



The A.R.T. of Franchising

An Important Franchising Update from the firm of Jackson Walker L.L.P.

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The A.R.T. of Franchising Advice - Reminders - Tips

Dear Franchisor,

Welcome to the Jackson Walker's *ART of Franchising* newsletter. As always, our intention is to provide you with timely and easy-to-read franchise *advice, reminders and tips*, so that, as industry leaders, your knowledge of franchising will be continually expanding.

Today's Advice

It is important for all franchisors who are franchising in multiple states to be aware that they may be subject to state taxes on royalty payments earned in the states where their franchisees are located. The case law has very consistently held that despite a franchisor's lack of physical presence in a particular state, such state may impose an income tax on revenue earned by an out-of-state franchisor through its franchisees in-state operations. Thus, a Texas-based franchisor must pay Iowa state income tax on royalties earned from Iowa-based franchisees. It must also be noted that such out-of-state tax collections are growing rapidly as states are more aggressively looking for sources of revenue. Ten years ago the odds of a franchisor getting targeted for failing to pay a state's income tax on royalties collected from in-state franchisees was negligible. Today, the odds of getting targeted are much higher.

If you are a franchisor franchising in multiple states, I strongly recommend that you raise this issue with your CPA to determine whether you are subject to such out-of-state taxes. It is further recommended that you address this sooner rather than later, as penalties and interest for failing to pay applicable taxes can be significant. In the case that you need additional counsel in this area, I would offer the expertise of our tax partners here at Jackson Walker, through an inquiry to myself or Mark Miller. Our contact information is found below.

Today's Reminder

Remember, your brand's prominence is directly dependent on franchisees doing a great job of championing your brand and building your customer base. Your franchisees are on the "front lines" and can have a lot to say about how your brand is translating to your customers. Viewing your franchisees as strategic partners who can assist you in making your brand better can have significant upside. Franchising is full of anecdotes of franchisee ideas that became huge successes for their franchisors. Both the Big Mac and the Fish Filet sandwich were invented by McDonald's franchisees, as an example.

The key is to put systems in place that promote collaboration, while at the same time keeping the final approval or decision making authority in your hands, as the franchisor. For example, with

respect to new products, suppliers or systems, franchisees should have a very clear understanding of the approval process. The system of approval should be detailed in terms of what information must be delivered to you, testing requirements, expectations with regard to timing, costs involved, etc. This process should not discourage innovation, but clearly manage franchisees expectations, while leaving the ultimate decision making power with you.

I also recommend the formation of a franchisee advisory board. These boards generally include a certain number of franchisees and serve as advisory council to a franchisor in areas such as advertising, marketing, and other business related matters. The franchise system is encouraged to funnel ideas through this advisory board, and the franchisor can use the board to disseminate information throughout the system. These boards have no decision making authority, acting only in an advisory capacity; however, they provide franchisees with a clear channel of communication to their franchisor.

Today's Tip

As a culture that relies more and more on social media for communication and information, it is critical that franchisors understand the need to build parameters in this area in an effort to protect their brands. Social media is a network of services that allows us to communicate online and form communities around shared interests and experiences. While it can be a very effective tool for building brand awareness, it can also be devastating to a brand if used improperly.

So, I recommend that franchisors address this issue in two ways. The first is to establish a policy and a code for online conduct, which provides specific guidelines and requirements. This should be drafted very carefully and included as part of the operating manuals that must be adhered to by all franchisees in accordance with your franchise agreement. The policy should cover not only social media usage but also email usage and all online activity, including blogs, microblogs, and social networking sites (such as Facebook, LinkedIn and MySpace), video-sharing and photo-sharing sites (such as YouTube and Flickr), review sites (such as Yelp and Urbanspoon), marketplace sites (such as eBay and Craigslist), Wikis, chat rooms and virtual worlds.

The second tool for addressing this issue is to include a provision in your franchise agreement specifically stating that any type of social media usage, emailing, or other online activity must be done in strict compliance with your operating manuals on this subject.

By taking this proactive step to insure that the online reputation of your brand is protected and promoted in a positive way, you and your hard working franchisees will certainly benefit.

We welcome your comments and suggestions. Please send to wbunch@jw.com or mmiller@jw.com.

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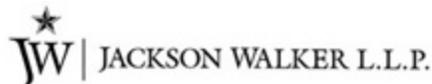
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