



# 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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## Recently Published

An article in the Summer 2016 issue of *Franchise Law Journal* by Carmen D. Caruso and Bruce S. Schaeffer on the new business rule for lost profits claims is [available here](#).

## We Write the Book

**Franchise Regulation and Damages**, the only treatise that covers damages in franchise disputes and valuations of

## Valuations: "Tax Affecting" Discount Denied Again

### *Ninth Circuit Affirms Tax Court's Denial of Discount for Tax Affecting With Regard to Pass-Through Entities*

"Tax affecting" in the valuation context is the practice of adopting a fictional discount from the value of pass through entities such as LLCs, limited partnerships and Sub S corporations for an imaginary tax - that they do not pay - in an attempt to make their results the same as if they were C corporations, which they are not. In December 2014 (though not previously reported in this newsletter) in the much litigated case of *Estate of Natale B. Giustina, v. Commissioner of Internal Revenue*,<sup>[1]</sup> the Court of Appeals for the Ninth Circuit sustained the Tax Court's holding that Pass Through Entities should not be diminished in value for so called "tax affecting" - a position regularly endorsed by this newsletter. On remand the Tax Court followed the appellate court's direction in *Giustina III*.<sup>[2]</sup>

### *Whitney Houston Estate vs. IRS Over Intangible Property Values*

In another Tax Court dispute<sup>[3]</sup> Whitney Houston's estate says the royalties, residuals, and the late performer's right of publicity are worth much less than the IRS contends. The IRS claims the estate underreported the value of intellectual property rights by \$22.6 million, resulting in a tax deficiency of \$7.92 million and \$3.17 million in penalties. Similar valuation disputes have been raised with respect to the estates of Michael Jackson and the artist known as Prince as well.

### *Facebook Sued By IRS Over Intangible Valuation*

Facebook has been ordered to appear in court to show why it shouldn't be compelled to comply with several IRS summonses concerning the valuation of intangibles transferred to an Irish subsidiary. Facebook recently received a Statutory Notice of Deficiency from the IRS related to an examination of the company's 2010 tax year. The company could owe between \$3 billion and \$5 billion in additional federal taxes, plus interest and penalties. Facebook says it does not agree with the IRS' position and will file a petition in U.S. Tax Court challenging the deficiency notice. The case is *United States v. Facebook Inc. and Subsidiaries* (No. 3:16-cv-03777).

[1]U.S. Court of Appeals, Ninth Circuit; 12-71747, December 5, 2014. Rev'g and remanding N. Giustina Est., Dec. 58,671(M), 101 TCM 1676, TC Memo. 2011-141

[2]*Estate of Giustina v. Commissioner*, CCH Dec. 60,629(M), (Jun. 13, 2016), 2016 Tax Ct. Memo LEXIS 113 (June 13, 2016)

[3]*Estate of Houston v. Commissioner*, T.C. No. 12098-16

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](#).

## DISCLAIMER

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.

Please visit our websites at [www.FranchiseValuations.com](http://www.FranchiseValuations.com) and [www.ftm.biz](http://www.ftm.biz)

## Damages: Franchisors Excluded From Class

### ***Ruled Not Entitled to Damages In Oil Spill Settlement***

In a case that stands in marked contrast to the recent flood of decisions finding franchisors to be joint employers, the 5th Circuit has found that fast-food restaurant franchisors, unlike their franchisees, were excluded from the Deepwater Horizon oil spill settlement class because they do not own facilities within the covered Gulf Coast areas.[1] The case was reported by the CCH [Antitrust Law Daily](#), an excellent resource for franchise law decisions.

The issues on appeal were whether the franchisors met the requirements of being entities that "owned, operated, or leased a physical facility in the Gulf Coast areas" or were "service businesses with one or more full-time employees (including owner-operators) who performed their full-time services while physically present in the Gulf Coast Areas." The appellate court found that the geographic restriction on putative class members could not be satisfied by relying on legally independent businesses holding that franchisees are third-party businesses that are not part of the larger franchisor.

### ***Another Learned Article on the New Business Rule***

As our readers may know, Carmen Caruso and Bruce Schaeffer recently published an [article in the Franchise Law Journal on the New Business Rule](#). Readers who are interested in the subject may also want to review a recent article by Victor Goldberg, the Jerome L. Greene Professor of Transactional Law at Columbia Law School, entitled "The New Business Rule and Compensation for Lost Profits" published in *The Criterion Journal on Innovation* (Vol 1, 2016, p. 341).

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[1] *Claimant ID 100197593 v. BP Exploration & Production, Inc.*, November 16, 2016, Per Curiam

## Expert Testimony

### ***New Study Reviews "Daubert" Challenges to Class Certifications***

In a study conducted by PriceWaterhouse Coopers, two cases that were before the Supreme Court in recent years are reviewed (*Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 131S. Ct. 2541 (2011) and *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013)) where the Court provided perspective on the matter, but stopped short of mandating a *Daubert* inquiry at the class certification stage. It is a valuable study.

## Tax Nexus

### ***New Mexico Gross Receipts (Sales and Use) Tax Due on Sale of Franchises***

In 2006 the New Mexico Supreme Court ruled that franchise fees paid by New Mexico franchisees to an out-of-state corporation (Sonic) for the right to operate fast food restaurants in New Mexico were not subject to New Mexico gross receipts tax because the franchising activities constituted out-of-state sales.[1]. In reaching its conclusion, the New Mexico Supreme Court relied on its decision in *Kmart* [2]. Even though *Kmart* involved the

assessment of the gross receipts tax on trademark licensing royalties rather than the taxability of franchise fees, there was no legally significant distinction between the two, and the Court held that its analysis in *Kmart* was applicable to the facts of *Sonic*.

However in the more recent case of *In the Matter of the Protest of A & W Restaurants, Inc.*,<sup>[3]</sup> a restaurant company was found liable for the New Mexico gross receipts tax on its franchise licenses of trademarks because the company was engaged in the business of franchising in New Mexico. The Tax Department found that taxable gross receipts includes money from granting a right to use a "franchise" employed in New Mexico and that by engaging in the business of franchising, all of the company's receipts from granting the franchise were taxable.

### ***Ohio Supreme Court Affirms Liability for Commercial Activity Tax: Bright-Line Presence Test Met by Retailer With No Physical Presence***

The Ohio Supreme Court has affirmed Ohio Board of Tax Appeals opinions upholding commercial activity tax (CAT) assessments on out-of-state retailers with no physical presence in Ohio.<sup>[4]</sup> The taxpayers contested the CAT assessments arguing that Ohio may not impose a tax on the gross receipts associated with its sales to Ohio consumers because the taxpayers lacked a "substantial nexus" with Ohio. The taxpayers argued that substantial nexus in a state is a necessary prerequisite for the state to impose the tax under the federal dormant Commerce Clause. The taxpayers argued that their nexus to Ohio was not sufficiently substantial because they each lacked physical presence in Ohio.

On appeal to the Ohio Supreme Court, the Tax Commissioner argued that the Commerce Clause case law does not impose a physical-presence requirement and that as a result, the \$500,000 sales receipts threshold set forth in the Ohio CAT statute satisfies the Commerce Clause requirement of a substantial nexus. The majority discussed *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) at length and determined that *Quill's* holding that physical presence is a necessary condition for imposing the tax obligation does not apply to a business-privilege tax like the CAT, as long as the privilege tax is imposed with an adequate quantitative standard that ensures that the taxpayer's nexus with the state is substantial. The Majority felt that the quantitative standard is the \$500,000 sales-receipts threshold.

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[1]*Sonic Industries v. State of New Mexico*, New Mexico Supreme Court, No. 26,447, August 3, 2006, 401-136, rev'g, New Mexico Court of Appeals, No. 20,676, July 3, 2000, 400-988

[2]*Kmart Corp v. Taxation and Revenue Dept* (NM S Ct 2005) 131 P3d 22

[3]New Mexico Taxation and Revenue Department, No. 16-49, October 17, 2016

[4]The Court's main decision is contained in *Crutchfield, Inc. v. Testa. Newegg, Inc. v. Testa, and Mason Companies, Inc. v. Testa* were issued as companion cases to *Crutchfield*. The three cases were consolidated for purposes of oral argument.

## **Succession Planning for Franchisees**

### ***Seeking Readers' Opinions***

Call us for a free confidential consultation. And for a forthcoming paper to

appear in the *Franchise Legal Digest* I invite readers to submit comments or issues you think should be addressed. Send me your ideas at [Bruce@FranchiseValuations.com](mailto:Bruce@FranchiseValuations.com).