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State Taxation

Collection of Royalty Fees Under Franchise Agreement Subject to Gross Receipts Tax in New Mexico

The New Mexico Court of Appeals affirmed a decision by an administrative hearing officer that a franchisor's receipt of royalty fees under a franchise agreement were subject to gross receipts tax pursuant to New Mexico's Gross Receipts and Compensating Tax Act. *A&W Rests., Inc. v. Taxation & Revenue Dep't*, 2018 WL 4024741 (N.M. Ct. App. Aug. 22, 2018). In 2007, the state legislature amended the Act so that the definition of taxable "gross receipts" included the amount of money received "from granting a right to use a franchise employed in New Mexico," and so that the definition of "property" included "licenses other than the licenses of . . . trademarks." Following an audit in 2013, the New Mexico Taxation and Revenue Department assessed gross receipts tax on the royalty fees A&W collected under its franchise agreements. A&W protested the Department's decision, arguing that the royalty fees were exempt from gross receipts tax because trademarks are not considered "property" under the Act.

The critical issue in the case was whether the royalty fees under the franchise agreement were received from the grant of a franchise or from the licensing of the trademark. The court concluded that the legislature's change to the definition of gross receipts evidenced the state's intent to subject money received from the grant of a franchise, such as royalties, to gross receipts tax. Because a franchise is viewed as a "bundled form of property" that includes a limited trademark license along with additional rights and obligations, the court held that it should be treated differently from a standalone trademark license agreement, which is exempt from gross receipts tax.

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