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CURRENTS

it's not nice to fool the IRS

Delivering the cash with the cream

By Julie Bennett

Four hundred Massachusetts Dunkin' Donuts franchisees are implicated in a tax fraud conspiracy for which a local dairy has pleaded guilty and paid a \$7.2 million fine, the largest criminal tax fine in the state's history.

According to Samantha Martin, a spokeswoman for the U.S. Attorney's office in Boston, criminal charges for tax evasion may be filed against franchisees who participated in the dairy's illegal rebate program. To date, the U.S. Attorney's office has not released the names of any of the franchisees involved, although Martin said that some of them are multi-unit operators. There are 579 Dunkin' Donuts stores in the state.

The corporate offices of Dunkin' Donuts Inc., in Randolph Massachusetts, issued a short statement saying that the company has been "fully cooperating with the investigation." None of the Massachusetts Dunkin' Donuts franchisees contacted would comment on the case.

According to U.S. Attorneys Donald Stern and Michael Lahey, between 1992 and 1997, a local dairy, West Lynn Creamery of Lynn, Massachusetts offered a "rebate" program to 1,400 customers, including the Dunkin' franchisees, by providing them "false and inflated invoices." For example, certain Dunkin' Donuts franchisees paid \$4.28 for one half-gallon of light cream and received a \$2 per unit "rebate" from West Lynn Creamery, in the form of cash or loans. Franchisees who chose not to participate paid only \$2.28 for the same product.

The investigators said that the dairy launched the conspiracy because of competition. "To keep customers' business, West Lynn Creamery delivered cash as well as cream," said U.S. Attorney Stern. As much as \$12,000 was turned over to one Dunkin' donuts owner in a single delivery, he said.

Some of the franchisees, the charges continue, used the invoices to inflate their expenses and under report their net income to the IRS. During the five years of the scheme, West Lynn Creamery paid out approximately \$14.2 million in rebates, resulting in a tax loss to the U.S. Treasury of about \$4 million. In 1997, Dunkin' Donuts started its own delivery system and West Lynn Creamery no longer billed franchisees directly.

What: Government investigation of illegal dairy rebate program

Who's implicated:

400 Massachusetts franchisees in the Dunkin' Donut chain

What's involved: West Lynn Creamery paid out about \$14.2 million in rebates, resulting in a tax loss to the U.S. Treasury of about \$4 million.

In 1998, West Lynn Creamery was sold to Suiza Foods, of Dallas, the country's largest dairy processor and distributor. Suiza Foods paid the fine as part of a settlement agreement with the federal government, but has announced that it plans to go after the previous owners for restitution.

The implications to the franchising communities go

beyond the borders of Massachusetts. Kevin Hein, an attorney with Dorsey & Whitney, said "Other franchise systems need to make it clear to their franchisees that any rebates that they receive pursuant to programs sponsored by franchisers, vendors, or franchisee buying groups must be treated as income as stated as such on their tax returns. I suspect that there are other deals out there that could be construed as tax evasion."

The Dunkin' Donuts corporate statement pointed to another problem—during the period of the conspiracy franchisees that misrepresented the profitability of their units had a "detrimental effect on the Dunkin' Donuts system." Hein said that either an overstatement of expenses or an understatement of net income could have affected the earnings claims Dunkin' Donuts published during that period.

But, another attorney, Robert Zarco, of Zarco & Pardo PA in Miami, questions the scope of the investigation. "It's ludicrous to believe that 400 out of 579 stores, or 75 percent of the franchisees in Massachusetts, would voluntarily and with full knowledge participate in a tax evasion," Zarco said.

"If I were to guess, I'd think that the manner in which these rebates or inflated invoices were made was a misrepresentation by the creamery. I wonder if the dairy is trying to dump some of the blame on the franchisees."

Zarco also wondered if other franchisees could be committing tax evasion. "Franchisees are always looking for cash flow, for ways of putting more cash in their pockets. I could see how they could think that there was nothing wrong with a program that gave them a discounted price or a rebate."

Unlike Zarco, an attorney who asked not to be named said, "The Grand Jury investigation into this matter has been going on for years. As I understand it, many of the Dunkin' Donuts franchisees have an exposure that can lead to criminal charges by the government. Franchising may be facing a major scandal."