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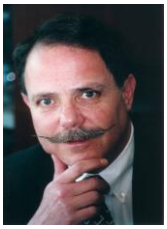
The Franchise Valuations Reporter

Our Expertise



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

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- Finance, Accounting and Tax
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We offer a free initial consultation. If any readers have questions, you are welcome to email or phone us and we will provide our best answer as quickly as possible.

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Franchise Regulation and Damages, the only treatise that covers 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 CCH web page here.

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Using Rollover IRAs to Buy Franchises: A Big Tax Problem

IRS Deems Loans in ROBS Scheme a "Prohibited Transaction"

A recent Tax Court decision sticks it to franchisees who funded their franchise purchase with funds from a Rollover IRA and then guaranteed the business's loans or lent money to the business, saying they face termination of the IRA and substantial taxes and penalties.

Since July of 2010 there has been much discussion of an IRS initiative investigating situations known as Rollovers for Business Startups which was garnished with the acronym ROBS. The initiative focused on the details of the mass use of a technique to make IRA or 401(k) benefits available for investment in start-up businesses on a pre-tax, rather than after-tax basis - a 30-40% bonus of deferred taxes at today's rates. The technique is sold by economic advisers on a confidential "secret sauce" type basis and has been ignored by the IRS for the most part since then. However, the issue has been resurrected because of the "prohibited transaction" rules which totally disqualified a ROBS IRA in the recent case of *Peek v. Commissioner.*[1]

In *Peek*, the taxpayers sought to purchase a business in 2001 and to do so they established IRAs, transferred funds to the IRAs from existing IRAs, set up a new corporation, sold shares in the new corporation to the IRAs, and used the funds from the sale of shares to purchase the business. But, most importantly, the taxpayers also personally guaranteed a $200,000 promissory note to the seller. Then in 2003 and 2004, the taxpayers rolled over the stock in the "traditional" IRAs they set up for the original ROBS transaction, to Roth IRAs and paid a certain tax on the appreciation. Finally, in 2006, the taxpayers directed the Roth IRAs to sell the stock, which had significantly appreciated in value and assumed that their Roth IRAs were not subject to tax on the gains.

The Tax Court disagreed and said the original loan transaction destroyed the tax exempt status of the ROBS IRA from the date of the loan guarantee because that was a "prohibited transaction" under IRC Section 4975 and disqualified the IRA *ab initito*. The Court wrote, "The loan guarantees were not a once-and-done transaction with effects only in 2001 but instead remained in place and constituted a continuing prohibited transaction, thus preventing [the taxpayers'] accounts that held the FP Company stock from being IRAs in subsequent years." The deficiencies asserted by the IRS were upheld -- approximately a half a million dollars.

Additionally, a 20% undervaluation penalty was upheld in the face of the taxpayers' argument of reasonable reliance on expert advice. Because the certified public accountant on whose advice the taxpayers claimed to have relied was, as noted by the Court, not a disinterested professional but a promoter of the very plan employed by the taxpayers, the penalty was sustained under Code Sec. 6664(c).

[1] U.S. Tax Court, Dkt. No. 5951-11 6481-11, 140 TC -, No. 12, May 9, 2013

Valuation: Private Equity Funds

Private Equity Valuations Being Subjected to Intense Scrutiny

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At a Private Equity International Conference in New York City earlier this year it was disclosed that regulators have turned their attention to private equity funds, and the valuation of their portfolios. Bruce Karpati, chief of the SEC enforcement division's asset management unit, reported that, "Many private equity products lack transparency, especially into the valuation of illiquid assets." Conference organizer Cindy Ma highlighted the changing environment by (literally) playing Bob Dylan's "The Times They Are A-Changin'" between sessions to emphasize the importance of independent valuations.

Valuation: Newsletter Cited With Approval

Franchise Law Journal Article Spring 2013

We were flattered to discover in the current edition of the ABA Journal an article entitled, "The Continuing Evolution of Franchise Valuation: Expanding Traditional Methods" by Nicole Ligouri Micklich, Michael W. Lynch and Ingrid C. Festin, which cites and parallels many of our published articles and columns in this newsletter.

Canadian Donut Wars: Continued

Quebec Court Rejects Intervenor Status for Canadian Franchise Association

As our readers may know, Ned Levitt of Aird and Berlis in Toronto and I recently authored a white paper on the second battle of the Canadian Donut Wars which was cited with approval by Dunkin' Donuts in their appeal in the Québec case of *Dunkin' Brands Canada Ltd. c. Bertico Inc*[1].

An update: On May 10, 2013, the Québec Court of Appeal dismissed an attempted motion to intervene filed by the Canadian Franchise Association in the ongoing proceedings between Dunkin' Donuts and 21 of its plaintiff franchisees. The Court of Appeal drew a distinction between public and private disputes in determining the standing of parties wishing to intervene in what was the first time the CFA sought leave as a third-party intervenor in a private franchising dispute.

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[1]*Dunkin' Brands Canada Ltd. c. Bertico Inc.*, 2012 QCCS 2809.

Expert Testimony: Daubert Comes to Florida

Sunshine State Poised to Apply Daubert Rules

From 1923 until 1993 the controlling authority with respect to the admissibility of "expert" testimony in the federal courts and in many state courts was *Frye v. United States*.[1] Under the *Frye* test, as it became known, expert testimony was admissible if the expert's methods were generally accepted within the relevant expertise.[2]

The *Frye* precedent was discarded by the U.S. Supreme Court in 1993 in *Daubert v. Merrell Dow Pharmaceuticals*[3] which ruled that the *Frye* test was not compatible with the adoption of the new Federal Rules of Evidence.[4] In *Daubert*, SCOTUS held that under the Federal Rules of Evidence expert testimony must pass a two-part test to be admissible: (a) it must be reliable -- based on scientific knowledge, and (b) it must be relevant -- of assistance to the trier of fact.

Since then there has been a common misperception that *Daubert* is unequivocally the law of the land. Although that is true in federal courts, it is not so with respect to the various states. In fact, only nine states have adopted the full *Daubert* trilogy[5]: Arkansas, Delaware, Louisiana,

Massachusetts, Mississippi, Nebraska, Oklahoma, Texas and Wyoming. But several other states continue to apply *Frye*, including Alabama, Arizona, California, District of Columbia, Florida, Illinois, Kansas, Maryland, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New York, Pennsylvania and Washington.

Now it appears that one of the *Frye* states will be adopting *Daubert*. On April 26, 2013, the Florida legislature passed a bill that requires courts to evaluate expert testimony under the *Daubert* standard. Assuming Governor Scott signs the bill, the law will go into effect on July 1, 2013.

Currently, expert testimony in Florida is admissible if the witness has "scientific, technical, or other specialized knowledge" that relates to an issue in the case and assists the jury. But a major anomaly in the Florida evidence rules allows testimony to be admitted free of the "gatekeeper" function under the state's "pure opinion exception" which provides that, if the expert relies only on his or her personal experience or training, the testimony is admissible without being subject to a *Frye* hearing.

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[1]293 F. 1013 (D.C. Cir. 1923).
[2]*Frye* ruled " We think the systolic blood pressure deception test [the "lie detector"] has not yet gained such standing and scientific recognition among physiological and psychological authorities as would justify the courts in admitting expert testimony deduced from [it]." The court held, "Somewhere in this twilight zone the evidential force of the principle must be recognized, and while courts will go a long way in admitting expert testimony deduced from a well-recognized scientific principle or discovery, the thing from which the deduction is made must be sufficiently established to have gained general acceptance in the particular field in which it belongs" at p. 1014.
[3]509 U.S. 579, 113 S.Ct. 2786 (1993).
[4]The new Rules had been adopted in 1975
[5] In addition to *Daubert*, the trilogy consists of *General Electric Co. v. Joiner* 522 U.S. 136 (1997) and *Kumho Tire v. Carmichael*, 526 U.S. 137, 119 S.Ct. 1167 (1999).

Nexus Roundup

Florida -- Sales and Use Tax: Click-Through and Affiliate Nexus Legislation Dies in Committee

According to CCH, Florida legislation that would have amended the definition of "mail order sale" to add click-through and affiliate nexus provisions died in the House Appropriations Committee.

Kansas -- Sales and Use Tax: Guidance Provided on Click-Through and Affiliate Nexus Requirements

Also according to CCH, the Kansas Department of Revenue has issued guidance on recent changes to state law that impose a duty on certain remote retailers to register with the department as retailers and to collect and remit Kansas retailers' sales tax or use tax on taxable sales of tangible personal property for use, consumption, or storage in Kansas. The click-through nexus provisions take effect on October 1, 2013, and the affiliate nexus provisions and various amendments to the definition of "retailer doing business in this state" take effect on July 1, 2013.

More Reasons to Harden Your Network Security

Links to Recent Articles on Cybercrime

What an IP Address Can Reveal About You (Office of the Privacy Commissioner of Canada Date Published: May 2013)

Apple devices vulnerable to attack via bogus charger