

# BUSINESS LAW NOTES

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Our law firm has provided exceptional legal services to clients throughout the state and the U.S. for more than 45 years. A full-service firm founded in 1955, we have built a reputation for helping clients solve difficult problems with sound counsel, sophisticated analysis and superior performance.

A hallmark of our firm is personalized client service. Recognizing that each of our clients has a unique set of issues, objectives and needs, our firm is committed to individualized attention and works as an integrated team to respond to our clients' needs. We serve diverse clients, including Fortune 500 companies, government agencies, professional associations, closely held corporations, limited liability companies, partnerships and individuals.

## Business Succession Planning: PART Four

# VALUATION: HOW MUCH IS YOUR BUSINESS WORTH??

By F. Stephen Glass

### How much is your piece of your business worth?

The valuation provision of your buy-sell agreement should be given careful thought. Valuing a closely held business is fraught with potential difficulties, but it is a critical part of the agreement. There are different valuation methods that should be carefully considered, some of which are:

- capitalized earnings formula
- book value
- professional valuation appraisal
- agreed price, or
- arbitration

Which one is the best? The one that best fits the needs of the shareholders, the feasibility of funding and the needs of the business. The method chosen should be carefully defined so there is less likelihood that a disagreement could occur regarding the value to be used for the sale and purchase of the shares of the corporation.

Some business owners value their business at a low level (below fair market value) in their buy-sell agreement, thinking this will reduce their estate tax liability. However, a buy-sell agreement price is binding for estate tax determination **only** if it meets of specific conditions and complies with *IRC Section 2703*. If these conditions are not met, the IRS can reject the value for purposes of determining the tax due from a deceased shareholder's estate. In a worse case scenario, the heirs may end up owing the IRS more in estate tax than they received from the sale of the deceased shareholder's shares back to the business or to surviving shareholders.

A buy-sell agreement must be updated regularly to ensure its provisions adequately address current business circumstances and the present value of the business interest. Certainly, when there is a change in structure, ownership, ownership intent or a substantial sustainable increase in profits, the business valuation should be updated immediately.



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**Jean Winborne Boyles** concentrates her practice in health law, corporate law, bankruptcy and creditors' rights, commercial leasing, anti-trust and state administrative law.

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## **MY FRANCHISOR IS DESTROYING MY BUSINESS. HELP!**

by M. Blen Gee, Jr.

to commence an arbitration as a group. However, some franchise agreements have limitations on group arbitrations and the franchise agreement would have to be examined. If a franchisee association is formed, the association could finance a "test case."

4. With respect to any requirement by the franchisor that you purchase products from him, the federal antitrust laws may provide some protection. This will depend on the circumstances of the particular case but could be quite useful.

5. Bankruptcy, of course, is a possible option. This depends on your personal financial situation. Careful planning is required to maximize the benefits of a bankruptcy.

6. A sale of your franchise to some other person is always a possibility. Sometimes a business has more "goodwill" value than the owner realizes. A favorable lease may have value. An established location with a regular clientele may have value. Your customer list may have value. Sometimes the business can be sold outside the franchise system. Restrictions in your franchise agreement would have to be carefully examined, however.

I have attached several issues of our firm newsletter which contain some franchise related articles that may be helpful. I especially call your attention to the article "Exiting of Troubled Franchise" contained in the fall 2004 issue.

## BUSINESS LAW NOTES

### 2005 BANKRUPTCY REFORM ACT

By Jean Winborne Boyles

The Bankruptcy Abuse Prevention and Consumer Protection Act was signed into law in April and became effective October 17, 2005. This revision of the Bankruptcy Code was in the making for many years. It was primarily supported by credit card companies whose debts were being fully discharged in Chapter 7 cases. This new law puts into place a Means Test for Chapter 7 debtors. In short, any debtor wishing to file Chapter 7 bankruptcy, whose income is over the State means as defined by the Internal Revenue Service, will have to file Chapter 13 bankruptcy. The filing of a Chapter 13 case means that the debtor will have to pay a dividend on each debt to his creditors over a period of three to five years. Previously a Means Test was not applicable and the debtor could file a Chapter 7 case and discharge all his unsecured debt if he had no assets after asserting his state exemptions.

There were quite a few filings prior to October 17th and there have been few filings since then. The various federal districts are in the process of setting up certain rules regarding the change in the law. More responsibility is placed on the attorney to seek information concerning the debtor's financial state. I anticipate that there will be far fewer Chapter 7 Petitions filed. The filing of a Chapter 7 case will be more expensive which will make it more difficult for people in financial trouble to seek Bankruptcy protection.

Due to the increased costs of oil prices and the large natural disasters in our country, many more individuals will be seeking bankruptcy but most likely will find it harder to find the relief which they found under the previous Act. This, in turn, will hurt non-consumer creditors.

### LIKE-KIND EXCHANGES

By F. Stephen Glass

A "1031 Like-Kind Exchange" is one of the most powerful tax deferral strategies available for taxpayers.

The advantage of a 1031 Like-Kind Exchange is the ability of a taxpayer to sell investment or business property and replace it (or them) with like-kind replacement property without having to pay federal income taxes on the sales transaction.

Generally, under Internal Revenue Code §1031, if you exchange business or investment property solely for business or investment property of a like-kind, no gain or loss is recognized. If, as part of the exchange, you also receive other (not like-kind) property or money, gain is recognized to the extent of the other property and money received, but a loss is not recognized.

IRC Section 1031 does not apply to exchanges of inventory, stocks, bonds, notes, other securities or evidence of indebtedness, or certain other assets.

Properties are of like-kind if they are of the same nature or character, even if they differ in grade or quality. Personal properties of a like class are like-kind properties. However, livestock of different sexes are not like-kind properties. Also, personal property used predominantly in the United States and personal property used predominantly outside the United States are not like-kind properties. Real properties generally are of like-kind, regardless of whether the properties are improved or unimproved.

There is more than one way to structure a tax-deferred exchange under IRC Section 1031. However, The proper sequence for the sale-purchase is critical and timing IS everything! "Safe-harbor" Regulations establish approved procedures for Section 1031 exchanges, which include the use of a Qualified Intermediary, direct deeding, the use of qualified escrow accounts for temporary holding of "exchange funds" and other procedures which now have the official blessing of the IRS. Nonetheless, complexities abound for those desiring to utilize this valuable tax deferral strategy.

**There is more than one way to structure a tax-deferred exchange under IRC Section 1031.**



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## BUSINESS LAW NOTES

# BUSINESS TAX LAW

## RECENT DEVELOPMENTS . . .

**Code Section 1031-Exchange of property held for productive use or investment-FCC licenses.** Taxpayer's exchange of FCC licenses to rights in two radio bandwidths for FCC licenses to right in two other radio bandwidths qualifies as like kind exchange. (PLR 200532008)

**Code Section 1031-Like-kind property exchanges-timberlands.** Exchange of taxpayer's 100% interest in old-growth timberlands, held for investment, for timber corp.'s reproduction timberland, also held for investment, will be like-kind exchange. (PLR 200541037)

**James M. Barton, et ux. v. Commissioner,** (2005) TC Memo 2005-97: This case dealt with IRC § 162 - Business deductions/auto and entertainment expenses-substantiation. Held: the company sales representative was not entitled to unreimbursed employee business expense deduction above the amount that the IRS allowed because the taxpayer did not meet strict substantiation requirements as to purported auto expenses. In this case, the non-contemporaneous reconstructed mileage log directly conflicted with other evidence that the sales rep had flown to the same locations on the same day for which he claimed auto mileage. Credit card summary statements were similarly unpersuasive where they failed to delineate between business and personal auto use. Also, entertainment expense claims, supported only by vague testimony and the same mixed business/personal use credit card statements offered for auto expenses, were likewise rejected.



## MY FRANCHISOR IS DESTROYING MY BUSINESS. HELP! (A true story)

by M. Blen Gee, Jr.

*Our office recently received an e-mail from a franchisee who was nearing the point of desperation in his dealings with his franchisor. His story was an all too typical tale: a franchisor only interested in selling new franchises; no support; no communication; failure to implement new technologies; threats; mandatory purchases of goods marked up 100% or more; and nothing being done to improve the situation.*

*Here it is our quick e-mail response, modified only slightly for this article:*

I am sorry to hear that you are having trouble with your franchise. Unfortunately, this is an all too common problem.

There are a lot of potential options, but it depends on the particular facts of your situation as to what would be the best course of action. Here are some general ideas about your options:

1. If a large number of the franchisees are united, a franchisee association can be formed. The very existence of a franchisee association can moderate the harsh conduct of a franchisor. Also, it allows the franchisees to pool their resources for legal advice and group buying, to have a united voice on franchisor issues, to have a unified strategy in dealing with the franchisor, etc. Our firm could help you with the formation of such an association.

2. With respect to your personal situation we would have to review your franchise agreement, any amendments, the UFOC (Uniform Franchise Offering Circular), brochures and other promotional information given to you before you signed the franchise agreement, and pertinent correspondence from the franchisor since you signed the agreement. Especially important are the terms of the franchise agreement. Frequently, the franchise agreement is very tightly drafted with many onerous provisions. Generally speaking, the courts uphold the franchise agreements as written, which can be a severe problem. However, from time to time, a franchise agreement may contain a glaring loophole that would allow you to get out of it. Also, the franchisor may be in breach of the agreement to a sufficiently great extent to allow you to abrogate the agreement. We would need to do a detailed review of these materials and a thorough interview of you by phone to get a complete history of your situation and develop a strategy.

3. It probably is possible for a group of franchisees who have the same basic issues to pool their resources and file a lawsuit as a group. Many franchise agreements these days have a requirement that any dispute be submitted to arbitration. If your agreement contains such a provision, you probably cannot file a lawsuit; you will have to arbitrate. In general, it is possible for franchisees [continued on page 4] to commence an arbitration as a group. However, some fran-