

Law & Business Report

Legal News You Need to Know

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NEW MICHIGAN TAX BITES OUT-OF-STATE BUSINESSES

By EDWARD J. CASTELLANI, CPA

Michigan's Treasury is taking a bite from out-of-state businesses with the Michigan Business Tax (MBT), which replaces Michigan's Single Business Tax (SBT), even if they only have minimal contacts, or "nexus" in Michigan. Effective, January 1, 2008, the MBT 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:

- The person has 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 by meeting 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 and active solicitation of sales in Michigan.

The first nexus standard under the MBT is that 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. The critical question

to this issue is what is meant by physical presence. Formerly, a person generally had to have an office, employee or an independent contractor in Michigan to establish physical presence with Michigan. Recent cases have held nexus to be present when a taxpayer has substantial economic presence in a state even without physical presence in the State. This concept is supported by the Treasury Department in Revenue Administrative Bulletin 2007-6 (the "RAB"), which provides that

with 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.

Under this analysis a person maybe found to have physical presence in Michigan if it engages in direct mail, telephone solicitation and web site sales in Michigan without an office, employees or independent contractors present

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NEW MICHIGAN TAX BITES CONTINUED...

in Michigan. Companies that sell products in Michigan through their web site may have nexus with Michigan and be subject to the MBT.

Nexus is also established under the MBT 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 its written guidance through the RAB, which describes how the Treasury Department interprets “actively solicits”. Under the RAB active solicitation means:

“Actively solicits” 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 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.

In addition to the Due Process Clause and the Commerce Clause 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 PL 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, as if the MBT can be bifurcated into two distinct taxes.

The MBT, along with recent case law, 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. Persons that make sales to Michigan residents must review the MBT and its new standards to determine whether they are subject to the MBT.

“Under this interpretation of the MBT nexus rules, a business may be actively soliciting business in Michigan, and have 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.”

FTD&D OFFICERS ELECTED FOR QUASQUICENTENNIAL:

Fraser Trebilcock Davis & Dunlap, P.C. has announced its Board of Directors for 2008. Mark R. Fox was re-elected as President of the law firm. Fox concentrates his national practice in the areas of commercial and intellectual property litigation. Also re-elected were Iris K. Linder and Douglas J. Austin as Vice-Presidents, Michael P. Donnelly as Treasurer, and Thaddeus E. Morgan as Secretary.

Linder has extensive experience in corporate transactions and Austin focuses his practice in the area commercial real estate and business. Donnelly, who manages the firm’s Detroit office, has a commercial litigation practice. Morgan, who is also the Chair of the firm’s Litigation Department, concentrates in the areas of commercial and construction litigation.

These officers, elected at the Annual Shareholders Meeting last month, will preside this year as the firm celebrates its quasiquicentennial – 125 years of providing legal services throughout Michigan and the country.

Fraser Trebilcock is a full-service law firm with some 50 lawyers, government relations and other professional consultants, and has offices in downtown Lansing and downtown Detroit. It is the oldest law firm in mid-Michigan.

ATTORNEY ACTIVITIES OF NOTE:

■ **HOUK & NELSON NAMED TO NATIONAL ARBITRATION ROSTER**

In the fall of 2007, former Ingham County Circuit Court Judge Peter Houk and Robert Nelson, attorneys with Fraser Trebilcock Davis & Dunlap, P.C. in Lansing, Michigan, each attended a course in “Arbitration Fundamentals and Best Practices for New AAA Arbitrators” at the offices of the American Arbitration Association.

Houk successfully completed the course in Atlanta and Nelson did so in Chicago. Completion of the course was necessary for both to be admitted to the AAA National Roster of Arbitrators and Mediators. Houk and Nelson also had to meet other stringent requirements for inclusion in the roster.

The course covered the case management system of AAA, the AAA rules and ethical considerations for arbitrators. In addition to the two Fraser attorneys, there were a number of notable attendees in Atlanta and Chicago including former federal judges and CEOs of major corporations.

■ **ATTORNEY RAVEN KEYNOTE SPEAKER AT INGHAM COUNTY MEDICAL SOCIETY ANNUAL DINNER**

Attorney Jonathan E. Raven was the keynote speaker on January 19 at the Ingham County Medical Society’s Annual President’s Night Gala at the University Club in East Lansing, Michigan. Mr. Raven, who chairs the Healthcare Law Department at Fraser Trebilcock, spent nearly two decades in the competitive healthcare industry, not only as General Counsel and later President of Nu Vision, Inc., one of the nation’s largest commercial eye-care chains, he also served as a member of the Sparrow Health System Board for the past ten years.

■ **ATTORNEY MILLER ELECTED SHAREHOLDER**

John Miller was elected shareholder of the Lansing and Detroit firm of Fraser Trebilcock Davis & Dunlap, P.C. at the annual shareholders meeting held December 20, 2007. Mr. Miller has been with Fraser Trebilcock since October of 2001, joining the firm after receiving his Master of Laws (LL.M.) in Taxation from New York University School of Law. Miller received his J.D., cum laude, from the University of Toledo College of Law, where he was the Assistant Managing Editor of the University of Toledo Law Review.

Mr. Miller’s practice focuses on Corporate and Tax Law and he has authored several articles on the recent tax law changes, including *United States Unveils Updated Tax Law Treaty* (Michigan International Lawyer, Winter 2007). Recently, he addressed the Greater Lansing REALTORS® Association on the new Michigan Business Tax.