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The Franchise Valuations Reporter

See You in Toronto

On November 30th, I will be speaking with Ned Levitt at the Ontario Bar Association/Lexpert conference, Franchising: Diving Deep, on the topic of valuing franchises. Call 1-877-298-5868 or email Lexpert Events to register.

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We've Moved!

Franchise Valuations Ltd. and Franchise Technology Risk Management have moved 5 blocks north to new offices at:

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"Economic Nexus" for Income Tax

Franchisors Now Have Two Stark Choices: Follow the IFA's Consistently Losing Argument That "Physical Presence" Is Required or Work Out a Deal

In 2005 the IFA submitted an amicus brief to the U.S. Supreme Court in the A&F Trademark case saying "physical nexus" was required for income taxation of royalties because to rule otherwise would be a big surprise to franchisors. SCOTUS refused certiorari. A few months ago the IFA filed another amicus brief, in KFC v. Iowa, saying "physical nexus" was required for income taxation of royalties because to rule otherwise would be a big surprise to franchisors. Again SCOTUS refused certiorari.

In fact, the IFA, as an organization, has been aware of this issue since 1979 when they sent their then counsel, Andrew A. Caffey, to New Mexico to argue against "economic nexus" as it was being asserted there with respect to the state's Gross Receipts Tax. That was 32 years ago. It should not be a surprise any longer.

Shortly after the seminal case of Geoffrey v. South Carolina ruled that "economic nexus" was sufficient for the income taxation of royalties, the late Phil Rudnick (RIP), then a lead IFA attorney, wrote (in "South Carolina Extends the Reach of State Income Taxes to Franchisors," *Franchise Legal Digest*, Fall 1993) that such a decision was jeopardizing the license revenues of Walt Disney, Mickey Mouse and Michael Jordan. Another very smart and preeminent tax attorney has been representing the taxpayers on appeal - and consistently losing on this issue - for at least 17 years.

It is time for franchisors to give up the ghost and realize that if they have not filed at all in a state, no statute of limitations starts to run and they are liable for any and all taxes going back to their first receipt of royalties, whenever that was. Generally, the result with interest and penalties can be a tripling (or more) of the tax liability - and the penalties may not be deductible for federal income tax purposes.

One of Napoleon's maxims of war was "God fights on the side of the larger battalions." In this conflict, franchisors that are not in compliance and rely on the "physical presence" argument have basically no guns and no ammunition. That's not a good outlook for the outcome of a battle with the taxing authorities. The smart business decision is to make a deal before you get caught and it's too late. Call us if you want someone to negotiate a deal for you - someone with credibility who has been consistently right on this issue for more than 20 years - or go ahead and fight. It's your funeral!

Battle of the Experts Over the Right Discount Rate

A Primer on Selecting a Discount Rate to Calculate Lost Profits and Business Valuation

The discounted cash flow method (DCF) for calculating lost profits

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generally has four elements: 1) projected revenues; 2) projected expenses; 3) a discount rate to reduce the future cash flows to a net present value; and 4) a "terminal value".

One of the most frequently contested elements in the so-called battle of the experts is the appropriate discount rate to apply. Thus, a discussion of certain sources and recognized authorities is in order.

In simple terms, the discount rate is the expected rate of return required for attracting capital to the investment. One of the original and foremost authorities in the area of the DCF method of business valuation is Shannon Pratt. He defines the discount rate "in economic terms [as] an 'opportunity cost,' that is, the expected rate of return (or yield) that an investor would have to give up by investing in available alternative investments that are comparable in terms of risk and other investment characteristics."

The rates accepted by courts in some of the most significant cases involving the DCF method vary widely. Selecting an appropriate discount rate requires a keen understanding of market conditions and the specific circumstances at issue.

Here is more discussion of other authorities as well as a review of cases where various discount rates have been accepted by the courts.

CCH's BFG and FRDD: An Unsolicited Testimonial

Wolters Kluwer Adds Links to Its Franchise Publications

The *Business Franchise Guide* and my treatise *Franchise Regulation and Damages*, both published by CCH Wolters Kluwer, have added a really useful feature. They have tied in practically all the case citations to the actual text of the decisions. For example, now when you are reading the text in my chapter on Lost Profits and a footnote cites a case in support of the thesis, a reader can just go to the footnote and click on the cited case and it brings it right up. Cool Beans, as my techie friends would say.

Valuation Credentials: Are There Too Many?

What Good Are the Initials and What Do They Mean Anyhow?

Business Valuation (BV) has lots of credentialing organizations such as the Institute of Business Appraisers, the National Association of Certified Valuators and Analysts, the American Society of Appraisers and others. In fact, even though it is a relatively small profession, it supports not one, not two, but FIVE different sets of credentials as evidenced by the alphabet soup of initials often found following the names of BV professionals.

Its enough to make you wonder: Does the business valuation profession suffer from inter-service rivalry?

It has been argued in certain BV publications that perhaps this is good in that competition among the credentialing organizations has led to more continuing professional education options and more BV journals. On the other hand, it has also been argued that the many credentialing organizations makes it hard to establish an accepted set of credentials based on an accepted curriculum, and creates skepticism with respect to

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the real meaning and value of such credentials in the eyes of lawyers and judges. Moreover, this has become a sore point in the BV community where it has also been argued that with competition among multiple credentialing organizations, there is the temptation for an organization to attract more members by watering down the requirements for entry.

Cybercrime: More Reasons to Harden Your Network Security

Links to Other Recent Articles on Cybercrime:

In China, business travelers take extreme precautions to avoid cyber-espionage

For hackers, the next lock to pick is cellphones