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SINGLE BUSINESS TAX NEXUS STANDARDS

(Replaces Revenue Administrative Bulletin 1989-46)

RAB 98 - 1. This Revenue Administrative Bulletin (RAB) describes the jurisdictional standard to determine whether a taxpayer is subject to tax under Michigan's Single Business Tax or is subject to tax in another state for purposes of apportionment under the Single Business Tax Act. This RAB supersedes RAB 1989-46. See page 3.

The limitations and extent of this State's jurisdiction to impose tax is an evolving area and this RAB is not intended to be an all encompassing or all inclusive description of this subject. This RAB may be modified by changes in either federal or state laws or by decisions of the U.S. Supreme Court, the Michigan Supreme Court, or the Michigan Court of Appeals. It may also be modified and reissued to incorporate nexus guidelines that may be published from time-to-time by agencies such as the Multistate Tax Commission or to clarify the Department's position. Where no conflict exists between this RAB and previously published positions taken by the Department, those positions, as they relate to nexus, will remain in effect.

ISSUES

- I. What is the jurisdictional standard to determine whether a taxpayer is subject to Michigan's single business tax jurisdiction?
- II. What is the jurisdictional standard to determine whether a taxpayer is taxable in another state for purposes of apportionment under the single business tax?
- III. When is this RAB effective?
- IV. What time periods are covered once nexus is established?
- V. When will a taxpayer subject to Michigan's taxing jurisdiction be required to file a single business tax return?

CONCLUSIONS

- I. An out-of-state business is subject to Michigan's single business tax jurisdiction when it engages in any of the following activities:
 - 1) It has one or more Michigan resident employees conducting business activity in Michigan.
 - 2) It owns, rents, leases, maintains, or has the right to use and uses tangible personal or real property that is permanently or temporarily physically located in Michigan.
 - 3) Its employees own, rent, lease, use, or maintain an office or other establishment in Michigan.
 - 4) Its agents, representatives, independent contractors, brokers or others, acting on its behalf, own, rent, lease, use or maintain an office or other establishment in Michigan, and this property is used in the representation of the out-of-state business in Michigan and is significantly associated with its ability to establish and maintain a market in Michigan.
 - 5) It has goods delivered to Michigan in vehicles it owns, rents, leases, uses, or maintains or delivered by a related party acting as a representative of the out-of-state business.
 - 6) It regularly and systematically conducts in-state business activity through its employees, agents, representatives, independent contractors, brokers or others acting on its behalf, whether or not these individuals or organizations reside in Michigan.
 - (a) Regular and systematic business activity exists if at least 10 days of business activity occurs in Michigan on an annual ("annual" meaning a 12 month taxable year) basis;
 - (b) Regular and systematic business activity may exist depending on the facts and circumstances of the taxpayer if less than 10 days of business activity occurs in Michigan on an annual ("annual" meaning a 12 month taxable year) basis.
 - (i) When examining the facts and circumstances of in-state business activity, conducting any of the following activities in the State of Michigan for 2 or more days on an annual basis will be rebuttably presumed to constitute regular and systematic business activity:
 - (1) Soliciting sales;
 - (2) Making repairs or providing maintenance or service to property sold or to be sold;
 - (3) Collecting current or delinquent accounts related to sales of tangible personal property through assignment or otherwise;
 - (4) Installing or supervising installation at or after shipment or delivery;
 - (5) Conducting training for employees, agents, representatives, independent contractors, brokers or others acting on its behalf, or for customers or potential customers;
 - (6) 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;

- (7) Investigating, handling, or otherwise assisting in resolving customer complaints;
 - (8) Providing consulting services; or
 - (9) Soliciting, negotiating, or entering into franchising, licensing, or similar agreements.
- (ii) Conducting any of the activities listed in 6)(b)(i) in the State of Michigan for 10 days or more will constitute regular and systematic business activity.
 - (c) Lawyers, accountants, investment bankers, and other similar professionals in Michigan who perform services for an out-of-state business in their professional capacity shall not be considered to be conducting in-state business activity on behalf of the out-of-state business.
- 7) If none of the business' activities in Michigan fall under paragraph 6)(b)(i) and its only contacts with Michigan are limited to conducting any of the activities listed below for less than ten days, such contacts will be presumed not to create nexus. If an activity is listed in (a) through (f) below but also is described under paragraph 6)(b)(i), then paragraph 6)(b)(i) shall control. If a business' only in-state activity is listed in 7)(g) such activity shall not be considered as solicitation for the purposes of paragraph 6)(b)(i). Conducting any of the activities listed below for more than ten days will not necessarily create nexus. Whether nexus has been created will depend on the facts and circumstances of the in-state business 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 lists; or
 - (g) Attending and/or participating at a trade show at which no orders for goods are taken and no sales are made.
- II. The same standards used to determine nexus for out-of-state taxpayers, as described in paragraph I above, will be applied to determine whether a taxpayer is taxable in another state for purposes of apportionment under the single business tax. For purposes of Michigan's throwback rule, "nexus" in other states must be documented and will be subject to verification by the Department of Treasury.
- III. This RAB applies to all open tax periods ending on or after January 1, 1989 in accordance with the *Guardian Industries Corp v Dep't of Treasury*, 198 Mich App 363; 499 NW2d 349, *lv app den* 444 Mich 943; 512 NW2d 846 (1994), and *Gillette Co v Dep't of Treasury*, 198 Mich App 303; 497 NW2d 595 (1993), *lv app den* 445 Mich 861; 519 NW2d 156 (1994), decisions of the Michigan Court of Appeals. In these cases the Court held that Public Law 86-272, 15 USC §318(a) (1959)(P L 86-272), was not the appropriate nexus standard for the Michigan single business tax.

- IV. Once nexus is established by a taxpayer during a tax year for single business tax purposes, nexus shall exist for that taxpayer for at least that entire tax year.

Taxpayers that fall within the State's taxing jurisdiction will be required to file single business tax returns if they conduct business activity within the State and have apportioned or allocated gross receipts plus adjustments provided in MCL 208.23b (a), (b), and (c); MSA 7.558 (23b) in excess of the amounts provided under MCL 208.73; MSA 7.559 (73). Currently MCL 208.73 provides that no return filing obligation accrues if adjusted apportioned or allocated gross receipts do not exceed:

- For tax years beginning before January 1, 1991 -- \$40,000;
- For tax years beginning after December 31, 1990 and before January 1, 1992 -- \$60,000;
- For tax years beginning after December 31, 1991 and before January 1, 1994 -- \$100,000;
- For tax years beginning after December 31, 1993 and before January 1, 1995 -- \$137,500;
- For tax years beginning after December 31, 1994 -- \$250,000.

LAW AND ANALYSIS

Introduction

The Single Business Tax (SBT) is imposed on the adjusted tax base of "every person with business activity in this state." MCL 208.31(1); MSA 7.558(31)(1). A business is subject to the single business tax if it has nexus with the State of Michigan under the Due Process and Commerce Clauses of the U.S. Constitution and is conducting business activity in Michigan as defined under MCL 208.3(2); MSA 7.558(3)(2).

If the taxpayer is not subject to tax in another state, the taxpayer is not subject to apportionment and must allocate the entire tax base to Michigan. MCL 208.40; MSA 7.558(40). Sales made into other states where the taxpayer is not taxable are considered Michigan sales and are "thrown back" into the taxpayer's SBT tax base.

A taxpayer is "taxable in another state" if "(a) in that state he is subject to a business privilege tax, a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax, a tax of the type imposed under this act, or (b) that state has the jurisdiction to subject the taxpayer to 1 or more of the taxes regardless of whether, in fact, the state does or does not." MCL 208.42; MSA 7.558(42). In short, a taxpayer will be subject to a tax in another state if the taxpayer has due process and commerce clause nexus with that state. If a taxpayer is taxable in another state, sales made into that state from Michigan are excluded from the numerator of the sales factor used in the SBT's apportionment formula.

This bulletin is intended as a guide. Because commerce clause nexus is an ever-evolving area of law and is likely to change, readers are encouraged to review recent court decisions from Michigan and Federal appellate courts.

Rescission of RAB 1989-46

Following the publication of RAB 1989-46, the Michigan Court of Appeals determined that Public Law 86-272 did not apply to taxes imposed under the SBT and invalidated RAB 1989-46. *Gillette Co, supra*; *Guardian Industries Corp, supra*. Pursuant to these decisions, the requirements of P L 86-272 do not control whether a taxpayer is taxable in Michigan or whether a taxpayer is taxable in another state for the purposes of the single business tax apportionment. Any activity that would otherwise be considered protected under P L 86-272 will not be protected for the purposes of determining nexus or "throwback sales" under the SBT.

Jurisdictional Standard

The Due Process and Commerce Clauses of the U.S. Constitution define U.S. constitutional limitations on state jurisdiction to tax. The nexus requirements of both Clauses must be satisfied before an out-of-state business may be subject to the taxing jurisdiction of a State. Due Process nexus is satisfied for application of the single business tax when a person has economic or physical presence in Michigan. Economic presence is satisfied when a business purposefully, on its own or through a representative, avails itself of the benefits of an economic market in Michigan. *Quill Corp v North Dakota*, 504 US 298; 119 LEd 2d 91; 112 SCt 1904 (1992); *Burger King Corp v Rudzewicz*; 471 US 462; 105 SCt 2174; 85 LEd 2d 528 (1985); *International Shoe v Washington*, 326 US 310; 66 SCt 154; 90 LEd 95 (1945). For example, the U.S. Supreme Court has held that engaging in continuous and widespread solicitation of business within a state constitutes economic presence. *Quill*, 504 US at 308.

The United States Supreme Court held in *Complete Auto Transit, Inc v Brady*, 430 US 274; 97 SCt 1076; 51 LEd 2d 326 (1977), that a state tax satisfies the requirements of the Commerce Clause if it meets four requirements:

1. The tax is applied to an activity with substantial nexus with the taxing state.
2. The activity -- both in and out of the state -- is fairly apportioned.
3. The tax does not discriminate against interstate commerce.
4. The tax is fairly related to services provided by the state.

The U.S. Supreme Court has most recently addressed the Commerce Clause substantial nexus requirement for use tax collection in *Quill, supra*. In *Quill*, the Supreme Court stated that substantial nexus for use tax collection is a bright line physical presence test. The Court reaffirmed its twenty-five year old holding in *National Bellas Hess*, 386 US 753; 87 SCt 1389; 18 LEd 2d 505 (1967), 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. The Court noted that substantial nexus for use tax collection is satisfied by the presence of a "small sales force, plant, or office" in the taxing state. In a footnote, the Court commented that it had previously rejected a "slightest presence standard of constitutional nexus" in *National Geographic Society v California Bd of Equalization*, 430 US 551, 556; 97 SCt 1386; 51 LEd 2d 631 (1977).

The *Quill* Court also stated that it has not imposed a physical presence requirement for any taxes other than sales and use 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. The Court noted, however, that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today." *Quill*, 504 US 311, 314. This leaves open the question of whether a physical presence standard applies to taxes other than sales and use taxes or whether, in fact, a lesser nexus standard applies. Nonetheless, 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 SBT.

The Michigan Court of Appeals in *Magnetek Controls, Inc v Dep't of Treasury*, 221 Mich App 400; 562 NW2d 219 (1997), applied the *Quill* decision and held that the requirement of "substantial nexus" does not mean that physical presence in the taxing state must be substantial but only that it be more than the slightest physical presence. Quoting from *Orvis v Tax Appeals Tribunal of the State of New York*, 86 NY2d 165; 654 NE2d 954, 960-961 (1995), the Michigan Court of Appeals stated the test as follows:

While a physical presence . . . is required, it need not be substantial. Rather, it must be demonstrably more than a 'slightest presence'. . . . And it may be manifested by the presence in the taxing State of . . . property or the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf.

Magnetek, at 411, citations omitted. /

Though the taxpayer in *Magnetek* had no offices or plants in the other states, the Court of Appeals found that the taxpayer's 10 business days or "two weeks of solid effort" annually in each of the destination states was sufficient. The Court rejected the argument that an in-state sales force continuously soliciting sales had to be present in each of the other states before the taxpayer could meet the "substantial nexus" requirement in those states. It regarded as relevant both the visits and activity of sales managers as well as sales visits by independent sales representatives.

The United States Supreme Court in *Tyler Pipe Industries, Inc v Washington Dep't of Revenue*, 483 US 232; 107 SCt 2810; 97 LEd 2d 199 (1987), held the activities of local sales representatives of an out-of-state corporation provided a sufficient nexus with the State of Washington to justify the collection of the wholesale tax on the corporation's local sales. For this purpose, it made no difference that the local representatives were independent contractors, rather than employees of the corporation.

In *Scripto, Inc v Carson*, 362 US 207; 80 SCt 619; 4 LEd 2d 660 (1960), the U. S. Supreme Court held that Florida may require a nonresident seller who has no regular employees or agents in the state and does not own, lease or maintain any office, distributing house, warehouse or other place of business there to register as a dealer and collect its use tax. The regular solicitation of sales by part-time independent brokers satisfies the requirement of nexus, that there be a definite link or a minimum connection between a state and the person, property or transaction it seeks to tax. Calling a "salesman" an "independent contractor" does not change his local function and has no bearing upon the effectiveness of his local solicitation, which results in a substantial flow of goods into the state.

In sum, the U. S. Supreme Court has held that substantial nexus exists when in-state activities are performed on behalf of an out-of-state company regardless of whether these activities are performed by employees, agents, representatives, independent contractors, brokers or others.

This RAB reflects the U.S. Supreme Court and the Michigan Court of Appeals decisions discussed above.

Definitions

The following definitions are used in this bulletin:

- (a) "Business Activity" as defined in MCL 208.3 (2); MSA 7.558(3) means a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but shall not include the services rendered by an employee to his employer, services as a director of a corporation, or a casual transaction. Although an activity of a taxpayer may be incidental to another or other of his business activities, each activity shall be considered to be business engaged in within the meaning of this act.
- (b) "Related Party" means any individual or entity that qualifies or would qualify as (i) an affiliated group or a controlled group of corporations under section 1563 of the internal revenue code or (ii) an entity under common control under internal revenue code regulation 1.414(c)-2 provided that "50 percent" shall be substituted for "80 percent" in determining when an individual or entity is part of an affiliated group, a controlled group of corporations, or an entity under common control.
- (c) "Representative" means any individual or entity that conducts business activities in the taxing State on behalf of another. The term does not include employees. The term includes, without any limitation on the foregoing, agents, corporate or other business

entities, related or unrelated to the other business, and independent contractors. The term also includes sub-representatives. A representative may be a resident or non-resident of the taxing State.

- (d) “Sale” or “sales” means the gross receipts arising from a transaction or transactions in which gross receipts constitute consideration: (i) for the transfer of title to, or possession of property that is stock in trade or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or properly held by the taxpayer primarily for the sale to customers in the ordinary course of its trade or business, or (ii) for the performance of services, which constitute business activities other than those included in (i), or from any combination of (i) or (ii).
- (e) “Use” means the exercise of a right or power over tangible personal property incident to the ownership of that property including transfer of the property in a transaction where possession is given.