



The Franchise Valuations Reporter

404 Park Avenue South, 16th Floor, NY, NY 10016
O: 212.689.0400 / Bruce@FranchiseValuations.com

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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.

Bruce S. Schaeffer, Editor
Bruce@FTRM.biz

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Valuations

A Primer on Valuing Intangibles

Recently Weston Anson, author of *IP Valuation and Management* and chairman of CONSOR, an intellectual asset consulting firm located in La Jolla, CA that specializes in trademark, patent and copyright licensing, valuations and expert testimony was interviewed by the ABA. He offered many points that franchise practitioners in particular should be aware of. Thus we quote several of his responses:

Why is IP knowledge important to a franchise practitioner?

- A basic understanding of intellectual property is a must for every lawyer, regardless of her area of practice.

Intellectual property now represents the largest portion of the value of most companies. Technology and the Internet are only accelerating this trend with a growing range of protectable intangible assets, from domain names to Web-based business methods. Today, there are few—if any—transactions involving lawyers that do not include intellectual property matters.

What is IP?

- Intellectual property is that piece of ownable property that has been legally protected and recognized under the laws of the country. It is [things like] trademarks and service marks, patents, trade secrets, copyrights and those ancillary rights that are

related to them.

What is goodwill?

- Today perhaps the best definition of goodwill is the value of the company that remains after you subtract from its total value, the value of all tangible and intangible assets. So, for example, if the balance sheet value of a company is \$1 billion, and its tangible assets are worth \$500 million, and its intangible and intellectual property assets are worth \$450 million, the remaining \$50 million would be goodwill.

How do you value IP?

- Valuing intellectual property is not mysterious; it's just that it's a bit more complex than other assets. Basic theory of

- valuation of intangible assets is not dissimilar from the methodologies you would use with tangible assets, like real estate. Broadly, there are three general ways to value these assets. One is cost; another is comparable or comparison based; and the third is income based.

But further, according to Anson, “There’s also a fourth methodology, which is known as relief from royalty. Unfortunately, that methodology has become badly overused and has become almost the standard for valuation of IP. So a word of caution—it is a very simplistic method that any undertrained, second-year accountant can use to value an intangible asset.”

Nexus Notes

It's Not Just New York: North Carolina Too May Require Franchisors to Report On All Their Operations and Their Franchisees' Operations

According to a recent “head’s up” from Troy Flannigan at the IFA, legislation has been introduced in the North Carolina House of Representatives mandating the reporting of specified information by franchisors to the state. It is similar to provisions enacted in New York State last year. Under the proposed legislation a franchisor is defined as: “A person that grants a franchise to a franchisee”.

And the proposed reporting requirements in the statute are:

(b) Annual transaction report. – A taxpayer listed in subsection (c) of this section must submit an annual report by May 1 of each year to the Secretary. The report must include the following information:

(1) The name and address of a recipient of consideration paid by an insurer or of a franchisee.

(2) The date of each transaction.

(3) If the report is by an insurer, the amount of consideration paid, itemized by recipient, and the total consideration paid during the period covered by the report.

(4) If the report is by a franchisor, the gross sales of each franchise located in this State, as reported by the franchisee to the franchisor; the total amount of sales by the franchisor to the franchisee, itemized by franchisee; and the income of each franchise located in this State, as reported by the franchisee to the franchisor.

It's Not Just California: Puerto Rico Too Requires Franchisees to Withhold Taxes on Royalties to Franchisors

Recently a franchisor with no affiliates or employees in Puerto Rico, which was not engaged in a trade or business in Puerto Rico but which did have franchisees in Puerto Rico was nonetheless found liable for

the tax imposed pursuant to Article 1233-1(a) of the Puerto Rico Internal Revenue Code of 1994 (PR Code) which taxes income actually or constructively received from *sources within Puerto Rico*. Therefore, such income in the nature of franchise royalties was subject to the Puerto Rico tax at the established rate of 29%.

If a franchisor does not agree with the Commonwealth to be subject to the levy, then the franchisees within the jurisdiction are obligated under Sections 1147 and 1150 of the PR Code to withhold and pay over that 29% tax directly to the Puerto Rican authorities. Franchisors generally must enter into agreements with Puerto Rico agreeing to be liable for the tax directly; only in that case are their franchisees exempt from the withholding obligation and allowed to pay their full royalties to the franchisor.

ESI and E-Discovery

Mandatory Electronic Filing: New York
Practitioners should be aware that New York State has just enacted Rule 202.5-bb of the Uniform Civil Rules For The Supreme Court entitled Electronic Filing in Supreme Court, (which is a mandatory program effective 4/26/10) in which all documents filed and served in Supreme Court in the following civil actions (in the counties specified) shall be filed and served by electronic means: (i) commercial actions in New York County; (ii) tort actions in Westchester County; and (iii) such classes of actions as shall be specified by order of the Chief Administrator of the Courts (excluding matrimonial actions) as defined by the Civil Practice Law and Rules.

Taxpayers Alleging “Physical Presence” Is a Requirement for Income Tax Nexus – FIN 48 and Reporting For Uncertain Tax Positions

IRS Commissioner Douglas H. Shulman gave the luncheon address on April 12 at the Tax Executives Institute’s 60th Annual Midyear meeting in Washington, D.C. at which he reiterated the importance of the Service’s proposed tax reporting for uncertain tax positions – such as alleging a franchisor is not liable for income taxes to a jurisdiction where they have only an “economic presence” but not a “physical presence”.

As part of this effort, Shulman explained, the IRS released the controversial Announcement 2010-9, I.R.B. 2010-7, 408, requiring business taxpayers to report their uncertain tax positions as described in FIN 48.

E-Discovery in Federal Courts

As most readers are aware, Rule 26 of the FRCP was modified in 2006 to create an entirely new environment whereby non-adversarial cooperation in discovery is mandated in federal actions. This is particularly important in the area of E-discovery and the required turnover of Electronically Stored Information (ESI).

A thoughtful review of this issue can be found in Steven C. Bennet, “How Can Courts Encourage Cooperation in Discovery?” *NYSBA Journal* (May 2010). This author, like all others knowledgeable in the area, has suggested that attorneys need to engage technical experts in this field to accomplish their ends in obtaining discovery from their adversaries and also in avoiding

sanctions for being non-compliant to the E-discovery requests made of them.

In one section of the article entitled “Requiring Competence”, the author writes: “Reasoned discussion of sometimes complex and technical discovery issues requires competent counsel supported by client representatives with knowledge of the client’s information and communications systems and record-keeping practices.” To ensure such competence, counsel generally need outside expertise.

Best Practice

When litigation is anticipated a litigation hold must be implemented at the earliest appropriate date. A systems and procedures manual addressing document retention and destruction practices has become an absolute necessity.

One important issue to consider is the duty to preserve ESI in terms of a timeline and under what conditions can a company destroy potentially discoverable records. US Court of Appeals for the Fourth Circuit has elaborated that “[t]he duty to preserve

CyberCrime

MORE REASONS TO BE FRIGHTENED!

Parties interested in this topic should read the recently released book by Richard A. Clarke and Robert K. Knake, “Cyber War: The Next Threat to National Security and What to Do About It” (Harper Collins, 2010) for an in-depth study of the appropriate level of paranoia that should be adopted.

material evidence arises not only during litigation but also extends to that period before litigation when a party reasonably should know that evidence may be relevant to anticipated litigation.” *Silvestri v. General Motors Corp.*, 271 F.3d 583, 591 (4th Cir. 2001). This principle also undoubtedly applies to ESI.

To protect themselves and their clients, we recommend counsel engage E-Discovery experts – like the Chan brothers of Franchise Technology Risk Management – to explain the nuances of ESI in general to counsel, how it is stored, to what degree it can be recovered, how imaging of hard drives and devices should be done to preserve a litigation hold and how such images can then be further copied and annotated to provide a searchable database for discovery and trial.

In the area of E-discovery FTRM offers the rare combination of legal experience and extraordinary computer forensics expertise. We invite you to call us at 212.689.0400 or e-mail: Henry@FTRM.biz or Henfree@FTRM.biz.

Links to Recent Articles on Cyber-Crime

More Legal Threat Malware E-Mail

<http://isc.sans.org/diary.html?storyid=8620>

Web hit by hi-tech crime wave

<http://news.bbc.co.uk/2/hi/technology/8630160.stm>

(Hi-tech criminals are racking up more than 100 attacks a second on the world's computers, a survey suggests.)

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