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MICHIGAN BUSINESS TAX – “ACTIVELY SOLICITS” DEFINED

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 07-6

Under the Michigan Business Tax ("MBT"), a taxpayer, other than an insurance company under MCL 208.1235 *et seq.*, has nexus with the State of Michigan and is subject to the MBT if "the taxpayer has a physical presence in this state for a period of more than 1 day during the tax year or if the taxpayer actively solicits sales in this state and has gross receipts of \$350,000 or more sourced to this state." MCL 208.1200(1). In other words, there are two nexus standards under the MBT. First, a person may have nexus with the state if that person has physical presence in the state for more than one day during the tax year. Alternatively, a person may have nexus with the state if the person actively solicits sales in this state and has Michigan gross receipts of \$350,000 or more.

This Revenue Administrative Bulletin ("RAB") defines the phrase "actively solicits." "Actively solicits" is also referred to in this RAB as "active solicitation." This RAB shall be applied on a prospective basis only. This RAB is not intended to describe the physical presence nexus standard.

ISSUE

What does it mean to "actively solicit" sales in this state for purposes of MCL 208.1200?

CONCLUSION

"Actively solicits" means purposeful solicitation of persons within this state. Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order.

Solicitation is purposeful when it is directed at or intended to reach persons within Michigan or the Michigan market.

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

Examples of active solicitation include sending mail order catalogs; sending credit applications; maintaining an internet site offering online shopping, services, or subscriptions; and soliciting through media advertising, including internet advertisements.

In evaluating whether acts of solicitation are sufficient to establish "active solicitation," the Department of Treasury (the "Department") looks to the quality, nature, and magnitude of the activity on a facts and circumstances basis.

Active solicitation, coupled with \$350,000 in Michigan gross receipts, constitutes nexus under the MBT and satisfies the Due Process and Commerce Clauses of the U.S. Constitution.

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 MBT. 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 MBT is comprised of four taxes: a business income tax, a modified gross receipts tax, a gross direct premiums tax, and a franchise tax. The gross direct premiums tax and franchise tax apply only to insurance companies and financial institutions respectively.

Unless stated otherwise in the MBT, a person has nexus with Michigan and is subject to the MBT if "the taxpayer has a physical presence in this state for a period of more than 1 day during the tax year or if the taxpayer actively solicits sales in this state and has gross receipts of \$350,000 or more sourced to this state." MCL 208.1200(1). In other words, there are two alternative nexus standards under the MBT. First, a person may have nexus with the state if that person has physical presence in the state for more than one day during the tax year. Alternatively, a person may have nexus with the state if the person actively solicits sales in this state and has Michigan gross receipts of \$350,000 or more.

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. 15 USC 381 *et seq.* A person whose activities are limited to that protected by PL 86-272 is not subject to the business income tax portion of the MBT. However, such a person otherwise having sufficient nexus with Michigan will be subject to the modified gross receipts tax portion of the MBT.

"Actively solicits" is not defined under the MBT. Instead, "'actively solicits' shall be defined by the [D]epartment through written guidance that shall be applied prospectively." MCL 208.1200(2). This RAB is the written guidance defining "actively solicits."

Constitutional Standards. The Due Process (US Const, Am XIV, §1) and Commerce (US Const, art I, §8) Clauses of the U.S. Constitution 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." *Quill Corp v North Dakota*, 504 US 298, 306 (1992). Building upon this principle – among others – 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." *Quill Corp*, 504 US at 307; *Burger King Corp v Rudzewicz*, 471 US 462 (1985). 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 forum state irrespective 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 foreign state must also be evaluated when determining whether Due Process nexus exists. *International Shoe Co v Washington*, 326 US 310, 319 (1945); *Quill Corp*, 504 US at 308. 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. *Zippo Mfg Co v Zippo Dot Com Inc*, 952 F Supp 1119 (WD Pa 1997). 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. *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. *Complete Auto Transit, Inc v Brady*, 430 US 274 (1977).

The U.S. Supreme Court most recently addressed the substantial nexus requirement under the Commerce Clause in *Quill*. In that case, the Court held that substantial nexus for use tax collection is a bright line physical presence test. *Quill* reaffirmed the twenty-five year old holding in *National Bellas Hess, Inc v Illinois*, 386 US 753 (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. 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." *Quill*, 504 US 311, 315.

However, the U.S. Supreme Court has never required physical presence in its review of 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. 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." *Quill*, 504 US 311, 314. In other words, although *Quill* upheld the bright line physical presence test for sales and use tax purposes, the Court clearly implied that *Quill* applies only to sales and use taxes and not to other types of state taxes, such as the MBT.

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. See, e.g., *MBNA America Bank v Tax Comm'r of West Virginia*, 640 SE2d 226 (W Va S Ct, 2006), *cert den FIA Card Services v Tax Comm'r of West Virginia*, 127 S Ct 2997 (2007); *Lanco, Inc v Director, New Jersey Div of Taxation*, 879 A2d 1234 (NJ Super Ct App Div, 2005), *cert den* 127 S Ct 2974 (2007); *A&F Trademark, Inc v North Carolina*, 605 SE2d 187 (NC Ct App, 2004), *cert den* 546 US 821 (2005). Although the Department recognizes that some states have reached the opposite conclusion, the Department concludes that *MBNA* best summarizes the current state of Commerce Clause jurisprudence:

we believe that the *Bellas Hess* physical-presence test, articulated in 1967, makes little sense in today's world. In the previous almost forty years, business practices have changed dramatically. When *Bellas Hess* was decided, it was generally necessary that an entity have a physical presence of some sort, such as a warehouse, office, or salesperson, in a state in order to generate substantial business in that state. This is no longer true. The development and proliferation of communication technology exhibited, for example, by the growth of electronic commerce now makes it possible for an entity to have a significant economic presence in a state absent any physical presence there. For this reason, we believe that the mechanical application of a physical-presence standard to [taxes other than sales and use taxes] is a poor measuring stick of an entity's true nexus with a state. [*MBNA*, 640 SE2d at 234.]

The MBT – by its express terms – adopts a bright line physical presence test similar to *Quill* and a substantial economic presence standard 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. *MBNA*, 640 SE2d at 235. Active solicitation coupled with \$350,000 in gross receipts sourced to Michigan constitutes substantial economic presence. This conclusion is consistent with the facts and holding of *MBNA*, which held that the taxpayer in that case engaged in substantial "direct mail and telephone solicitation and promotion in West Virginia" and had "significant gross receipts attributed to West Virginia customers." *MBNA*, 640 SE2d at 235-236. Thus, the taxpayer had established a "significant economic presence sufficient to meet the substantial nexus prong of *Complete Auto*." *MBNA*, 640 SE2d at 235-236.

Active Solicitation. A taxpayer has nexus with Michigan and is subject to the MBT if "the taxpayer *actively solicits* sales in this state and has *gross receipts of \$350,000 or more sourced to this state.*" MCL 208.1200(1) (emphasis added).

Pursuant to MCL 208.1200(2), the Department defines "actively solicits" as follows:

Purposeful solicitation of persons within this state. Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order. Solicitation is purposeful when it is directed at or intended to reach persons within Michigan or the Michigan market.

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

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.

To the extent that a taxpayer "actively solicits sales in this state" as defined above and has "gross receipts of \$350,000 or more sourced to this state," that taxpayer will have nexus with Michigan for purposes of the MBT.¹

Examples. Select examples of what amounts to active solicitation or not are listed below. 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 and the Michigan market. 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 or the Michigan market. The retailer is not actively soliciting sales in Michigan.

¹ Due to the difference between the definition of "sales" under MCL 208.1115, used to calculate the sales factor for apportionment purposes, and "gross receipts" under MCL 208.1111, it is possible that gross receipts sourced to Michigan may differ from gross receipts apportioned to Michigan. In most cases, however, these numbers will be the same.

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 manufacture is not actively soliciting sales in Michigan.

4. A retailer located outside Michigan advertises in a newspaper not circulated in Michigan. The newspaper has a small number of mail subscribers in Michigan. The retailer does not direct its activities at persons within Michigan or the Michigan market. The retailer is not actively soliciting sales in Michigan.

5. A manufacturer 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.