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Franchise Technology Risk Management

The Franchise Valuations Reporter

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Our areas of expertise in the franchise, distribution and dealership context are:
Finance, accounting and tax;
Damages, valuations and expert testimony; and
Cyber-security and E-discovery of ESI (Electronically Stored Information)
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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Valuations and Estate Planning

So Called "Death Taxes" – Do Senator Kyl and the IFA Speak for You?

In an article entitled "What To Do About 'Death Taxes': Adopt Permanent Reforms," appearing in the July 2010 issue of *Franchising World*, Senator John Kyl (R-Ariz) writes about the allegedly devastating effects of the "death tax" as he and his cohorts pejoratively call it. His position has the full support of the IFA.

My initials are BS. And in my opinion Senator Kyl and the IFA are full of my initials.

The purpose of the estate tax, as originally enacted under President Roosevelt, was to provide tax revenues and avoid too much capital accumulation in the super-rich - so we didn't destroy our democracy by the creation of a wealthy aristocracy. Strangely, in his attack on the estate tax Senator Kyl makes no mention of the fact that taxes pay down budget deficits (which supposedly offend him). President Reagan's former budget director, David Stockman, recently excoriated the Republicans for this behavior in the *New York Times* (7/31/10) claiming they have abandoned their principles and crippled the economy, as did Alan Greenspan..

In his fantasy piece Senator Kyl wrote: "Small, family-owned businesses, particularly manufacturers, often earn relatively low profit margins but are considered wealthy by the government because they own expensive production machinery or real estate. When the owner of such a company dies – unless he has spent vast sums to pay for life insurance instead of re-investing resources back into the business to create jobs – families are forced to sell off the business (or parts if they can) just to pay the estate tax." If Senator Kyl had any examples to prove this tortured tear jerker he'd have used them.

It should be pointed out that this argument is a new tack: for the past few decades "death tax" opponents like Kyl always cried that the estate tax was killing family farms. But when a study came out showing that there was not one example of a family farm being lost to estate taxes they quietly dropped that. Now there's this new supposed example about "expensive production machinery".

The argument is totally and completely disingenuous. In fact, since the 1986 revision of the Internal Revenue Code, and even before, there have been a variety of "hardship" provisions in the estate tax for general problems; and there are a myriad of specific provisions that allow for the payout of any estate tax liability for closely-held businesses over 10 or 15 years with some provisions offering a very low interest rate and payments of interest only for the first years.

And because death is a sure thing, any reputable adviser should plan for it: the cost of $1 million of life insurance to be put in an irrevocable trust to pay estate taxes is generally not too expensive unless the person is very old or uninsurable. It's an easily planned for liability and has been since the original estate tax was passed in the 1930s under a specific banner, disclosed in the Congressional record, of "soak the rich." This is not a tax levied on poor people who can't afford it. It's a tax for multi-millionaires and billionaires, like the recently deceased George Steinbrenner owner of the New York Yankees.

Look at his example: He bought the Yankees in the 1970s for $10 million. Over his life the value of the team increased to more than $1.6 billion. During those almost 40 years Steinbrenner never paid a penny of income taxes – capital gain or otherwise – on the increase in value of his asset. So at a 20% capital gain rate that's about $320 million in income taxes avoided.

But then there's the "death tax" kicker: at Steinbrenner's demise the Yankees were estimated to be worth $3 billion if the YES TV network is included. So that means that Steinbrenner, who died this year when there is no estate tax, avoided the unified transfer tax (the correct name for the levy) to the tune of about $1.5 billion – that's "b" as in boy.

Thus, George Steinbrenner basically beat the US government out of about $2 billion in combined taxes. I, for one, do not consider that wholesome, or good for the republic or capitalism.

Kyl, in his article, says he has "always believed that permanent repeal of the Death Tax (initial caps in the original for emphasis presumably) represents the best policy, since it frees capital in the private market for more productive uses than fueling the government's spending binge." This argument - that giving the super-rich tax holidays results in increased employment - is ludicrous unless readers think the Yankees increased their roster by more than 1,000 players.

The argument is rubbish. As further proof, on August 4, 2010, 30 billionaires agreed with Bill Gates and Warren Buffet to leave half their fortunes to charity. How does that free capital for the private market? Billionaires like Larry Ellison from Oracle don't put their money back into the US economy. They buy yachts that cost hundreds of millions of dollars (built in Germany) and pay lobbyists to get elected representatives to speak and vote like Senator Kyl. The rest of the money they just keep in liquid assets like Treasury notes or company stock to avoid paying taxes. How many steaks can one man eat?

So when will people like Kyl and the IFA stop acting like high priced shills and front men for the super-rich and start acting like public servants interested in the common good? As Kyl noted in his article, at most the new estate tax will impact 600,000 people over the next ten years. The population of the US is close to 350 million.

For whom do Kyl and the IFA speak? Not for me.

The Estate Tax: It's Coming Back!

Unless you are sure that your death will come this year, 2010, like George Steinbrenner, you are cautioned to plan for the revival of the estate tax.

Although Congress has yet to take any action, all the news reports give the impression that the suspension of the estate tax will not be continued. That means it will be revived with respect to all deaths after January 2011 with an exemption from the tax of only $1 million – down from the $3.5 million of 2009.

So people with franchise businesses must get valuations of their operations to plan for the resurrection of the estate tax.

ESI and E-Discovery

Best Practices: Policies and Procedures

Do you (or your franchise clients) have a policies and procedures manual that addresses Electronically Stored Information, its storage, archiving and rights of access?

If not, we work with companies and counsel to supplement your manuals and procedures.

Also, for anyone involved in or contemplating litigation, in the area of E-Discovery we offer a unique combination of legal experience and computer forensics expertise particularly in the area of Rule 26 obligations.

We invite you to call us at 212.689.0400 or e-mail: Henry@FTRM.biz or Henfree@FTRM.biz.

Nexus Notes

KFC Argues "Physical Presence" Is a Requirement for Income Tax Nexus in Iowa

A tax nexus case has reached the Iowa Supreme Court where KFC Corporation is arguing that the *Quill* sales tax "physical presence" requirement for nexus should apply to the Iowa income tax. See *KFC Corporation v. Iowa Department of*

Revenue, as reviewed in 16 LJN Franchising Business & Law Alert No. 10 (July, 2010). We will be surprised if they prevail in the face of twenty years of decisions to the contrary in many jurisdictions.

New York Tax Representatives Discuss the New Reporting Law Affecting Franchisors

Brian Haas and Nonie Manion from the New York Tax Department in charge of compliance with the new NY franchisor reporting law announced to a group from the NYSBA Franchise Law Committee hosted by David Oppenheim of Kaufmann, Gildin Robbins & Oppenheim on July 14, 2010, that they have received filings from only about 400 franchisors of the thousands that have franchisees in the state.

Their discussion made it clear that they are using the information returns primarily as a means of auditing the sales tax returns of franchisees.

Apparently many franchisors are ignoring the new law's requirements to provide information returns with respect to the operations of the zors and zees within the system.

Franchisors should be aware they are risking substantial audit fees, penalties and the potential for offending the authorities with respect to back taxes that may be found to be due.

We suggested the implementation of an amnesty of some kind for franchisors that are determined to be "out of compliance" (i.e. having not paid any requisite taxes for prior periods) and they took it under advisement. It seems clear that it is negotiable at this stage.

IFA Opposes North Carolina Legislative Proposal to Require Franchisors to Report All Their Operations and Their Franchisees' Operations: Like New York

On June 11, 2010 Troy Flannigan, Director Government Relations at the IFA wrote Representative Pryor A. Gibson of the North Carolina House of Representatives condemning the legislation introduced.

CyberCrime

MORE REASONS TO BE FRIGHTENED! Links to Recent Articles on Cyber-Crime

Hackers Aren't Only Threat to Privacy

http://online.wsj.com/article/SB10001424052748704122904575314703487356896.html?mod=WSJ_hps_sections_tech

Hewlett-Packard GC Says Tech Industry Faces 'Erosion of Trust' Over Cybersecurity
http://www.abajournal.com/news/article/hewlett-packard_gc_says_tech_industry_faces_erosion_of_trust_over_cybersecu

Glitch in California Court Computer System Exposed Confidential Data
http://www.abajournal.com/news/article/glitch_in_california_court_computer_system_exposed_confidential_data

For E-Data, Tug Grows Over Privacy vs. Security
http://www.nytimes.com/2010/08/03/technology/03blackberry.html?hpw