



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



Valuations: Discounts for Estate and Gift Taxes At Risk

The IRS Has Been Threatening for Years to Curtail Discounts for Intra-Family Transfers

On August 2, 2016, the IRS issued a Notice of Proposed Rulemaking which was described by the Wall Street Journal as an attempt to "[Clamp Down on a Tactic to Avoid Estate Tax](#)". And as described by the Business Valuation Wire, "It appears that the proposed regulations eliminate almost all minority discounts for closely held entity interests, including operating businesses owned by a family." That may be overstatement but it's certainly an alert to the wise.

According to the IRS description of their authority and motives:

Section 2704(b)(4) provides that the Secretary may by regulations provide that other restrictions shall be disregarded in determining the value of any interest in a corporation or a partnership transferred to a member of the transferor's family if the restriction has the effect of reducing the value of the transferred interest for transfer tax purposes but does not ultimately reduce the value of the interest to the transferee.

Succession Planning Alert: The Proposed Regulations could have a big impact on family wealth planning particularly because they focus on LLCs, the current entity of choice. It should be a powerful incentive for families that own franchises - whether zees or zors - to complete any planned intra-family transfers in a timely manner. If adopted, the new rules would take effect 30 days after the final regulations are published.

Nonetheless, it should be noted that the IRS has a history of losing in court on this issue. For example:

- *Estate of Bright v. U.S.*[1]
 - The court rejected family attribution and allowed minority interest discounts.
- *Estate of Andrews v. Comr.*[2]
 - The court constructed the willing-buyer/willing-seller test based on a hypothetical using unrelated parties and recognized the distinction between the minority interest discount and the lack of marketability discount.
- *Roy O. Martin, Jr. v. Comr.*[3]
 - The court addressed the issue of multiple level discounts involving minority interests in a holding company that owned minority

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.

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interests in other companies.

- *Charles W. Ward and Virginia P. Ward v. Comr.*[4]
 - The court held that no discount was allowable for potential liquidation expenses at the corporate level but rejected the IRS argument with respect to family attribution and allowed minority interest and lack of marketability discounts.
- *Northern Trust Company v. Comr.*[5]
 - The court held that the use of public companies as comparable valuation criteria was not acceptable with respect to a closely held company and allowed two separate discounts: 25% for a minority interest and 20% for a lack of marketability.
- *Estate of Saul R. Gilford v. Comr.*[6]
 - The court allowed a 33% discount on the value of restricted stock in a publicly traded corporation.
- *Estate of Stirton Oman v. Comr.*[7]
 - The court held that a "key man" discount was not available because the son had taken over the operation of the business before the decedent's death.
- *Estate of Ralph E. Lenheim v. Comr.*[8]
 - The court allowed a 25% discount for minority interest and lack of marketability. Moreover, the court respected the decedent's gifts of stock to his children three months before his death as changing his interest from control to minority.
- *Estate of Elizabeth B. Murphy v. Comr.*[9]
 - The court held that voting and nonvoting stock should be given the same value when the holdings are enhanced by being held by the same person. However, the court refused to accept purported transfers by the decedent just prior to her death as reducing her holdings below 50%. Cf. *Estate of Lenheim*, above.
- *Estate of Catherine Campbell v. Comr.*[10] - The court held, after a careful review of experts' testimony, that the taxpayer was entitled to a combined minority and lack of marketability discount of 57%.

The amount and availability of discounts come up primarily in the estate and gift tax area. On October 20, 2006, the IRS issued "Appeals Coordinated Issue Settlement Guidelines" concerning "Discounts for Family Limited Partnerships," in which it appeared to have conceded that discounts were proper although they continued to disagree with respect to the amount. In its Guidelines the IRS also noted several cases[11], such as *Lappo*, where the Tax Court allowed a 24% marketability discount and a 19% minority discount.[12]

It's hard to ignore the truth that a minority discount is appropriate for a

minority interest whether or not it is intra-family. But we shall have to wait and see. The proposed regulations could change, or they might never go into effect.

Control Premium Study

FactSet Mergerstat, LLC issued a study of the valuation impact of control premiums for the first quarter of 2014 which they defined as the additional consideration that an investor would pay over a marketable minority equity value (i.e., current, publicly traded stock prices) in order to own a controlling interest in the common stock of a company. According to the study, premiums for domestic transactions ranged from -69.0% to 912.5%

[1] 658 F.2d 999 (5th Cir. 1981).

[2] 79 T.C. 938 (1982).

[3] 50 T.C.M. 768 (1985).

[4] 87 T.C. 78 (1986).

[5] 87 T.C. 349 (1986).

[6] 88 T.C. 38 (1987).

[7] 53 T.C.M. 52 (1987).

[8] 60 T.C.M. 356 (1990).

[9] 60 T.C.M. 645 (1990).

[10] T.C. Memo 1991-615.

[11] Such as *McCord v. Commissioner*, 120 T.C. 358 (2003); *Lappo v. Commissioner*, T.C. Memo 2003-258; *Peracchio v. Commissioner*, T.C. Memo 2003-280; and *Estate of Webster E. Kelley v. Commissioner*, T.C. Memo 2005-235.

[12] See also *Keller v. United States* (S.D. Tex. August 20, 2009) 2009 WL 260611, where a taxpayer's expert's value was accepted, which included a 47.5% discount. The IRS valuation was rejected because it violated several tenets of the hypothetical willing-buyer/willing-seller valuation principle, including consideration of the true identities of the buyer and seller

Tax Court: Impact of Former Judge's Indictment

Taxpayer, Subject of an Adverse Determination, Files Motion for Reconsideration Based on Judge's Criminal Behavior

Eaton Corp, an industrial manufacturer that engages in the licensing of its technology for its products, including circuit breakers, switches and pushbutton controls to overseas subsidiaries, has moved for reconsideration of a ruling by a former U.S. Tax Court Judge based on her indictment in April 2016 for tax fraud. The judge, Diane Kroupa, and her husband were indicted for conspiracy to defraud the United States, tax evasion, making and subscribing a false return, and obstruction of an IRS audit .

The government claimed that the couple understated their taxable income by \$1 million, and understated their tax liability by \$400,000, by, among other things, deducting personal expenses as business deductions, including home utilities expenses, interior design costs and travel expenses to places including Australia, China and Thailand. In addition, it was alleged that certain personal expenses, such as personal grooming services and designer handbags, were claimed as unreimbursed employee expenses.

Judge Kroupa resigned from the bench in 2014, four years prior to the end of her term, which began in 2003. In light of the indictment and the information that the judge and her husband were under audit at the time of the ruling against them, Eaton Corp. is requesting reconsideration. Will any of her other decisions be questioned?

Cyber Security: Hackers Sentenced to Jail

Chris Correa, Ex-Cardinals Scouting Director, Sentenced to 46 Months

Correa pleaded guilty in January to five counts in connection with having unauthorized access of the Houston Astros' network from 2013 to at least 2014. In addition to jail time, Correa was ordered to pay \$279,038 for unauthorized use of a rival team's personnel database.

It was the first known case of cyber-espionage involving a professional sports team hacking into another team's database. Correa, who was fired last summer, was the only person in the Cardinals organization charged over the incident, though Major League Baseball said it will wait until it has more information from authorities before deciding whether to levy punishments against the Cardinals. According to prosecutors, Correa accessed the Astros' computer network repeatedly in 2013 and 2014, including their scouting list of every eligible player in the 2013 draft, notes about trade discussions and information about potential bonuses.

Man Gets 6 Months in Prison For Hacking Hundreds of Email Accounts, Including Those of Celebrities

Andrew Helton, a 29-year-old resident of Portland, Ore., acknowledged that for two years starting in March 2011 he operated a phishing scheme that gave him usernames and passwords for 363 email accounts, prosecutors said. "There was no expertise involved. All I did was essentially copy and paste," he wrote in a letter to the judge.

Helton used a faux log-in page for Apple or Google and victims would unwittingly hand over their login information by entering their password and username, according to court documents. With the private information, he canvassed the email accounts and retrieved 161 nude or partially nude images from more than a dozen people, including well-known figures in the entertainment industry.

International Franchising

"Cross Border Franchising: A First Look"

With more and more franchisors confronted with a saturated domestic market, the clear opportunity of international franchising can't be ignored. In the June 2016 issue of *Franchising World* there is an article by Aaron Chaitovsky and Jeffrey Slavet that we recommend. It is a fine primer for operators considering expanding abroad, and Aaron is a very knowledgeable guy.