BLOGS

Practice of Franchise Law

U.S. Supreme Court Expands Sales Tax Nexus

On June 21, 2018, the U.S. Supreme Court eliminated the physical presence requirement for sales tax collection. In a 5-4 decision in *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2018), the Court overruled its prior decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), in which the Court had ruled that a state could require an out-of-state seller to collect sales tax on sales into the state only if that seller has a physical presence in the state. The Court was reviewing South Dakota's economic nexus statute that imposes a sales tax obligation on out-of-state sellers with at least $100,000 or more in sales or at least 200 sales into the state during a year. In light of this decision, states can now assess sales taxes on out-of-state sellers of products, and it is very likely that other states imposing a sales tax will also adopt this economic nexus standard tied to meeting certain minimum thresholds of sales in the state.

What does this mean for franchisors? Overall, this decision may not have a significant impact on franchisors who do not engage in e-commerce. But there are a few takeaways:

- Franchise or royalty fees for the use of trademarks typically would be an intangible, and therefore not generally subject to sales tax. If the franchise or royalty fees include, or relate to the provision of, taxable property or services, however, a state may assert that these fees are subject to sales tax. South Dakota, which is one of a handful of states that charge sales tax on most business services, subjects a royalty fee to sales tax if any taxable service or property is included. New York, in a 2016 advisory opinion, stated that such fees were not taxable where they include only limited property, such as operations manuals.
- The sales tax treatment of other fees, such as marketing, installation, and IT support fees, will vary from state to state. The sale to franchisees of inventory to be resold by the franchisee typically would be exempt from sales tax as a sale for resale although the seller should obtain an exemption certificate from the franchisee.
- Franchisors should evaluate their sales tax collection policies in light of this new nexus standard, focusing in particular on the states with more significant sales activity.

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It is important to note that this case dealt only with the nexus requirement for the collection of sales and use taxes. Many states already apply an economic nexus standard, rather than a physical presence standard, in determining whether an out-of-state business is subject to income tax in the state.