized, feel free to call us and we will work with you to determine which

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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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portions (if any) of the up front franchise fees can be currently taken into income rather than deferred ratably over the term of the franchise agreement.

Guess what? **This will require keeping at least 2 sets of books**: for financial accounting and for tax accounting. Similarly, two sets of books will now be required for financial accounting as opposed to tax accounting under the new tax law which does away with depreciation (for tax purposes) in many instances and allows the expensing of many items which previously had to be depreciated. Call us if you have questions.

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[1]FASB ASC 606; *https://www.iasplus.com/en-us/standards/fasb/revenue/asc606*

Joint Employer and Vicarious Liability

SCOTUS Denies Cert - Ruling Stands

The United States Supreme Court announced that it will not hear the case *Hall vs. DirecTV* which arose after technicians hired by DirecTV contractor DirectSAT and DirectSAT's subcontractors accused DirecTV of neglecting to pay them overtime under the Fair Labor Standards Act (FLSA). The case had been appealed by DirecTV after the Fourth Circuit ruled the satellite company was considered a joint employer and was liable for the unpaid wages.

Subsidiary of Franchise Holding Company Was Not Employer of Assistant Managers at Applebee's Restaurants

Finding that an assistant manager at franchised Applebee's restaurants did not plausibly establish an employment relationship with a subsidiary of a franchise holding company, the federal district court in Chicago granted a motion to dismiss a Fair Labor Standards Act (FLSA) overtime claim against the subsidiary. Although some complaint allegations supported an inference that there was cooperation and integration between three corporate entities, at most, those allegations showed only that the subsidiary played some role in developing policies that applied to the employee. No allegations established that the subsidiary controlled the activities of the employees of its sister subsidiary.[1]

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[1] *Ivery v. RMH Franchise Corp.*, December 8, 2017, Tharpe, J., Jr.

New Tax Law and Pass-Through Entities

Internal Revenue Code Section 199A Is Basically Incomprehensible

Under the provisions of the newly passed tax law it is very difficult to determine who gets the new deduction for LLCs and S corps and at what income levels. We suggest waiting until they release the new Form 8903 worksheet before making plans. Here is a link to Section 199A. Read it if you dare.

Tax Nexus: Sales Tax

Maryland Demands Sales Tax Collection from Online Travel Companies (OTCs) Like Travelocity

In *Travelocity vs Comptroller of Maryland*[1] the Court ruled that OTCs must collect and pay over sales tax on the sales of hotel rooms and car rentals it makes to its customers to the extent of the surcharge it collects (but not on the amounts paid to the hotels or rental car companies which have their own obligation to collect and remit sales tax to the extent of their receipts) regardless of the fact that they had no "physical presence".

Texas: Sales Tax Nexus Found Without Physical Presence

An out-of-state corporation that provided repair and maintenance services to Texas retail stores by using a network of local independent contractors had sales tax nexus with Texas. Therefore, the taxpayer was liable for collecting and remitting tax from Texas customers on services performed by the contractors.[2]

Washington-Business and Occupation, Sales and Use Taxes: Consignment Jewels Establish Nexus

An out-of-state diamond and gold wholesaler had nexus with Washington since it owned jewelry located in the state. While the taxpayer did not make retail sales and had no employees in Washington, it did have relationships with numerous jewelry retailers such that it shipped jewels to retailers and consigned jewels to them for five day periods. If customers selected the taxpayer's jewels, the retailer purchased the jewels from the taxpayer and resold them. The Department of Revenue ruled that the taxpayer had physical presence in Washington on the basis of its ownership of tangible personal property within the State.[3]

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[1]Maryland Tax Court No. 12-SU-00-1184. Special thanks to Allan Hillman, Esq.

[2]Decision, Hearing No. 111,156 , Texas Comptroller of Public Accounts, September 29, 2017 , released December 2017

[3] Determination No. 17-0057, Washington Department of Revenue, October 31, 2017

Franchise Times Legal Eagles

If you were thinking of voting for yours truly to be a Legal Eagle, save your vote. *Franchise Times* has determined that I am not a lawyer for their purposes although I have two law degrees, a J.D. and an LL.M. (in Taxation), and have been practicing law for 40 years. The last time I received their award they rescinded it.

Quotations

[Please] pray constantly for [the King] - he needs grace more than ever, in order to behave in a manner contrary to his inclinations and habits. Mme de Maintenon (second wife of Louis XIV) speaking of the Sun

King (current application??)