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## REVENUE ADMINISTRATIVE BULLETIN 2008-4

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### MICHIGAN BUSINESS TAX NEXUS STANDARDS

Pursuant to MCL 205.6a, a taxpayer may rely on a Revenue Administrative Bulletin issued by the Department of Treasury after September 30, 2006, and shall not be penalized for that reliance until the bulletin is revoked in writing. However, reliance by the taxpayer is limited to issues addressed in the bulletin for tax periods up to the effective date of an amendment to the law upon which the bulletin is based or for tax periods up to the date of a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted or have expired that overrules or modifies the law upon which the bulletin is based.

#### **RAB 2008-4**

The Michigan Business Tax ("MBT") is comprised of four components: a business income tax, a modified gross receipts tax, a gross direct premiums tax, and a franchise tax. The gross direct premiums tax and franchise tax apply only to insurance companies and financial institutions respectively.

Persons have nexus with Michigan and are subject to the MBT if "the taxpayer has a physical presence in this state for a period of more than 1 day during the tax year or if the taxpayer actively solicits sales in this state and has gross receipts of \$350,000 or more sourced to this state."<sup>1</sup> In other words, there are two alternative nexus standards under the MBT. First, a person has nexus with the state if that person has *physical presence* in the state for more than one day during the tax year. Alternatively, a person has nexus with the state if the person *actively solicits sales in this state and has Michigan gross receipts of \$350,000 or more*.

In addition, the business income tax is levied on taxpayers with Michigan business activity "unless prohibited by 15 USC 381 to 384."<sup>2</sup> 15 USC 381 to 384, more commonly known as PL 86-272, is a federal law that prohibits Michigan from imposing a business income tax if the only in-state business activity of the out-of-state person is the solicitation of orders for sales of tangible personal property where the orders are sent outside the state for approval or rejection and are filled by shipment or delivery from a point outside the state.<sup>3</sup> A person whose activities

<sup>1</sup> MCL 208.1200(1).

<sup>2</sup> MCL 208.1201.

<sup>3</sup> 15 USC 381 *et seq.*

are limited to those protected by PL 86-272 is not subject to the business income tax portion of the MBT. However, such a person otherwise having sufficient nexus with Michigan will be subject to the modified gross receipts tax portion of the MBT.

"Actively solicits" was defined by the Department of Treasury (the "Department") in RAB 2007-6.

## **ISSUES**

- I. What is the jurisdictional standard to determine whether a taxpayer is subject to Michigan's MBT jurisdiction?
- II. How does PL 86-272 operate under the MBT?
- III. Are there *de minimis* contacts with Michigan that do not establish nexus?
- IV. What is the jurisdictional standard to determine whether a taxpayer is taxable in another state for purposes of apportionment under the MBT?
- V. When is this RAB effective?
- VI. What time periods are covered once nexus is established?
- VII. How is nexus determined for Unitary Business Groups?
- VIII. When will a taxpayer with nexus with Michigan be required to file an MBT return?

## **CONCLUSIONS**

### **I. JURISDICTIONAL STANDARDS**

Under the MBT, a taxpayer has substantial nexus with Michigan and is subject to the MBT if "the taxpayer has a physical presence in this state for a period of more than 1 day during the tax year *or* if the taxpayer actively solicits sales in this state and has gross receipts of \$350,000 or more sourced to this state."<sup>4</sup>

In other words, there are two alternative nexus standards under the MBT. First, a person may have nexus with the state if that person has physical presence in the state for more than one day during the tax year. Or, a person may have nexus with the state if the person actively solicits sales in this state and has Michigan gross receipts of \$350,000 or more. Both alternative nexus standards apply to all components of the MBT.

Taxpayers that fall under the protections of PL 86-272 are not subject to the business income tax component of the MBT. However, even taxpayers protected by PL 86-272 may still be subject to the modified gross receipts tax. Furthermore, PL 86-272 is a "safe harbor" and not an exclusion; any activity conducted by a taxpayer outside the protection of PL 86-272 will cause

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<sup>4</sup> MCL 208.1200(1) (emphasis added).

that taxpayer to lose the protection otherwise provided. Income from protected activities are not excluded or deducted from the tax base.

**A. Physical Presence Nexus Standard**

A taxpayer has nexus with Michigan for MBT purposes if that taxpayer "has a physical presence in this state for a period of more than 1 day during the tax year."<sup>5</sup> "Physical presence" means:

any activity conducted by the taxpayer or on behalf of the taxpayer by the taxpayer's employee, agent, or independent contractor acting in a representative capacity. Physical presence does not include the activities of professionals providing services in a professional capacity or other service providers if the activity is not significantly associated with the taxpayer's ability to establish and maintain a market in this state.<sup>6</sup>

Physical presence is determined on a facts and circumstances basis. A taxpayer will have physical presence in Michigan and be subject to the MBT when – for a period of 2 or more days in a tax year – the taxpayer or on behalf of the taxpayer its employees, agents, or independent contractors acting in a representative capacity:

1. Conducts business activity in Michigan. In-state business activity includes, but is not limited to:
  - a. Performing services.
  - b. Selling, renting, or leasing property, whether real, personal, or mixed, tangible or intangible.
  - c. Soliciting sales.
  - d. Making repairs, doing warranty work, or providing maintenance or service to property sold or to be sold.
  - e. Collecting current or delinquent accounts related to sales of tangible personal property through assignment or otherwise.
  - f. Installing or supervising installation at or after shipment or delivery.
  - g. Conducting training, seminars, or similar events for employees, agents, representatives, independent contractors, brokers or others acting on its behalf, or for customers or potential customers.
  - h. Providing customers any kind of technical assistance or service including, but not limited to, engineering assistance, design service, quality control, product inspections, or similar services.

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<sup>5</sup> MCL 208.1200.

<sup>6</sup> MCL 208.1200.

- i. Investigating, handling, or otherwise assisting in resolving customer complaints.
  - j. Providing consulting services.
  - k. Soliciting, negotiating, or entering into franchising, licensing, or similar agreements.
2. Owns, rents, leases, maintains, or has the right to use and uses tangible personal or real property permanently or temporarily located in Michigan, including offices or other establishments.
3. Delivers goods to Michigan in vehicles it owns, rents, leases, uses, or maintains.
4. If the taxpayer's only activities in Michigan are strictly limited to the activities listed below for less than 10 days, such activity will not constitute physical presence resulting in nexus. To the extent that any activity listed below is identified elsewhere in this RAB or RAB 2007-6 as establishing nexus, then the activity shall establish nexus. Conducting any of the activities listed below for 10 days or more will not necessarily constitute physical presence resulting in nexus. In that case, whether nexus has been established will depend on the facts and circumstances of the in-state activity.
  - a. Meeting with in-state suppliers of goods or services.
  - b. In-state meeting with government representatives in their official capacity.
  - c. Attending occasional meetings (e.g., board meetings, retreats, seminars and conferences sponsored by others, etc.).
  - d. Holding recruiting or hiring events.
  - e. Advertising in the state through various media.
  - f. Renting to or from an in-state entity customer list.
  - g. Attending and/or participating at a trade show at which no sales are solicited or made.

Additionally, physical presence does not include "the activities of professionals providing services in a professional capacity or other service providers if the activity is not significantly associated with the taxpayer's ability to establish and maintain a market in this state."<sup>7</sup> In other words, lawyers, accountants, investment bankers, and other similar professionals that are not employees of the out-of-state taxpayer who perform services in Michigan in their professional capacity for that out-of-state taxpayer shall not be considered to be conducting business activity in Michigan on behalf of the out-of-state taxpayer so long as those services are not intended to establish or maintain a market on behalf of the taxpayer. Similarly, other service providers that are not employees of the out-of-state taxpayer that perform services in Michigan for an out-of-

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<sup>7</sup> MCL 208.1200(3).

state taxpayer shall not be considered to be conducting business activity in Michigan on behalf of the taxpayer so long as those services are not intended to establish or maintain a market for the taxpayer.

Corporations incorporated – or entities or persons organized – within the state have physical presence in Michigan.

Finally, physical presence exists for one day when physical presence is established for any portion of a day. Physical presence of more than one day is established when the presence of the taxpayer or its employees, agents, or independent contractors extends beyond a single day or occurs in more than one day. For example, an out-of-state taxpayer that drives into Michigan to perform repair services for two hours on March 1 does not have physical presence in Michigan for more than one day. If that same taxpayer returns to Michigan on March 2 – or any other day within the tax year – to complete the repair job, then the taxpayer will have physical presence in Michigan for two or more days and will have nexus under the physical presence nexus standard.

#### **B. Active Solicitation w/ Substantial Michigan Gross Receipts Nexus Standard**

A taxpayer has nexus with Michigan and is subject to the MBT if "the taxpayer actively solicits sales in this state and has gross receipts of \$350,000 or more sourced to this state."<sup>8</sup>

Under RAB 2007-6, and pursuant to MCL 208.1200(2), "actively solicits" means purposeful solicitation of persons within this state. Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order. Solicitation is purposeful when it is directed at or intended to reach persons within Michigan or the Michigan market.

Active solicitation includes, but is not limited to, solicitation through (1) the use of mail, telephone, and e-mail; (2) advertising, including print, radio, internet, television, and other media; and (3) maintenance of an internet site over or through which sales transactions occur with persons within Michigan.

Examples of active solicitation include sending mail order catalogs; sending credit applications; maintaining an internet site offering online shopping, services, or subscriptions; and soliciting through media advertising, including internet advertisements. In evaluating whether acts of solicitation are sufficient to establish "active solicitation," the Department looks to the quality, nature, and magnitude of the activity on a facts and circumstances basis.

Active solicitation, coupled with \$350,000 in Michigan gross receipts, constitutes nexus under the MBT.

## **II. PL 86-272**

Generally, PL 86-272 restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property, which orders are to be sent outside the state for acceptance or rejection, and, if accepted, are filled by shipment or

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<sup>8</sup> MCL 208.1200(1).

delivery from a point outside the state. The term "net income tax" includes the business income tax component of the MBT, but does not include the modified gross receipts, gross direct premiums, or franchise tax portions of the MBT. In other words, even if a taxpayer has nexus with Michigan, that taxpayer may be protected from the imposition of the business income tax under PL 86-272, but still be subject to the modified gross receipts tax.

**A. Tangible Personal Property**

Only the solicitation to sell *tangible personal property* is afforded immunity under PL 86-272; therefore, the leasing, renting, licensing or other disposition of tangible personal property, or transactions involving intangibles, such as franchises, patents, copyrights, trademarks, service marks and the like, or any other type of property are not protected activities under PL 86-272. The solicitation, sale, or performance of any type of service is also not protected under PL 86-272 unless ancillary to solicitation or otherwise protected under this RAB.

**B. Solicitation and Activities Ancillary to Solicitation**

For the in-state activity to be a protected activity under PL 86-272, it must be limited solely to solicitation (except for *de minimis* activities described below). "Solicitation" means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order.

Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders. Activities that a seller would engage in apart from soliciting orders shall not be considered as ancillary to the solicitation of orders. The mere assignment of activities to sales personnel does not, merely by such assignment, make such activities ancillary to solicitation of orders. Additionally, activities that seek to promote sales are not ancillary, because PL 86-272 does not protect activity that facilitates sales; it only protects ancillary activities that facilitate the request for an order. For example:

Providing a car and a stock of free samples to salesmen is part of the "solicitation of orders," because the only reason to do it is to facilitate requests for purchases. Contrariwise, employing salesmen to repair or service the company's products is not part of the "solicitation of orders," since there is good reason to get that done whether or not the company has a sales force. Repair and servicing may help to increase purchases; but it is not ancillary to requesting purchases, and cannot be converted into "solicitation" by merely being assigned to salesmen.<sup>9</sup>

The conducting of activities not falling within the foregoing definition of solicitation will cause the company to lose its protection from the business income tax afforded by PL 86-272, unless the disqualifying activities are either *de minimis* or are otherwise permitted under this RAB.

**C. Unprotected Activities**

The following in-state activities are not considered to be solicitation of orders or ancillary thereto or otherwise protected under PL 86-272 and will cause otherwise protected sales to lose their

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<sup>9</sup> *Wisconsin Dep't of Revenue v William Wrigley, Jr, Co*, 505 US 214 (1992) (internal citation omitted).

protection under the PL 86-272, and will cause the taxpayer to be subject to the business income component of the MBT:

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
3. Investigating credit worthiness.
4. Installation or supervision of installation at or after shipment or delivery.
5. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation.
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.
7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.
8. Approving or accepting orders.
9. Repossessing property.
10. Securing deposits on sales.
11. Picking up or replacing damaged or returned property.
12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation.
13. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.
14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the state during the tax year.
15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.
16. Owning, leasing, using or maintaining any of the following facilities or property in-state:
  - a. Repair shop.
  - b. Parts department.

- c. Any kind of office other than an in-home office as described as permitted under sections II.C.18 or II.D.2 below.
- d. Warehouse.
- e. Meeting place for directors, officers, or employees.
- f. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
- g. Telephone answering service that is publicly attributed to the company or to employees or agent(s) of the company in their representative status.
- h. Mobile stores, *i.e.*, vehicles with drivers who are sales personnel making sales from the vehicles.
- i. Real property or fixtures to real property of any kind.

17. Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.

18. Maintaining, by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under PL 86-272 or this RAB). A telephone listing or other public listing within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity. However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the company shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or its employee or representative. The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this Statement. For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.

19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee within the state.

20. Conducting any activity not listed in the Protected Activities list below which is not entirely ancillary to requests for orders, even if such activity helps to increase sales.

**D. Protected Activities**

The following in-state activities will not cause the loss of protection for otherwise protected sales:



1. Soliciting orders for sales by any type of advertising.
2. Soliciting orders by an in-state resident employee or representative of the company, so long as such person does not maintain or use any office or other place of business in the state other than an "in-home" office as described in section II.C.18 above.
3. Carrying samples and promotional materials only for display or distribution without charge or other consideration.
4. Furnishing and setting up display racks and advising customers on the display of the company's products without charge or other consideration.
5. Providing automobiles to sales personnel for their use in conducting protected activities.
6. Passing orders, inquiries and complaints on to the home office.
7. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise immune.
8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.
9. Checking of customers' inventories without a charge therefor (for re-order, but not for other purposes such as quality control).
10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within the state during the tax year.
11. Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.
12. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.
13. Shipping or delivering goods into this state by means of private vehicle, rail, water, air or other carrier, irrespective of whether a shipment or delivery fee or other charge is imposed, directly or indirectly, upon the purchaser.
14. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software that is limited to the carrying on of protected solicitation and activity entirely

ancillary to such solicitation or permitted by this RAB under the Protected Activities list shall not, by itself, remove the protection under this RAB.

**E. Independent Contractors**

PL 86-272 provides protection to certain in-state activities if conducted by an independent contractor that would not be afforded protection if performed by the business or its employees or agents. Independent contractors may engage in the following limited activities in the state without the company's loss of immunity:

1. Soliciting sales.
2. Making sales.
3. Maintaining an office.

Sales representatives who represent a single principal are not considered to be independent contractors and are subject to the same limitations as those provided under PL 86-272 and this RAB. Maintenance of a stock of goods in the state by the independent contractor under consignment or any other type of arrangement with the company, except for purposes of display and solicitation, shall remove the protection.

**F. Foreign Commerce**

PL 86-272 applies, by its terms, to "interstate commerce" and does not directly apply to foreign commerce. The Department, however, shall apply the same standards set forth in the PL 86-272 and in this RAB to business activities in foreign commerce to ensure that foreign and interstate commerce are treated on the same basis. Such an application also avoids the necessity of expensive and difficult efforts in the identification and application of the varied jurisdictional laws and rules existing in foreign countries.

**G. Incorporation or Domicile**

The protection afforded by PL 86-272 and the provisions of this RAB do not apply to any person incorporated or organized within this state or to any individual who is a resident of or domiciled in this state.

**H. Duration**

The protection afforded under PL 86-272 and the provisions of this RAB shall be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the company conducts activities that are not protected under PL 86-272 or this RAB, no sales in this state or income earned by the company attributed to this state during any part of said tax year shall be protected from taxation under PL 86-272 or this RAB.

**III. De Minimis Activities**

*De minimis* activities are those that, when taken together, establish only a trivial connection with Michigan or the taxing state and do not establish nexus.<sup>10</sup> An activity conducted within Michigan on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether or not an activity consists of a trivial or non-trivial connection with the state is to be measured on both a qualitative and quantitative basis.

For purposes of PL 86-272, if an activity either qualitatively or quantitatively creates a non-trivial connection with the taxing state, then such activity exceeds the protection of PL 86- 272. Establishing that the disqualifying activities only account for a relatively small part of the business conducted within the taxing state is not determinative of whether a *de minimis* level of activity exists. The relative economic importance of the disqualifying in-state activities, as compared to the protected activities, does not determine whether the conduct of the disqualifying activities within the taxing state is inconsistent with the limited protection afforded by PL 86-272.

For purposes of the physical presence nexus standard under MCL 208.1200 and further described under section I.A. of this RAB, the Department determines that *de minimis* activities that establish only a trivial connection with Michigan are limited to the following activities conducted in Michigan for less than 10 days:

1. Meeting with in-state suppliers of goods or services.
2. In-state meeting with government representatives in their official capacity.
3. Attending occasional meetings (e.g., board meetings, retreats, seminars and conferences sponsored by others, etc.).
4. Holding recruiting or hiring events.
5. Advertising in the state through various media.
6. Renting to or from an in-state entity customer list.
7. Attending and/or participating at a trade show at which no sales are solicited or made.

Whether any of these activities conducted for 10 days or more establish nexus will depend on the facts and circumstances of the in-state activity.

#### **IV. What is the jurisdictional standard to determine whether a taxpayer is taxable in another state for purposes of apportionment under the MBT?**

The same standards used to determine nexus for out-of-state taxpayers, as described in sections I, II, and III above, will be applied to determine whether a taxpayer is taxable in another state for purposes of apportionment under the MBT. For purposes of apportionment, the Department may

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<sup>10</sup> See *Wrigley*, 505 US 214; *Quill Corp v North Dakota*, 504 US 298 (1992).

require taxpayers to document nexus in other states, which will be subject to verification by the Department.

**V. When is this RAB effective?**

This RAB and the nexus standards described herein are effective January 1, 2008.

**VI. What time periods are covered once nexus is established?**

Once nexus is established by a taxpayer during a tax year for MBT purpose, nexus shall exist for that taxpayer for the entire tax year.

**VII. Unitary Business Groups**

A taxpayer under the MBT includes a unitary business group.<sup>11</sup> A unitary business group is comprised of two or more U.S. persons.<sup>12</sup> So long as one member of a unitary business group has nexus with Michigan, all members of the unitary business group must be included when calculating the taxpayer's business income and modified gross receipts tax bases and apportionment formula. Furthermore, so long as one member of a unitary business group has nexus with Michigan and exceeds the protections of PL 86-272, all members of the unitary business group – including members protected under PL 86-272 – must be included when calculating the taxpayer's business income tax base and apportionment formula.

**VIII. When will a taxpayer with nexus with Michigan be required to file an MBT return?**

Taxpayers, other than insurance companies or financial institutions taxed under chapters 2A or 2B of the MBT, must file an MBT return if the taxpayer's apportioned or allocated gross receipts equal or exceed \$350,000.<sup>13</sup>

**LAW AND ANALYSIS**

**Introduction.** The MBT is comprised of four components: a business income tax, a modified gross receipts tax, a gross direct premiums tax, and a franchise tax. The gross direct premiums tax and franchise tax apply only to insurance companies and financial institutions respectively. Unless stated otherwise in the Michigan Business Tax Act, a person has nexus with the State of Michigan and is subject to the MBT if "the taxpayer has a physical presence in this state for a period of more than 1 day during the tax year or if the taxpayer actively solicits sales in this state and has gross receipts of \$350,000 or more sourced to this state."<sup>14</sup>

In other words, there are two alternative nexus standards under the MBT. That is, a person may have nexus with this state if that person has physical presence in this state for more than one day during the tax year. Or, a person may have nexus with this state if the person actively solicits sales in this state and has Michigan gross receipts of \$350,000 or more. For certain taxpayers, PL 86-272 may preclude the imposition of the business income tax notwithstanding nexus.

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<sup>11</sup> MCL 208.1117(5).

<sup>12</sup> MCL 208.1117(6).

<sup>13</sup> MCL 208.1505.

<sup>14</sup> MCL 208.1200(1).

**Constitutional Standards.** The Due Process<sup>15</sup> and Commerce<sup>16</sup> Clauses of the U.S. Constitution define U.S. constitutional limitations on state jurisdiction to tax. The nexus requirement of both clauses must be satisfied before an out-of-state person may be subject to the taxing jurisdiction of a State.

Due Process nexus is satisfied when a person has either economic or physical presence in the taxing state.<sup>17</sup> Economic presence is satisfied when a person purposefully avails itself of the benefits of an economic market in the forum state irrespective of that person's lack of physical presence in the taxing state.<sup>18</sup>

A state tax satisfies the Commerce Clause if it meets the following four requirements: (1) the tax is applied to an activity with a substantial nexus with the taxing state; (2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to services provided by the state.<sup>19</sup>

The U.S. Supreme Court most recently addressed the substantial nexus requirement under the Commerce Clause in *Quill*. In that case, the Court held that substantial nexus for use tax collection is a bright line physical presence test. *Quill* reaffirmed the twenty-five year old holding in *National Bellas Hess, Inc v Illinois*<sup>20</sup> that those persons whose contacts with a state do not exceed U.S. mail or common carrier do not have substantial nexus and cannot be required to collect use taxes. Under *Quill*, nexus for sales and use tax purposes "may turn on the presence in the taxing State of a small sales force, plant, or office."<sup>21</sup>

However, the U.S. Supreme Court has never decided whether the bright line physical presence test required for sales and use taxes by *Quill* applies to other taxes. The Court reaffirmed the "bright line" physical presence test of *National Bellas Hess* based on the reliance interest of taxpayers and because it was a long-standing rule. Moreover, the Court noted that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today."<sup>22</sup> The Court also stated that it had never, in its review "of other types of taxes," required physical presence. In other words, although *Quill* upheld the bright line physical presence test for sales and use tax purposes, the Court clearly implied that *Quill* applies only to sales and use taxes and not to other types of state taxes, such as the MBT.

There is no question that when a person has physical presence in this State, substantial nexus under the Commerce Clause exists for imposition of the MBT. In fact, the Michigan Court of Appeals in *Rayovac Corp v Dep't of Treasury*<sup>23</sup> concluded that the bright-line physical presence test of *Quill* should be implemented "by not giving any consideration to the substantiality of the physical presence of the sales force and, instead, finding that the presence of any sales force at all provides more than a slightest presence in a state, so that the substantial nexus will be

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<sup>15</sup> US Const, Am XIV, §1.

<sup>16</sup> US Const, art I, §8.

<sup>17</sup> See *Quill*, 504 US 298.

<sup>18</sup> *Quill*, 504 US 298; *Burger King Corp v Rudzewicz*, 471 US 462 (1985).

<sup>19</sup> *Complete Auto Transit, Inc v Brady*, 430 US 274 (1977).

<sup>20</sup> 386 US 753 (1967).

<sup>21</sup> *Quill*, 504 US 311, 315.

<sup>22</sup> *Quill*, 504 US 311, 314.

<sup>23</sup> 264 Mich App 441 (2005).

found."<sup>24</sup> Under the MBT, physical presence for two or more days establishes substantial nexus under the Commerce Clause.

In addition, a number of other states that have considered *Quill's* bright line physical presence test have rejected its application to taxes other than sales and use taxes.<sup>25</sup> In accordance with the decisions of those states, the Department concludes that *MBNA* best summarizes the current state of Commerce Clause jurisprudence:

we believe that the *Bellas Hess* physical-presence test, articulated in 1967, makes little sense in today's world. In the previous almost forty years, business practices have changed dramatically. When *Bellas Hess* was decided, it was generally necessary that an entity have a physical presence of some sort, such as a warehouse, office, or salesperson, in a state in order to generate substantial business in that state. This is no longer true. The development and proliferation of communication technology exhibited, for example, by the growth of electronic commerce now makes it possible for an entity to have a significant economic presence in a state absent any physical presence there. For this reason, we believe that the mechanical application of a physical-presence standard to [taxes other than sales and use taxes] is a poor measuring stick of an entity's true nexus with a state.<sup>26</sup>

The MBT adopts an economic presence standard – in addition to the physical presence standard discussed above – codified as active solicitation coupled with \$350,000 of Michigan gross receipts. Whether substantial economic presence is established depends on the quality and quantity of the taxpayer's contacts with the taxing state and the degree to which the taxpayer exploits the market.<sup>27</sup> Active solicitation coupled with \$350,000 in gross receipts sourced to Michigan constitutes substantial economic presence. This conclusion is consistent with the facts and holding of *MBNA*, which held that the taxpayer in that case engaged in substantial "direct mail and telephone solicitation and promotion in West Virginia" and had "significant gross receipts attributed to West Virginia customers," thereby establishing a "significant economic presence sufficient to meet the substantial nexus prong of *Complete Auto*."<sup>28</sup>

**Public Law 86-272.** Enacted under the Commerce Clause, PL 86-272 restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property, which orders are to be sent outside the state for acceptance or rejection, and, if accepted, are filled by shipment or delivery from a point outside the state. The term "net income tax" includes the business income tax component of the MBT, but does not

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<sup>24</sup> *Rayovac*, 264 Mich App 441, 445-446 (internal quotations omitted). *Rayovac* analyzed nexus under the Single Business Tax using *Quill's* bright-line physical presence standard as precedent. However, the nexus standards under the MBT clearly reject *Quill* as the definitive nexus standard by adopting an economic presence nexus standard. Thus, while *Rayovac* is no longer binding precedent with respect to nexus under the MBT, it is still informative with respect to what constitutes physical presence.

<sup>25</sup> See, e.g., *MBNA America Bank v Tax Comm'r of West Virginia*, 640 SE2d 226 (W Va S Ct, 2006), *cert den FIA Card Services v Tax Comm'r of West Virginia*, 127 S Ct 2997 (2007); *Lanco, Inc v Director, New Jersey Div of Taxation*, 879 A2d 1234 (NJ Super Ct App Div, 2005), *cert den* 127 S Ct 2974 (2007); *A&F Trademark, Inc v North Carolina*, 605 SE2d 187 (NC Ct App, 2004), *cert den* 546 US 821 (2005).

<sup>26</sup> *MBNA*, 640 SE2d 226, 234.

<sup>27</sup> *MBNA*, 640 SE2d at 235.

<sup>28</sup> *MBNA*, 640 SE2d at 235-236.

include the modified gross receipts, gross direct premiums, or franchise tax portions of the MBT. In other words, while a taxpayer may be protected from the imposition of the business income tax due to PL 86-272, that taxpayer may be subject to the modified gross receipts tax.

The Department shall impose the business income tax in accordance with the MBT and subject to the protection offered by PL 86-272. Interpretation of the solicitation of orders standard in PL 86-272 requires a determination of the fair meaning of "solicitation." The U.S. Supreme Court has established a standard for interpreting the term "solicitation" and the Department and this RAB conforms to such standard.<sup>29</sup> In those cases where there are reasonable differences of opinion as to whether the disputed activity exceeds what is protected by PL 86-272, the Department will apply the principle that the preemption of state taxation – as required by PL 86-272 – will be limited to those activities that fall within the "clear and manifest purpose of Congress."<sup>30</sup>

### **EXAMPLES**

Activities conducted by the taxpayer are limited to those described in the examples. While this RAB may indicate that nexus exists, MBT liability may nonetheless be absent due the filing threshold, application of various credits, etc.

1. A retailer located outside Michigan maintains an internet site over and through which customers may browse widgets and place orders. The internet site is generally available to all persons throughout the country. Through maintenance of the interactive site, the retailer intends to reach all persons and markets, including persons within Michigan and the Michigan market. Retailer has gross receipts sourced to Michigan of \$300,000. Widgets are shipped to Michigan customers via common carrier.

- The retailer does not have physical presence in Michigan. The retailer is actively soliciting sales in Michigan, but does not have \$350,000 or more of Michigan gross receipts. The retailer does not have nexus with Michigan.

2. Same facts as in #1 above, but the retailer has \$400,000 of Michigan gross receipts.

- The retailer does not have physical presence in Michigan. The retailer is actively soliciting sales in Michigan and has \$350,000 or more of Michigan gross receipts. The retailer has nexus with Michigan. However, the solicitation activities here are protected under PL 86-272. Thus, the retailer will be subject to only the modified gross receipts tax component of the MBT.

3. A retailer located outside Michigan solicits sales of flags in Michigan through nonresident employees and independent contractors. Flag orders are sent to the retailer's home state for acceptance and are filled by delivery via common carrier from outside Michigan. Retailer has \$350,000 or more of Michigan gross receipts.

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<sup>29</sup> *Wrigley*, 505 US 214; RAB 2007-6.

<sup>30</sup> See *Dep't of Revenue of Oregon v ACF Industries, Inc*, 510 US 332 (1994); *Cipollone v Liggett Group, Inc*, 505 US 504 (1992); *Heublein, Inc v South Carolina Tax Com*, 409 US 275, 281-282 (1972).

- Retailer has physical presence. The retailer is also actively soliciting sales in Michigan and has \$350,000 or more of Michigan gross receipts. The retailer has nexus with Michigan under both standards. However, the solicitation activities here are protected under PL 86-272. Thus, the Department is prohibited from subjecting the retailer to the business income tax.
4. Same facts as in #3 above, except the retailer also solicits sales of a flag-ironing service.
- Retailer has physical presence in Michigan. The retailer is also actively soliciting sales in Michigan and has \$350,000 or more of Michigan gross receipts. The retailer has nexus with Michigan under both standards. PL 86-272 does not apply in this case since the retailer is soliciting sales of services and not strictly tangible personal property.
5. LLC owns an interest in a condominium used on occasion by executives and employees of the company for recreational purposes. LLC owns, rents, leases, maintains, or has the right to use and uses tangible personal or real property located in Michigan.
- LLC has physical presence in Michigan. LLC has nexus with Michigan.
6. Corporations X, Y, and Z form a unitary business group. Corporation X has nexus with Michigan.
- The unitary business group of Corporations X, Y, and Z must file a combined MBT return as a single taxpayer.
7. An employee of Corporation M located outside Michigan flies from New York to Seattle and back with a layover in Detroit both ways. The employee conducts no activity on behalf of the Corporation M in Michigan and is not acting in a representative capacity.
- Corporation M does not have physical presence in Michigan. Corporation M does not have nexus with Michigan.
8. Corporation A, located outside Michigan, contracts with a common carrier to pick up a shipment of miniature collectibles from a Michigan supplier for delivery to Corporation A's warehouse. Corporation A also retains an attorney to defend a lawsuit filed against it in a Michigan court. Although the attorney and common carrier are conducting activity in Michigan on behalf of Corporation A, such activity is not significantly associated with Corporation A's ability to establish and maintain a market in this state.
- Corporation A does not have physical presence in Michigan. The common carrier and attorney do have physical presence in Michigan provided such presence is for two or more days. Corporation A does not have nexus with Michigan.
9. A manufacturer located outside Michigan sends a small team of officers and employees into Michigan to meet with potential suppliers. The officers and employees are in Michigan for 6 days and conduct no other activity in the state.



- Meeting with suppliers without conducting any other activity in the state is a *de minimis* activity that establishes only a trivial connection with Michigan. Manufacturer does not have nexus with Michigan.

10. Same facts as in #9 above, except employees of the manufacturer also spend 2 days providing limited consulting services to one of the potential suppliers.

- The consulting services provided by the manufacturer constitute physical presence in Michigan. Consulting services are not included in the *de minimis* activities identified in section I.A.4. of this RAB. Manufacturer has nexus with Michigan.