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DEPARTMENT OF TREASURY  
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**REVENUE ADMINISTRATIVE BULLETIN 2014-5**

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**MICHIGAN CORPORATE INCOME 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.

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## RAB 2014-5

### **INTRODUCTION**

Part 2 of the Income Tax Act, also known as the Michigan Corporate Income Tax Act, or CIT, is comprised of three separate components: a corporate income tax, a gross direct premiums tax, and a franchise tax. The corporate income tax applies to a corporation with business activity in Michigan or an ownership interest or beneficial interest in a flow-through entity that has business activity in Michigan.<sup>1</sup> A “corporation” is a person that elects to file or is required to file as a C corporation as defined under IRC 1361(a)(2) and 7701(a)(3).<sup>2</sup> A “flow-through entity” is defined in the CIT as a subchapter S Corporation, a general partnership, a limited partnership, a trust, a limited liability partnership, or a limited liability company that for the tax year is not taxed as a corporation for federal income tax purposes.<sup>3</sup> The gross direct premiums tax and franchise tax apply only to insurance companies and financial institutions, respectively.

A taxpayer 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 \$350,000 or more sourced to this state, or if the taxpayer has an

<sup>1</sup> MCL 206.623(1).

<sup>2</sup> MCL 206.605(1).

<sup>3</sup> MCL 206.607(2).

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 3 alternative ways in which a taxpayer has nexus with Michigan under the CIT:

1. the taxpayer has physical presence in the state for more than one day during the tax year, *or*;
2. the taxpayer actively solicits<sup>5</sup> sales in this state and has Michigan gross receipts of \$350,000 or more, *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 nexus in this state.

These nexus standards apply to corporations with regard to the corporate income tax and to financial institutions with regard to the franchise tax.<sup>6</sup> These nexus standards do not apply to insurance companies. Insurance companies with written premiums on property or risk located or residing in Michigan are subject to the gross direct premiums tax imposed under MCL 206.635.

The corporate income tax is levied on taxpayers with Michigan business activity “unless prohibited by 15 USC 381 to 384.”<sup>7</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>8</sup> A corporation whose activities are limited to those protected by PL 86-272 is not subject to the CIT. However, as 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 those protected by PL 86-272 – must be included when calculating the unitary business group’s tax base and apportionment formula.

## **ISSUES**

- I. What is the jurisdictional standard to determine whether a taxpayer is subject to Michigan's CIT jurisdiction?
- II. How does PL 86-272 operate under the CIT?
- 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 CIT?

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

<sup>5</sup> “Actively solicits” is defined at MCL 206.621(2).

<sup>6</sup> MCL 206.621(1); MCL 206.653(2).

<sup>7</sup> MCL 208.1201.

<sup>8</sup> 15 USC 381 *et seq.*

- 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 a CIT return?

## **CONCLUSIONS**

### **I. JURISDICTIONAL STANDARDS**

Under the CIT, a taxpayer has substantial 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 \$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>9</sup>

In other words, there are three alternative nexus standards under the CIT. First, a taxpayer may have nexus with the state if that taxpayer has physical presence in the state for more than one day during the tax year. Second, a taxpayer may have nexus with the state if the taxpayer actively solicits sales in this state and has Michigan gross receipts of \$350,000 or more. Third, a taxpayer may have nexus with the state if the taxpayer has a direct ownership interest or a beneficial interest in a flow-through entity, whether directly or indirectly through one or more other flow-through entities with nexus. These nexus standards apply to corporations with regard to the corporate income tax and to financial institutions with regard to the franchise tax.<sup>10</sup>

Taxpayers that fall under the protections of PL 86-272 are not subject to the corporate income tax. However, PL 86-272 is a “safe harbor” and not an exclusion or exemption from nexus. Therefore, any activity conducted by a taxpayer outside the protection of PL 86-272 will cause that taxpayer to lose the protection otherwise provided. Further, income from protected activities under PL 86-272 is not otherwise excluded or deducted from the tax base.

#### **A. Physical Presence Nexus Standard**

A taxpayer has nexus with Michigan for CIT purposes if that taxpayer “has a physical presence in this state for a period of more than 1 day during the tax year.”<sup>11</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

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<sup>9</sup> MCL 206.621(1) (emphasis added).

<sup>10</sup> MCL 206.621(1); MCL 206.653(2).

<sup>11</sup> MCL 206.621(1).

activity is not significantly associated with the taxpayer's ability to establish and maintain a market in this state.<sup>12</sup>

Physical presence is determined on a facts and circumstances basis. A taxpayer will have physical presence in Michigan and be subject to the CIT 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.
  - 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.

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<sup>12</sup> MCL 206.621(2)(b).

4. If the taxpayer's only activities in Michigan are strictly limited to the activities listed as a. through f. below for fewer than 10 days, such activity will not in and of itself constitute physical presence resulting in nexus. To the extent that any activity listed below is identified elsewhere in this RAB 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).
- d. Holding recruiting or hiring events.
- e. Advertising in the state through various media.
- f. Attending and/or participating at a trade show at which no sales are solicited or made.

The CIT expressly provides that “physical presence” for purposes of nexus 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>13</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 will 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-state taxpayer will 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. This applies only to the issue of establishing nexus with respect to the out-of-state client or customer for or on behalf of whom the professional or other service provider is conducting activity; it does not insulate the professional or other service provider from nexus for its own business activity.

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

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

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<sup>13</sup> MCL 206.621(2)(b).

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 with Substantial Michigan Gross Receipts Nexus Standard**

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 \$350,000.00 or more sourced to this state.”<sup>14</sup>

“Actively solicits” is expressly defined in the CIT statute 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.

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, but are not limited to: 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 CIT.

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<sup>14</sup> MCL 206.621(1).

**C. Ownership Interest or Beneficial Interest in Flow-Through Entity with Nexus with Michigan**

A taxpayer has nexus with Michigan “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>15</sup>

A “flow-through entity” is defined in the CIT statute to mean:

an entity that for the applicable tax year is treated as a subchapter S corporation under section 1362(a) of the internal revenue code, a general partnership, a trust, a limited partnership, a limited liability partnership, or a limited liability company, that for the tax year is not taxed as a corporation for federal income tax purposes. Flow-through entity does not include any entity disregarded under section 699.<sup>16</sup>

There is no minimum ownership percentage or degree of control threshold that a taxpayer owner of a flow-through entity must have in order for nexus with Michigan to exist.

A beneficial interest of a taxpayer in a flow-through entity exists where the taxpayer has a direct or indirect interest in the entity or in any benefits derived from the business activity of the entity distinct from any legal ownership or control of the entity.<sup>17</sup> For example, a taxpayer that is a beneficiary to proceeds or income derived from the assets or business activity of a trust or estate in Michigan has nexus with Michigan.

**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 delivery from a point outside the state.<sup>18</sup> The term “net income tax” applies to the corporate income tax imposed under MCL 206.623(1). In other words, even if a taxpayer has nexus with Michigan, that taxpayer may be protected from the imposition of the CIT under PL 86-272.<sup>19</sup>

The franchise tax applicable to financial institutions is not a net income tax; therefore, PL 86-272 does not apply.

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<sup>15</sup> MCL 206.621(1).

<sup>16</sup> MCL 206.607(2).

<sup>17</sup> See, e.g., *In Re Estate of Bessie Walther v Dep't of Treasury*, 205 Mich App 566 (1994) (using *Black's Law Dictionary (5th Ed)* definition of “beneficial interest,” where term was not defined in Inheritance Tax Act, court held that although partnership was recipient of testate assets upon death pursuant to partnership agreement, the partners in partnership who were lineal descendants of decedent held a beneficial interest in the testate assets transferred to the partnership, and were thus entitled to preferential tax treatment under Act).

<sup>18</sup> 15 USC 381.

<sup>19</sup> MCL 206.623(1).



**A. Tangible Personal Property**

Only the solicitation to *sell tangible personal property* is afforded protection 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 entirely ancillary to the facilitation of a request for an order for the sale of tangible personal property 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. However, employing salesmen to repair or service the company's products is not part of the “solicitation of orders,” since there is good reason to do that whether or not the company has a sales force. Repair and servicing may help to increase purchases, but it is not ancillary to requesting orders, and cannot be converted into “solicitation” by merely being assigned to salesmen.<sup>20</sup>

Conducting activities not falling within the foregoing definition of solicitation will cause the company to lose its protection from the corporate 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 protection under PL 86-272, and will cause the taxpayer to be subject to the corporate income tax:

1. Making repairs or providing maintenance or service to property sold or to be sold.

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<sup>20</sup> *Wisconsin Dep't of Revenue v William Wrigley, Jr, Co*, 505 US 214 (1992) (internal citation omitted).

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 (i) that 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 will 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 will 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 will, by itself, cause the loss of protection. 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, 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 protected.
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 (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 or 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. 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 will 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 loss of the company's protection:

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, will 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, will apply the same standards set forth in the PL 86-272 and in this RAB to business activities in foreign commerce.

#### **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 that tax year will be protected from taxation under PL 86-272 or this RAB.

#### **I. Distributive Share Income of Corporation from a Flow-through Entity Protected by PL 86-272**

The distributive share income of a corporation that has nexus with Michigan that is attributable to (or derived from) its ownership in a flow-through entity whose activities are otherwise protected by PL 86-272 is not itself protected by PL 86-272 and is not excluded from the corporation's corporate income tax base. The application of PL 86-272 is not triggered by the receipt of income from interstate commerce, but by the absence of certain contact by the taxpayer with the taxing state. In other words, PL 86-272 does not exempt from the corporate income tax the distributive income from a flow-through entity protected by PL 86-272 to its corporate owners; it only prevents a state from exercising its taxing jurisdiction over the business entity engaged in the protected activities, i.e., the flow-through entity. The distributive share income of a corporate owner that is itself not protected by PL 86-272 is not exempt from the corporate income tax merely because it flows from an entity otherwise protected by PL 86-272.

### 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>21</sup> An activity conducted within Michigan on a regular or systematic basis or pursuant to a company policy (whether or not such policy is in writing) shall normally not be considered trivial. Whether 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 206.621(1) 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 fewer than 10 days during the tax year:

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).
4. Holding recruiting or hiring events.
5. Advertising in the state through various media.
6. 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 during a tax year establish nexus will depend on the facts and circumstances of the in-state activity.

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<sup>21</sup> See *Wrigley*, 505 US 214; *Quill Corp v North Dakota*, 504 US 298 (1992).

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

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 CIT. For purposes of apportionment, the Department may 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 describes the nexus standards that became effective January 1, 2012.

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

Once nexus is established by a taxpayer during a tax year for CIT purposes, nexus will exist for that taxpayer for the entire tax year.

#### **VII. Unitary Business Groups**

A taxpayer under the CIT includes a unitary business group.<sup>22</sup> A unitary business group is comprised of two or more U.S. persons that are corporations, insurance companies or financial institutions.<sup>23</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 corporate income tax base 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 corporate income tax base and apportionment formula.

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

A taxpayer, other than an insurance company or a financial institution taxed under chapters 12 or 13 of the Income Tax Act, respectively, must file a CIT return if the taxpayer's apportioned or allocated gross receipts equal or exceed \$350,000.<sup>24</sup> However, a taxpayer whose tax liability under the CIT is less than or equal to \$100.00 is not required to file a CIT return or pay the tax imposed by the CIT statute.<sup>25</sup>

### **LAW AND ANALYSIS**

**Introduction.** The CIT is comprised of three separate components: a corporate income tax, a gross direct premiums tax, and a franchise tax. The corporate income tax applies to corporations with business activity in Michigan or that have an ownership interest or beneficial interest in a flow-through entity that has business activity in Michigan.<sup>26</sup> A “corporation” is a person that

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<sup>22</sup> MCL 206.611(5).

<sup>23</sup> MCL 206.611(6).

<sup>24</sup> MCL 206.685(1).

<sup>25</sup> MCL 206.685(1).

<sup>26</sup> MCL 206.623(1).

elects to file or is required to file as a C corporation as defined under section 1361(a)(2) and section 7701(a)(3) of the internal revenue code.<sup>27</sup> A “flow-through entity” is defined in the CIT statute as a subchapter S corporation, a general partnership, a limited partnership, a trust, a limited liability partnership, or a limited liability company that for the tax year is not taxed as a corporation for federal income tax purposes.<sup>28</sup> The gross direct premiums tax and franchise tax apply only to insurance companies and financial institutions, respectively.

Unless stated otherwise in the Income Tax Act, a taxpayer has nexus with the State of 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 \$350,000 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>29</sup>

In other words, there are 3 alternative ways in which a taxpayer has nexus with Michigan under the CIT:

1. the taxpayer has physical presence in the state for more than one day during the tax year, *or*;
2. the taxpayer actively solicits<sup>30</sup> sales in this state and has Michigan gross receipts of \$350,000 or more, *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 itself has nexus in this state.

**Constitutional Standards.** The Due Process<sup>31</sup> and Commerce<sup>32</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>33</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>34</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

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<sup>27</sup> MCL 206.605(1).

<sup>28</sup> MCL 206.607(2).

<sup>29</sup> MCL 206.621(1).

<sup>30</sup> “Actively solicits” is defined at MCL 206.621(2) and discussed in greater detail in RAB 2012-XX.

<sup>31</sup> US Const, Am XIV, §1.

<sup>32</sup> US Const, art I, §8.

<sup>33</sup> See *Quill*, 504 US 298.

<sup>34</sup> *Quill*, 504 US 298; *Burger King Corp v Rudzewicz*, 471 US 462 (1985).



apportioned; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to services provided by the state.<sup>35</sup>

The U.S. Supreme Court most recently addressed the substantial nexus requirement under the Commerce Clause in *Quill Corp v North Dakota*. 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>36</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>37</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* for use taxes 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>38</sup> The Court also stated that it had never, in its review “of other types of taxes,” required physical presence.<sup>39</sup> 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 CIT.

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 CIT. In fact, the Michigan Court of Appeals in *Rayovac Corp v Dep't of Treasury*<sup>40</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 found.”<sup>41</sup> Under the CIT, physical presence for two or more days establishes substantial nexus under the Commerce Clause.

Furthermore, a number of other states have considered *Quill's* bright line physical presence test and rejected its application to taxes other than sales and use taxes.<sup>42</sup> The Department concludes

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<sup>35</sup> *Complete Auto Transit, Inc v Brady*, 430 US 274 (1977).

<sup>36</sup> 386 US 753 (1967).

<sup>37</sup> *Quill*, 504 US at 315.

<sup>38</sup> *Quill*, 504 US at 311.

<sup>39</sup> *Quill*, 504 US at 314.

<sup>40</sup> 264 Mich App 441 (2005).

<sup>41</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 CIT clearly reject *Quill* as the definitive nexus standard by adopting an economic presence nexus standard as well as an ownership and beneficial interest standard. Thus, while *Rayovac*, an SBT case, is not binding precedent with respect to nexus under the CIT, it is still informative with respect to what constitutes physical presence.

<sup>42</sup> See, e.g., *KFC Corporation v Iowa Dep't of Revenue*, 792 NW2d 308 (Iowa S Ct, 2010), *cert den* 132 S Ct 97 (2011) (physical presence not required under Commerce Clause to impose an income tax on revenue earned by out-of-state corporation arising from use of intangibles by in-state franchisees); *Capital One Bank v Comm'r of Revenue*, 899 NE2d 76 (Mass S Ct 2009), *cert denied* 129 S.Ct. 2827 (2009) (bank's consumer lending activities and solicitation and conduct of credit card business involving thousands of residents and generating substantial amounts of money created nexus despite lack of physical presence in state); *Tax Comm'r of West Virginia v MBNA America Bank*, 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) (physical presence not required under Commerce Clause to impose business franchise tax and corporate net

that *MBNA* best summarizes the current state of Commerce Clause jurisprudence with respect to nexus. 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 real or tangible personal 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>43</sup> In explaining its rationale, the *MBNA* court stated:

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>44</sup>

The court in *KFC Corp* echoes the *MBNA* court's position in this regard, commenting that it doubts the Supreme Court would extend the "physical presence" rule outside the context of sales and use taxes in *Quill*.<sup>45</sup> Consequently, the Department concludes that the economic presence nexus standard contained in the CIT comports with appropriate constitutional standards.

The nexus standards adopted in the CIT in addition to the physical presence standard are an economic presence standard and an ownership interest or beneficial interest standard. The economic presence standard is 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>46</sup> Active solicitation coupled with \$350,000 in gross receipts sourced to Michigan constitutes substantial economic presence for purposes of CIT nexus. This conclusion

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income tax on out-of-state credit card company on gross receipts attributable to issuing and servicing of credit cardholders in state); *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)(physical presence not required to impose corporate business tax on income of out-of-state company derived from licensing intangible property to in-state retailers); *A&F Trademark, Inc v North Carolina*, 605 SE2d 187 (NC Ct App, 2004), *cert den* 546 US 821 (2005)(substantial nexus within Commerce Clause exists where out-of-state company licenses trademarks to related retailers operating in-state, subjecting income derived from licensing to income and franchise taxes); *Geoffrey, Inc v South Carolina Tax Comm'n*, 437 SE2d 13 (S Car, 1993) *cert den* 114 S Ct 550 (1993) (substantial nexus exists and state income taxes may be imposed on out-of-state franchisors on royalties income from in-state franchisees' use of franchisor's trademarks and trade names). Courts in two recent cases have held that out-of-state corporations that merely licensed trademarks and intellectual property to in-state entities did not have sufficient connection with the state to establish nexus with the taxing state. See, *Scioto Insurance Co v Oklahoma Tax Comm'n*, 279 P3d 782 (Okla, 2012); *Griffith v ConAgra Brands, Inc*, 728 SE2d 74 (W Va, 2012). As of the date of the issuance of this Revenue Administrative Bulletin, the U.S. Supreme Court has not granted certiorari review of either of these decisions.

<sup>43</sup> *MBNA*, 640 SE2d at 232, 234.

<sup>44</sup> *MBNA*, 640 SE2d at 234.

<sup>45</sup> *KFC Corp*, 792 NW2d at 325-326.

<sup>46</sup> *MBNA*, 640 SE2d at 235.

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>47</sup>

The ownership interest or beneficial interest standard provides that a taxpayer has nexus with Michigan for the CIT if it has an ownership interest or a beneficial interest in a flow-through entity that itself has nexus with Michigan under the standards of the CIT. The ownership or beneficial interest in the flow-through entity with nexus with Michigan may be direct or indirect through one or more other flow-through entities. In addition, the CIT does not specify any particular degree or minimum amount of ownership or beneficial interest in the flow-through entity with nexus with Michigan that is required in order to establish nexus for the taxpayer. Accordingly, as long as the taxpayer has some direct or indirect (through 1 or more other flow-through entities) ownership or beneficial interest in the flow-through entity the taxpayer has nexus with Michigan. Income to a taxpayer that is attributable to the activities of a flow-through entity in Michigan in which the taxpayer has an ownership interest or beneficial interest supports that taxpayer’s nexus with Michigan.<sup>48</sup>

Because “taxpayer” is defined to mean a corporation and a unitary business group for purposes of the corporate income tax, a unitary business group has nexus with Michigan if, through any of its corporation members, it has an ownership interest or beneficial interest, directly or indirectly through one or more flow-through entities, in a flow-through entity with nexus in Michigan.<sup>49</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 corporate income tax imposed under Chapter 11 of the Income Tax Act<sup>50</sup>, but does not include the gross direct premiums tax or franchise tax under Chapters 12 and 13, respectively, of the Income Tax Act.<sup>51</sup>

The Department shall impose the corporate income tax 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 meaning of “solicitation.” The U.S. Supreme Court has established a standard for interpreting the term “solicitation” and the Department and this RAB conform to that standard.<sup>52</sup> In those cases where there are reasonable differences of opinion as to whether

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<sup>47</sup> *MBNA*, 640 SE2d at 235-236.

<sup>48</sup> See *Int’l Harvester Co v Wisconsin Dep’t of Taxation*, 322 US 435, 441-443 (1944); *Wisconsin v JC Penney Co*, 311 US 435, 444-446 (1940).

<sup>49</sup> MCL 206.611(5). The term “taxpayer” is limited to corporations and unitary business groups for purposes of the corporate income tax (governed under Chapter 11 of the Income Tax Act). For purposes of Chapter 12 of the Income Tax Act (governing the gross premiums tax on insurance companies), “taxpayer” is limited to insurance companies and does not include corporations or financial institutions. Similarly, for purposes of Chapter 13 of the Income Tax Act (governing the franchise tax on financial institutions), “taxpayer” is limited to financial institutions and does not include corporations or insurance companies. MCL 206.611(5).

<sup>50</sup> MCL 206.621 et seq.

<sup>51</sup> MCL 206.635 et seq and MCL 206.651 et seq.

<sup>52</sup> *Wrigley*, 505 US 214.

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>53</sup>

### **EXAMPLES**

Activities conducted by the taxpayer are limited to those described in the examples. While this RAB may indicate that nexus exists, CIT liability may nonetheless be absent due to other circumstances, e.g., gross receipts below the filing threshold.

1. Corporation A, 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. Corporation A has gross receipts sourced to Michigan of \$300,000. Widgets are shipped to Michigan customers via common carrier.

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

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

- Corporation A does not have physical presence in Michigan. Corporation A is actively soliciting sales in Michigan and has \$350,000 or more of Michigan gross receipts. Corporation A has nexus with Michigan.

3. Corporation Z 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. Corporation Z has \$350,000 or more of Michigan gross receipts.

- Corporation Z has physical presence in Michigan. Corporation Z is also actively soliciting sales in Michigan and has \$350,000 or more of Michigan gross receipts. Corporation Z has nexus with Michigan under the physical presence standard and the economic presence standard under MCL 206.621(1). However, the solicitation activities here are protected under PL 86-272. Thus, the Department is prohibited from subjecting Corporation Z to the corporate income tax.

4. Same facts as in #3 above, except Corporation Z also solicits sales of a flag-ironing service.

- Corporation Z has physical presence in Michigan. Corporation Z is also actively soliciting sales in Michigan and has \$350,000 or more of Michigan gross receipts.

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<sup>53</sup> See *Dep't of Revenue of Oregon v ACF Industries, Inc*, 510 US 332, 345 (1994); *Heublein, Inc v South Carolina Tax Com*, 409 US 275, 281-282 (1972).

Corporation Z has nexus with Michigan under the physical presence and economic presence standards under MCL 206.621(1). PL 86-272 does not apply in this case since Corporation Z is soliciting sales of services and not strictly tangible personal property.

5. Corporation Y owns an interest in a condominium used on occasion by executives and employees of the company for recreational purposes. Corporation Y thus owns, rents, leases, maintains, or has the right to use and uses tangible personal or real property located in Michigan.

- Corporation Y has physical presence in Michigan, and thus has nexus with Michigan.

6. Corporations M, N, and O form a unitary business group. Corporation M has nexus with Michigan.

- The unitary business group of Corporations M, N and O must file a combined CIT return as a single taxpayer.

7. An employee of Corporation B 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 B in Michigan and is not acting in a representative capacity.

- Corporation B does not have physical presence in Michigan. Corporation B does not have nexus with Michigan.

8. Corporation Q, located outside Michigan, contracts with Corporation V, a common carrier, to pick up a shipment of miniature collectibles from a Michigan supplier for delivery to Corporation Q's warehouse. Corporation Q also retains an attorney employed by the law firm Smith & Jones, PC, a professional corporation, 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 Q, such activity is not significantly associated with Corporation Q's ability to establish and maintain a market in Michigan.

- Corporation Q does not have physical presence in Michigan. Corporation Q does not have nexus in Michigan.
- Note that Corporation V, the common carrier, and Smith & Jones, PC, through its employee attorney, do have physical presence in Michigan provided such presence is for two or more days, and have nexus with Michigan for purposes of the CIT.

9. Corporation H, 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 identified in section I.A.4. of this RAB that establishes only a trivial connection with Michigan. Corporation H does not have nexus with Michigan.

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

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

11. Corporation F, located in Maryland and with no physical presence in Michigan, has a 33% ownership interest in XYZ Company, a partnership located in Michigan that conducts research and development of solar energy technology.

- Corporation F has an ownership interest in XYZ Company, a flow-through entity with physical presence in, and thus nexus with, Michigan. Corporation F has nexus with Michigan.

12. Corporation S, located in New York and with no physical presence in Michigan, has a 5% ownership interest in Partnership A, also located in New York and with no presence in Michigan. Partnership A is a member with 3 other entities in Acme, LLC, located in Ohio with no physical presence in Michigan, and that is treated as a partnership for federal income tax purposes. Acme, LLC is a partner with a 25% ownership interest in Partnership B, which is located and conducts business activities in Michigan.

- Corporation S has an indirect ownership interest in Partnership B through two flow-through entities, Partnership A and Acme, LLC (treated as a partnership for federal income tax purposes and a flow-through entity for CIT purposes). Corporation S has nexus with Michigan.

13. Corporation A, a Delaware corporation, has a 3% ownership interest in General Partnership X that is located in Ohio. Partnership X in turn has a 10% ownership as a limited partner in Limited Partnership Y that has nexus with Michigan.

- Corporation A has an indirect ownership in Limited Partnership Y. Corporation A has nexus with Michigan.

14. Corporation Z, a New York corporation, is a beneficiary of XYZ Trust that conducts business activity in Michigan. Corporation Z has a beneficial interest in the income resulting from the business activity of XYZ Trust in Michigan.

- Corporation Z has nexus with Michigan.