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## REVENUE ADMINISTRATIVE BULLETIN 2013-9

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### CORPORATE INCOME TAX – “ACTIVELY SOLICITS”

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 2013-9**

Under Part 2 of the Income Tax Act (commonly referred to as the “Corporate Income Tax” or “CIT”), a taxpayer, other than an insurance company under MCL 206.635 et seq., has nexus with the State of Michigan and is subject to the CIT if one of three standards are met: (1) the taxpayer has a physical presence in Michigan for a period of more than 1 day during the tax year; (2) the taxpayer actively solicits sales in Michigan and has gross receipts of \$350,000 or more sourced to Michigan, or; (3) the taxpayer has an ownership interest or a beneficial interest in a flow-through entity, directly, or indirectly through 1 or more other flow-through entities, that has substantial nexus in Michigan.<sup>1</sup>

The second nexus standard uses the term “actively solicits,” which is expressly defined by MCL 206.621(2). This Revenue Administrative Bulletin (“RAB”) provides guidance regarding the term “actively solicits” and the Department’s interpretation of its use in determining nexus under the CIT. “Actively solicits” is also referred to in this RAB as “active solicitation.” This RAB is not intended to describe the other nexus standards in MCL 206.621(1).

#### **ISSUE**

What does it mean to “actively solicit” sales in this state for purposes of MCL 206.621?

#### **CONCLUSION**

The CIT defines “actively solicits” to mean either of the following:

<sup>1</sup> MCL 206.621(1); MCL 206.653(2).

(i) Speech, conduct, or activity that is purposefully directed at or intended to reach persons within this state and that explicitly or implicitly invites an order for a purchase or sale; or

(ii) Speech, conduct, or activity that is purposefully directed at or intended to reach persons within this state that neither explicitly nor implicitly invites an order for a purchase or sale, but is entirely ancillary to requests for an order for a purchase or sale.<sup>2</sup>

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.

Active solicitation, coupled with \$350,000 in gross receipts sourced to Michigan, constitutes nexus under the CIT. That is, active solicitation – on its own – does not necessarily create nexus. Rather, under MCL 206.621, active solicitation and Michigan gross receipts of \$350,000 or more create nexus.

The same standards used to determine nexus for out-of-state taxpayers, as described herein, will be applied to determine whether a taxpayer is taxable in another state for purposes of apportionment under the CIT. Nexus in a state other than Michigan, for apportionment purposes, must be documented and will be subject to verification by the Department.

## **LAW AND ANALYSIS**

**Introduction.** The CIT is comprised of three taxes: a business income 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. Except as otherwise provided in part 2 of the Income Tax Act, the CIT is levied and imposed on corporations with business activity in Michigan or that have an ownership or beneficial interest in a flow-through entity that has business activity in Michigan. “Corporation” is defined as “a person that is required or has elected to file as a C corporation as defined under section 1361(a)(2) and section 7701(a)(3) of the internal revenue code” and does not include insurance companies or financial institutions.<sup>3</sup>

Unless stated otherwise in the CIT, a corporation has nexus with Michigan and is subject to the CIT “if the taxpayer has a physical presence in this state for a period of more than 1 day during the tax year, if the taxpayer actively solicits sales in this state and has gross receipts of

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<sup>2</sup> MCL 206.621(2).

<sup>3</sup> MCL 206.605(1).

\$350,000.00 or more sourced to this state, or if the taxpayer has an ownership interest or a beneficial interest in a flow-through entity, directly, or indirectly through 1 or more other flow-through entities, that has substantial nexus in this state.”<sup>4</sup> In other words, there are three separate, alternative nexus standards under the CIT. First, a person has nexus with Michigan if that person has physical presence in the state for more than one day during the tax year. Second, a person has nexus with Michigan if the person actively solicits sales in Michigan and has Michigan gross receipts of \$350,000 or more. Third, a person has nexus with Michigan by virtue of ownership or beneficial interest in a flow-through entity, directly, or indirectly through other flow-through entities, that itself has nexus with Michigan.

PL 86-272 is a federal law that prohibits Michigan from imposing an 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>5</sup> A person whose activities are limited to those protected by PL 86-272 is not subject to the CIT.

**Constitutional Standards.** The Due Process and Commerce Clauses of the U.S. Constitution<sup>6</sup> place federal 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 “requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.”<sup>7</sup> Building upon this principle, the U.S. Supreme Court has held that if a “foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's in personam jurisdiction even if it has no physical presence in the State.”<sup>8</sup> In other words, Due Process nexus is satisfied when a person has economic or physical presence in the taxing state. Economic presence is satisfied when a person purposefully avails itself of the benefits of an economic market in the taxing state, regardless of that person's lack of physical presence in the taxing state.

The “quality and nature of the activity” of the out-of-state person in the taxing state and the “magnitude of [the] contacts” of the out-of-state person with the taxing state must also be evaluated when determining whether Due Process nexus exists.<sup>9</sup> Thus, while some forms of minimum contacts with a state – such as mere advertising or operation of a web site – may not satisfy Due Process nexus on their own, those contacts combined with substantial commercial transactions likely will.<sup>10</sup> For example, the U.S. Supreme Court has held that engaging in continuous and widespread solicitation of business within a state – combined with substantial sales in that state – constitutes economic presence and satisfies Due Process nexus standards.<sup>11</sup>

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<sup>4</sup> MCL 206.621(1).

<sup>5</sup> 15 USC 381 *et seq.*

<sup>6</sup> US Const, Am XIV, §1 and US Const, art I, §8, respectively.

<sup>7</sup> *Quill Corp v North Dakota*, 504 US 298, 306 (1992).

<sup>8</sup> *Id* at 307; *Burger King Corp v Rudzewicz*, 471 US 462 (1985).

<sup>9</sup> *International Shoe Co v Washington*, 326 US 310, 319 (1945); *Quill*, 504 US at 308.

<sup>10</sup> *Zippo Mfg Co v Zippo Dot Com, Inc*, 952 F Supp 1119 (WD Pa 1997).

<sup>11</sup> *Quill*, 504 US at 308.

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>12</sup>

The U.S. Supreme Court addressed the substantial nexus requirement under the Commerce Clause in *Quill Corp v North Dakota*.<sup>13</sup> In that case, the Court held that substantial nexus for use tax collection is a bright line physical presence test. *Quill* reaffirmed the holding in *National Bellas Hess, Inc v Illinois*<sup>14</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>15</sup>

However, the U.S. Supreme Court has never required physical presence for nexus under the Commerce Clause in its review of taxes other than sales and use taxes. The Court in *Quill* noted that “contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today.”<sup>16</sup> 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 Michigan CIT.

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>17</sup> Although the Department recognizes that some states have reached other conclusions, the Department concludes that the decision in *MBNA America Bank v Tax Comm'r of West Virginia* best summarizes the current state of Commerce Clause jurisprudence. In *MBNA*, the Supreme Court of West Virginia held that West Virginia’s imposition of its business franchise tax and corporation net income tax on a foreign credit card company with no property or employees located in West Virginia did not violate the federal Commerce Clause, and that the bright line physical presence requirement for showing Commerce Clause nexus applies only to sales and use taxes and not to business franchise and corporation net income taxes.<sup>18</sup> In explaining its rationale, the *MBNA* court stated:

[W]e 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

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<sup>12</sup> *Complete Auto Transit, Inc v Brady*, 430 US 274 (1977).

<sup>13</sup> 504 US 298 (1997).

<sup>14</sup> 386 US 753 (1967).

<sup>15</sup> *Quill*, 504 US at 311, 315.

<sup>16</sup> *Id* at 311, 314.

<sup>17</sup> See, e.g., *KFC Corp v Iowa Dep't of Revenue*, 792 NW2d 308 (Iowa S Ct 2010), *cert den* 132 S Ct 97 (2011); *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*, 551 US 1141 (2007); *Lanco, Inc v Director*, New Jersey Div of Taxation, 879 A2d 1234 (NJ Super Ct App Div, 2005), *cert den* 551 US 1131 (2007); *A&F Trademark, Inc v North Carolina*, 605 SE2d 187 (NC Ct App, 2004), *cert den* 546 US 821 (2005).

<sup>18</sup> *MBNA*, 640 SE2d at 232, 234.

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>19</sup>

The CIT expressly adopts a substantial economic presence standard, which is codified as active solicitation coupled with \$350,000 of Michigan gross receipts.<sup>20</sup> 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>21</sup> The CIT's standard of active solicitation coupled with \$350,000 in gross receipts sourced to Michigan constitutes substantial economic presence.

**Active Solicitation.** A taxpayer has nexus with Michigan and is subject to the CIT if “the taxpayer *actively solicits* sales in this state and has gross receipts of \$350,000 or more sourced to this state.”<sup>22</sup> Subsection 621(2) of the CIT expressly defines “actively solicits” to mean either of the following:

- (i) Speech, conduct, or activity that is purposefully directed at or intended to reach persons within this state and that explicitly or implicitly invites an order for a purchase or sale; or
- (ii) Speech, conduct, or activity that is purposefully directed at or intended to reach persons within this state that neither explicitly nor implicitly invites an order for a purchase or sale, but is entirely ancillary to requests for an order for a purchase or sale.<sup>23</sup>

A person is thus actively soliciting within this state if the person's speech, conduct, or activity is directed at or intended to reach persons within Michigan.

Speech, conduct or activity that does not explicitly nor implicitly invite an order for purchase or sale, but that is entirely ancillary to requests for an order for purchase or sale would be that engaged in by the taxpayer which would serve no independent business function apart from its connection to the soliciting of the order or the requesting of the purchase or sale. Such speech, conduct or activity would not include that which the taxpayer would have had reason to engage in anyway, regardless of the solicitation.<sup>24</sup>

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<sup>19</sup> *MBNA*, 640 SE2d at 234.

<sup>20</sup> The CIT also expressly adopts an ownership standard, which establishes nexus where the taxpayer has an ownership or beneficial interest in a flow-through entity that, directly, or indirectly through 1 or more other flow-through entities, itself has nexus in the state. MCL 206.621(1).

<sup>21</sup> *Id* at 235. See also, *Lamtec Corp v Dep't of Revenue*, 246 P3d 788 (Wash 2011), cert den 132 S Ct 95 (2011).

<sup>22</sup> MCL 206.621(1); emphasis added.

<sup>23</sup> MCL 206.621(2).

<sup>24</sup> See *Wisconsin Dep't of Revenue v William Wrigley, Jr. Co*, 505 US 214, 229 (1992).

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.** Listed below are select examples of active solicitation (Examples 1 and 7) or solicitation that does not rise to the level of active solicitation (Examples 2-6). In each example, the only contacts the person has with Michigan are those identified in the examples. To the extent that any of the persons below have additional contacts, nexus may be established through those additional contacts.

1. A retailer located outside Michigan maintains an internet site over and through which customers may browse products 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. The retailer is actively soliciting sales in Michigan.

2. A retailer located outside Michigan maintains an internet site over and through which customers may browse products and place orders. The retailer does not accept orders from and does not ship to persons within Michigan. The retailer does not direct its activities at persons within Michigan. The retailer is not actively soliciting sales in Michigan.

3. A manufacturer located outside Michigan maintains an internet site over and through which persons may view the manufacturer's products and specifications. The manufacturer does not accept orders through the internet site, provide order forms, or invite persons to call the manufacturer with orders. Although the internet site is generally available to all persons throughout the country, the manufacturer is not actively soliciting sales in Michigan.

4. A retailer located outside Michigan advertises in a newspaper not circulated in Michigan. The newspaper has mail subscribers in Michigan, but not a significant number such that the retailer would be considered to be directing its activities at persons within Michigan. The retailer is not actively soliciting sales in Michigan.

5. A manufacturer located outside Michigan advertises a consumer product in Michigan through television, radio, and newspaper advertisements. The advertisements are intended to increase awareness of the product. Consumers may not purchase the product from the manufacturer; rather, consumers must purchase the product from a retailer. The manufacturer offers no coupons in its print advertisements. The advertisements do not constitute solicitation and the manufacturer is not actively soliciting sales in Michigan.

6. A person within Michigan initiates contact with an out-of-state financial institution to request a loan. The out-of-state financial institution does not otherwise solicit sales in Michigan. Subsequent negotiations between the parties do not constitute active solicitation by the financial institution.

7. An out-of-state financial institution sends brochure information through the mail to various companies located in Michigan. The brochures contain information regarding interest rates and services and invites recipients to contact the financial institution's lending officers for more specific information on lending terms and requirements. The financial institution is actively soliciting in Michigan.