



# 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

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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## Have a Damages or Valuation Question?

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



## Valuation for Succession Planning

### *Interplay Between Fair Market Value, Estate Taxes and Income Taxes*

Example: Harry Landers owns a No Teeth Needed barbecue franchise through an LLC which he has been operating for more than twenty years. He has only six years left on his current franchise agreement but his unit is in New Jersey where it's almost impossible for a franchisee to be terminated. Also his franchise agreement allows for intra-family transfers of less than a controlling interest without franchisor approval. The fair market value of the Unit is between \$6 and \$8 million dollars and Harry's basis for income tax purposes, after twenty years is zero. It is anticipated that after Harry's death the Unit will be sold.

The objective of his succession planner should be to maximize the amount of money that will go to Harry's daughter after taxes when she sells the Unit. So the question is: what should Harry do so that the combined bite of income taxes and estate taxes is lowest? If the Unit is basically Harry's entire estate and the value is between \$6 and \$8 million, then the question becomes what fraction of the business, if any, to give away. The answer is: it all depends on the value. For example if it's \$6 million then the best alternative would be to do nothing which would result in an estate tax liability of \$275,000. But there would be no income tax liability on the subsequent sale because of the "stepped up basis" received when an asset is transferred at death.

But if the fair market value was \$8 million and Harry did nothing, the estate tax due would be \$1,275,000 although there would be no income tax. Whereas if Harry gave away a 25% interest before death, then Harry's remainder interest at death (with a discount for lack of marketability) would be valued at less than \$5.45 million. Thus, there would be no estate tax but his daughter who received the minority interest would face income tax of \$495,000 at the capital gain rate on the subsequent sale of the unit. That net result would be far better than doing nothing and paying the estate tax.

In estates of between \$6 and \$10 million the interplay between fair market value, estate taxes and income taxes should be looked at very carefully.

## Expert Testimony: Daubert vs Frye in Florida

### *We Thought the Issue Was Settled But . . .*

The Florida Supreme Court has scheduled oral arguments for Sept. 1 to decide the standard Florida courts will use with respect to admissibility of expert testimony in civil and criminal cases: will it be Daubert or will it be Frye? Three years ago the issue seemed to be settled when the legislature approved Daubert as the standard, as the federal courts did in 1993. But now the Florida Supreme Court is entertaining argument because the state's Constitution gives the courts jurisdiction over procedure, while the legislature has say over substance. But, as practitioners know, the difference between Frye and Daubert is part procedure and part substance. Hmmm.

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)

## Valuations

### ***A Valuation is an Estimate of Price at a Moment in Time (Effective Date)***

The fact that valuations can change over time has been illustrated dramatically in recent news headlines. In one example, Theranos, a once high flying unicorn that alleged it could provide painless blood testing, has been colossally devalued. Its founder's share, valued a couple of years ago at \$4.8 billion, is now valued at \$0.

And in another recently reported situation, the value of Zenefits, a health-benefits broker, was cut in half to give investors additional shares in exchange for release from legal claims. [Here is a link to a Wall Street Journal article on this topic.](#)

### ***Talk About Playing Your Cards Wrong***

A partner whose obnoxious behavior toward his partners offended a court has been dealt with severely. He owned a 3.08% interest worth \$4.85 million on a pure pro rata basis in a partnership which owned a major shopping mall until he took action to arbitrarily and wrongfully dissolve the partnership. The result was that his other partners brought suit claiming that his dissolution was wrongful and in violation of the partnership agreement. They claimed his motive was to force the partnership to buy out his interest at a steep premium.

The Court agreed and decided to punish him, ruling that he would be bought out at a price which deducted the other partners' damages including legal fees, a 15% discount for goodwill, a 35% marketability discount, and a whopping 66% minority discount from the value of his interest. He appealed but an Appellate Court in New York rejected it and basically upheld the trial court's valuation determination.[1]

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[1] *Congel v Malfitano*, 2016 NY Slip Op 03845 [2d Dept May 18, 2016]

## Cyber Security: Ransomware

### ***White Paper Addresses a New Cyber Risk***

Every company that uses the Internet is exposed to a new extortion technology called ransomware. To be prepared we recommend a compendium, [Crypto-Ransomware Mitigation Guide](#), from Webroot, a company that provides endpoint security and threat intelligence services. It gives direction on what to block, what to disable and what to filter, among other advice.

### ***Additional Malware Discovered By Wendy's***

Wendy's has announced that malicious cyber activity targeting customers' payment card information has recently been discovered in additional franchise-operated Wendy's restaurants. The company had previously announced its discovery and disabling of malware in the point-of-sale (POS) systems of approximately 300 franchise-operated Wendy's restaurants. The company believes that criminals first deployed malware on some Wendy's franchisee systems starting in late fall 2015.

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***And Another Instance: Hundreds of Noodles & Company Locations Hacked***

In the wake of Wendy's announcement, Noodles & Company announced that it too was a victim of a cyber-attack. It may have exposed thousands of customers' debit and credit card data. The company said that locations in 27 states and Washington DC may have been breached. The company began investigating in May, 2016, after its credit card processor reported "unusual activity." The Company's press release claims that it "contained the incident once the malware was identified." But it's a fair bet that Noodles & Company will soon be defending a federal consumer class-action lawsuit just like Wendy's.

***Got a cyber-security question? Contact Henry by [email](#) or phone 212-689-0400.***