

Michigan Business Tax Includes Expanded Definition of Nexus

By Edward J. Castellani

The Michigan Business Tax (MBT), which replaced Michigan's Single Business Tax (SBT) January 1, 2008, has new and expanded definitions of nexus. Under the MBT a person, other than an insurance company, has nexus with Michigan and is subject to the MBT if they have a physical presence in the state for a period of more than one day during the tax year or if the person actively solicits sales in this state and has gross receipts of \$350,000 or more sourced to Michigan. A person may have nexus with Michigan if he or she meets one of the two standards. More important than the new nexus rules under the MBT is the Treasury Department's interpretation of what constitutes physical presence, economic presence, and active solicitation of sales in Michigan.

Under the MBT a person may have nexus with Michigan if that person has physical presence in the state for more than one day during the tax year. A person generally must have an office, employee, or an independent contractor in Michigan to establish physical presence with Michigan. This is the traditional definition of physical presence and is not a new concept.

A second nexus test has evolved in recent caselaw known as economic presence. In *Tax Comm'r v MBNA Am Bank, NA*, 220 W Va 163, 640 SE2d 226 (2006), the West Virginia Supreme Court of Appeals held that MBNA's solicitation and maintenance of customer's credit cards amounted to economic presence that satisfied substantial nexus. Under the concept of economic presence, nexus is present when a taxpayer has substantial economic presence in a state without physical presence in the state. This concept is supported by the Treasury Department in Revenue Administrative Bulletin 2007-6 (the "RAB"), which provides, in part, as follows:

[w]ith 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. Whether a person

has substantial economic presence depends on the quality and quantity of taxpayer contacts with Michigan and the degree to which the taxpayer avails itself of the benefits of an economic market in the State.

The economic presence standard is addressed in the MBT under its active solicitation provisions. Under the MBT nexus is established if a person actively solicits sales in this state and has Michigan gross receipts of \$350,000 or more. Active solicitation of sales is not defined in the new law. Instead the MBT provides that "'actively solicits' shall be defined by the Treasury Department through written guidance that shall be applied prospectively." The Michigan Treasury Department recently provided their written guidance through the RAB, which describes the Treasury Department's interpretation of "actively solicits." Under the RAB active solicitation means:

purposeful solicitation of persons within this state. 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, the use of mail, telephone, and e-mail; advertising, including print, radio, internet, television, and other media; and maintenance of an internet site over or through which sales transactions occur with persons within Michigan.

The RAB examples of active solicitation include sending mail order catalogs; sending credit applications; maintaining an internet site offering online shopping, services, or subscriptions; and engaging in 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.

Under this interpretation of the MBT nexus rules, a business may be actively soliciting business in Michigan and have economic presence and nexus when its sales exceed \$350,000 solely by the fact that the taxpayer

maintains a Web site from which Michigan residents can make purchases. Michigan's adoption of the economic presence standard will subject many online sellers to the MBT that were not subject to the SBT and have no physical presence in Michigan.

In addition to the MBT rules discussed above, a federal statute, Public Law 86-272, also addresses a state's right to tax interstate transactions. Public Law 86-272 is a federal law that prohibits a state 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. The RAB addresses the interplay of this law on the MBT and its definition of nexus.

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. The RAB provides that a person whose activities are limited to those protected by P.L. 86-272 is not subject to the business income tax portion of the MBT but will be subject to the modified gross receipts tax portion of the MBT.

The MBT, along with recent caselaw such as *MBNA*, has clearly expanded the definition of nexus for MBT purposes. Consequently the MBT will apply to persons that were not subject to the SBT. The extent to which substantial nexus can be established without physical presence in Michigan will be determined by the facts and circumstances of each case and whether the new economic presence test can pass constitutional scrutiny. Persons that make sales to Michigan residents must review the MBT and its new standards to determine whether they are subject to the MBT.



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