South Dakota
Department of Revenue
445 East Capitol Avenue
Pierre, South Dakota 57501 - 3185

Franchise Operations

March 2011

This Tax Facts is designed to explain how sales and use tax applies to franchise operations. If this Tax Facts does not answer your specific question, please call the Department's toll-free Helpline at 1-800-TAX-9188 between 8:00 AM – 5:00 PM CST, Monday through Friday.

Information found in this document rescinds and replaces all previous written information on this subject. All readers and users of this publication are responsible for keeping informed about changes in tax laws and regulations by reading the Department of Revenue newsletters, press releases, Tax Facts, and other documents published by the Department of Revenue.

South Dakota's 4% sales tax applies to the sale of most services and tangible personal property. Sales tax applies to the sale of services provided by franchisers to franchisees and to the sale of equipment and supplies used in the operation of the franchisee's business.

Royalty fees

Royalties or service fees paid by a franchisee strictly for the privilege of engaging in business using the franchiser's name are not subject to sales or use tax. However, royalty fees are taxable if the franchiser provides services or tangible personal property with the payment of the royalty fee. When taxable sales are included within the royalty fee, and not separately stated, the entire royalty payment is subject to South Dakota sales or use tax. Examples of taxable items that may be included with the royalty fee are training, accounting, and software.

Taxable Products and Services

The following is a list of items and services sold by a franchiser to a franchisee that are subject to sales or use tax (this list is not inclusive):

- Accounting services
- Architectural services
- Camera ready advertising
- Computers
- Consulting services
- Customer service fees
- Equipment
- Franchise fee (if any service or property included)
- Furniture
- Initial fee (if any service or property included)
- Inspection services
- Instructional materials
- Management fee
- Menus
- On-line help services
- Operations manuals
- Point of sale advertising materials
- Promotional materials
- Renewal fee (if any service or property included)
- Reservation system services
- Royalty fee (if any service or property included)
- Site location services
- Software
- Tableware
- Third party reservation fees
- Training - On site

The following items are exempt from sales or use tax when sold by a franchiser to a franchisee:

- Advertising which is prepared and placed in the media (TV, Radio)
- Items which are sold in the regular course of the franchisee's business
- Royalty fees if no services or property are included
- Travel agency fees that are passed directly to the franchisee with no markup.

Franchisee Use Tax Liability

If sales tax is not charged by the franchiser on taxable services or on taxable tangible personal property, the franchisee owes 4% state use tax, plus applicable municipal tax. If services are provided and the charges for those services are not separately stated from the franchise fee, the entire franchise fee is subject to use tax. The franchisee should contact the franchiser and request the franchiser collect sales tax and itemize the charges for any taxable products.

Advertising

Under South Dakota law, an advertising service is the preparation of an advertisement and the placement of the advertisement in the media. Advertising which is prepared and placed in the media is exempt. If the advertising fee charged by the franchiser to the franchisee is for a national or local media campaign, the advertising fee is exempt from sales or use tax. If the advertising fee contains charges for advertising in the media, and also for non-media advertising, only the portion of the fee directly attributable to the non-media advertising is taxable. If the fee is not divided by type of advertising service provided, the entire fee is subject to sales tax. Advertisements, brochures, and promotional materials received from the franchiser are taxable.

Recordings

Recordings of music and advertisements are subject to sales tax. Telephone messages are not media. In order for advertising services to be exempt, the charge must include preparation of the advertisement and placement in the media.

Talk to Us!

If you have a tax problem or question, call the South Dakota Department of Revenue toll-free at 1-800-TAX-9188. Visit us on the web at www.state.sd.us/drr, email us at bustax@state.sd.us or write us:

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