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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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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 the Wolters Kluwer Law & Business web page here.

Tax Nexus for Franchisors

Wolters Kluwer (CCH) Has Allowed My Chapter To Be Distributed

As many of you know, I write the treatise "Franchise Regulation and Damages" for CCH and update it 3 times a year.[1] One of the chapters (60 pages) covers sales tax nexus and income tax nexus in the 50 states and Washington D.C. The publisher has set up a link to a pdf for any of our readers if they want to click through and obtain the chapter free of charge which discusses the issue and provides information on all the jurisdictions in tabular form.

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[1]Originally with the late Byron E. Fox who passed away in 2005.

Like Kind Exchange: 1031 Treatment Denied and Massive Penalties Upheld in Exelon Case

Reliance on Tax Opinion Denied: $87 Million in Accuracy Related Penalties Assessed

If a taxpayer contemplating a risky transaction rife with potential tax problems purchases a tax opinion to serve basically as insurance against penalties arising from an IRS audit, will that work? Especially if the taxpayer knows (or should have known) from years in the industry that the tax position they are asserting is really too good to be true? The answer in *Exelon v. Commissioner*[1], a 176 page Tax Court opinion was a resounding NO! The IRS's assessment of a $500 million deficiency as well as the assertion of accuracy-related penalties nearing another $100 million was sustained despite Exelon's receiving a detailed legal opinion blessing the transaction. The well-respected Judge Laro called the Section 1031 appraisal "tainted" and "useless".

Some would say you can't blame a taxpayer for trying: in this case the electric utility at issue had a major gain that it did not want to pay current tax on - almost $1.6 billion. The taxpayer was approached with a potential solution: engage in a purported §1031 exchange. This one was referred to as a "sale in, lease out" (SILO) transaction[2], but the IRS complained that, in reality, the taxpayer never actually acquired true ownership of the replacement property. Rather, it found the substance of the transaction amounted to an exchange of their old power plants for secured loans to the public utilities.

The issue of whether reliance on a tax advisor will insulate a taxpayer from civil penalties is supposed to be hornbook law and the most frequently cited authority is dicta in the Supreme Court. In the *Boyle*[3] case, the Tax Court relies on a three-part test case that essentially asks the following questions:

1. Was the advisor a competent professional who had sufficient expertise to justify reliance?

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2. Did the taxpayer provide necessary and accurate information to the advisor?
3. Did the taxpayer actually rely in good faith on the advisor's judgment?

And As to Reliability of the Appraisal?

In this case the court found that the attorneys Winston & Strawn, "interfered with the integrity and the independence of the appraisal process by providing Deloitte with a list of conclusions it expected to see in the appraisals to be able to issue tax opinions at the 'will' and 'should' level. Such interference improperly tainted the Deloitte appraisal, rendering it useless. Further, because Winston & Strawn directed the conclusions that Deloitte had to arrive at, we are highly suspicious that the tax opinions are similarly tainted" and followed it with "We cannot condone the procuring of a tax opinion as an insurance policy against penalties where the taxpayer knew or should have known that the opinion was flawed. **A wink-and-a-smile is no replacement for independence when it comes to professional tax opinions."** (emphasis added)

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[1]147 T.C. No. 9 (2016).
[2] The Tax Court noted that SILO transactions have not fared well in the Courts-with one major exception and wrote:
The courts considering SILO/LILO transactions have almost universally concluded that the taxpayers never obtained the benefits and burdens of ownership or attributes of a traditional lessor and, thus, were not entitled to claim various associated deductions. See [citation of many cases omitted]
[3]*US v Boyle*, 469 U.S. 241, 105 S.Ct. 687, 83 L.Ed.2d 622 (1985). See also *Neonatology Assoc. v Comm'r* 115 T.C. 43, 99 (2000), aff'd, 299 F.3d 221 (3d Cir. 2002). The cases applying the standard are heavily fact-driven.

Valuation Methods

As I have Said Repeatedly

Contrary to the uninformed musings and purported expertise of a judge and some valuation experts, there are three (**and really only three**) general methods that are acceptable for determining business value for closely held corporations.[1] These are - in legal terms - book value, capitalization of earnings, and comparable sales and in accounting terminology: cost, income and market.[2]

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[1]As an additional method see Aswath Damodaran, *Damodaran on Valuation* (Second Edition) who includes an option pricing methodology for determining the value of publicly traded corporations for M&A purposes.

[2] See e.g. Shannon P. Pratt, Robert F. Reilly and Robert P. Schweihs, *Valuing a Business* (Third Edition) p.42; George B. Hawkins and Michael A. Paschall,"CCH Business Valuation Guide" , p. 5024; "Valuing Intellectual Property", NYS Bar Association p. 10; Gary R. Trugman, *Understanding Business Valuation* chapters 9 - 12; Bruce S. Schaeffer, BNA Tax Management Portfolio "Tax Aspects of Franchising" p. 52-53 and most importantly see the AICPA's "Toolkit for Auditors, Auditing Fair Value Measurements and Disclosures" p. 28-33.

Trademarks

Little Caesar's Registration Denied for "Deep!Deep! Dish Pizza" Held:

Merely Descriptive

The Trademark Examining Attorney refused registration on the Principal Register of the mark DEEP!DEEP! DISH PIZZA (in standard characters, with "DEEP DISH PIZZA" disclaimed) for pizza in International Class 30 under Section 2(f) of the Trademark Act on the ground that it is merely descriptive under Section 2(e) (1) of the Trademark Act, 15 U.S.C. § 1052(e)(1), and has not acquired distinctiveness under Section 2(f) of the Act. 15 U.S.C. § 1052(f). Little Caesar's appealed to the Trademark Trial and Appeal Board and they affirmed the refusal to register.[1]

Louis Vuitton Denied Copyright Infringement Claim

Louis Vuitton Malletier ("LV"), the luxury designer and seller of high-end handbags, could not prevail on its claim that My Other Bag ("MOB"), infringed LV's trademarks by selling canvas tote bags with the text "My Other Bag ..." on one side and a drawing meant to evoke the iconic LV handbags on the other side because the federal district court in New York City correctly determined that there was no likelihood of confusion between LV's and MOB's products, according to the Second Circuit Court of Appeals. Furthermore, the lower court did not err in ruling against LV on its trademark dilution claims - finding that MOB was entitled to a fair-use dilution defense - and on LV's copyright infringement claim, also based on fair use.[2] Thus, the judgment of the district court was affirmed

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[1]USPTO Trademark Trial and Appeal Board, *In re LC Trademarks, Inc.* (December 29, 2016), Serial No. 85890412

[2]*Louis Vuitton Malletier, S.A. v. My Other Bag, Inc.* , December 22, 2016, per curiam No. 16-241-cv).

Attorneys' Fees Denied in Copyright Action

Kirtsaeng Not Entitled to Attorney Fees Under 'Totality of Circumstances' Standard

The case has been up and down to SCOTUS twice and was originally decided in 2009 when the USDC in the Southern District of New York held, in the case of *John Wiley & Sons, Inc. v. Kirtsaeng*, that Kirtsaeng had infringed on Wiley's copyright, and the Second Circuit affirmed. Wiley, a publisher of academic textbooks, alleged that Supap Kirtsaeng, an importer and reseller of Wiley's foreign edition textbooks, violated its exclusive right to distribute and import the textbooks.

The Second Circuit affirmed, holding that Kirtsaeng could not avail himself of the first sale doctrine because all the books in question were manufactured outside the United States. The Supreme Court reversed, however, holding that Kirtsaeng could invoke the Copyright Act's first sale doctrine as a defense to Wiley's copyright infringement claim. Finally, after its victory Kirtsaeng sued to recover its attorneys' fees, but now the federal district court in New York City denied the claim even though they were the prevailing party under Section 505 of the Copyright Act because plaintiff John Wiley & Sons, Inc.'s infringement claims were not unreasonable or frivolous and other circumstances did not warrant fee-shifting.[1]

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[1] (USDC SD NY) 08cv7834 (DLC), December 21, 2016.