



February 12, 2010

The Honorable Ross Hunter
Committee on Finance
Washington House of Representatives
John L. O'Brien Building
Room JLOB 223-A
P.O. Box 40600
Olympia, WA 98504-0600

Via Facsimile: (360) 786-7018

Dear Chairman Hunter:

I write to express concerns the International Franchise Association has with provisions included in House Bill 3176 related to economic nexus standards. The establishment of economic nexus, rather than physical presence, as the standard for state taxation is a bold departure from longstanding practices under existing tax code and will create significant confusion among the franchise systems that operate in Washington State.

The IFA's mission is to safeguard the business environment for franchising worldwide. The association represents businesses in more than 85 industries, including more than 11,000 franchisee, 1,200 franchisor and 600 supplier members nationwide. According to a 2008 study conducted by PricewaterhouseCoopers, there are more than 900,000 franchised establishments in the U.S. that are responsible for creating 21 million American jobs and generating \$2.3 trillion in economic output. In Washington alone there are 18,741 franchised small businesses employing 203,000 workers, providing an annual economic output to the state of \$16.8 billion.

The economic nexus provisions laid out by HB 3176 are of great concern to the franchise industry because of the business relationship between a franchisor and its franchisees. Central to that relationship is a shared brand identity, which is established and maintained by the franchisor's license of its trademark, trade dress and other intellectual property (*i.e.*, intangible property) to each of its franchisees. Thus, each of the hundreds of thousands of franchise relationships that exist in this country involves a license of intangible property, and the great majority of those licenses cross state lines.

The economic nexus standard represents a radical departure from the historical understanding of the reach of taxing authorities and a significant increase in the tax liability and burden of compliance of thousands of Washington small businesses. If every state where a franchisor has granted franchises is permitted to tax its income attributable to that state, franchisors will be subject to costly compliance burdens and overlapping taxes; and many no doubt will be forced to consider passing this cost of business on to their Washington franchisees by increasing the royalty fee. Under this scenario the party most harmed is the resident franchisee.

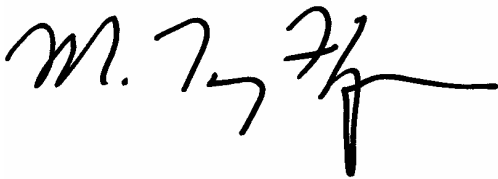
The franchise relationship evolved over the last half century with the understanding that the franchisor is not subject to state income taxes (other than those imposed by the franchisor's domicile state) on the royalty income paid to the franchisor by franchisees located in a different state. Most franchisors own no property in the state in which their franchisees operate, do not maintain offices there and employ no residents of those states. A franchisor's employees may make occasional visits to its franchisee's place of business to assist the franchisee in opening his or her business and to inspect the franchisee's performance and furnish training advice and

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guidance, but the duration of such visits normally is limited to a few hours or days. The services that a franchisor furnishes to its franchisees, and communication among a franchisor and its franchisees, are implemented almost entirely at the franchisor's principal offices and through interstate communications media. Most franchisors do not rely on the states of their franchisees' domicile for any services and impose no costs on those states.

Unless the traditional interpretation of the tax code is adhered to, changes such as the economic nexus standard of HB 3176 will impose high compliance costs on companies forced to operate in an environment in which their state tax liabilities are unclear. Again, the IFA urges the committee to reject this effort to establish an economic nexus standard as it will cause significant harm to small franchised businesses within the state as well as non-resident companies that do not benefit from your state's services and infrastructure.

Sincerely,

A handwritten signature in black ink, appearing to read "M. Troy Flanagan". The signature is stylized and cursive, with a long horizontal stroke at the end.

M. Troy Flanagan
Director, Government Relations

cc: Members of the House Committee on Finance