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REVENUE ADMINISTRATIVE BULLETIN 1999-1

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USE TAX NEXUS STANDARDS

RAB 1999-1. This Revenue Administrative Bulletin (RAB) describes the jurisdictional standard to determine whether a seller is subject to the collection requirements of Michigan's use tax.

The limitations and extent of this State's jurisdiction to impose tax is an evolving area and this RAB is not intended to be an all encompassing or all inclusive description of this subject. This RAB may be modified by changes in either federal or state laws or by decisions of the U.S. Supreme Court, the Michigan Supreme Court, or the Michigan Court of Appeals. It may also be modified and reissued to incorporate nexus guidelines that may be published from time-to-time by agencies such as the Multistate Tax Commission or to clarify the Department's position. Where no conflict exists between this RAB and previously published positions relating to use tax nexus taken by the Department, those positions will remain in effect.

ISSUES

- I. What is the jurisdictional standard to determine whether a seller is subject to Michigan's use tax collection responsibility?
- II. When is this RAB effective?
- III. Once nexus is established, how long does the filing requirement last?
- IV. When will a seller subject to Michigan's taxing jurisdiction be required to file a use tax return?
- V. Can nonfilers subject to these nexus guidelines request a Voluntary Disclosure Agreement?

CONCLUSIONS

I. An out-of-state seller is subject to Michigan's use tax collection responsibility when it engages in any of the following activities:

- 1) It has one or more employees resident or temporarily present in Michigan engaging in any activity other than those described in paragraph 7) below. An employee temporarily present in Michigan for two days will create nexus.
- 2) It owns, rents, leases, maintains, or has the right to use and uses tangible personal or real property that is permanently or temporarily physically located in Michigan.
- 3) Its employees own, rent, lease, use, or maintain an office or other place of business in Michigan.
- 4) It has goods delivered to Michigan in vehicles the out-of-state seller owns, rents, leases, uses, or maintains or has goods delivered by a related party acting as a representative of the out-of-state seller.

Examples:

A company that uses its own trucks to deliver goods to purchasers in Michigan will have nexus with Michigan.

A company, that has its wholly owned subsidiary acting as its representative, delivers goods to purchasers in Michigan will have nexus with Michigan.

A company that has all of its goods delivered to purchasers in Michigan by an unrelated common carrier will not have nexus with Michigan.

- 5) Its agents, representatives, independent contractors, brokers or others, acting on its behalf, own, rent, lease, use, or maintain an office or other place of business in Michigan, and this property is used in the representation of the out-of-state seller in Michigan.
- 6) Its agents, representatives, independent contractors, brokers or others acting on behalf of the out-of-state seller, are regularly and systematically present in Michigan conducting activities to establish or maintain the market for the out-of-state seller whether or not these individuals or organizations reside in Michigan.
 - (a) Activities that establish or maintain the market for the out-of-state seller include, but are not limited to, the following:
 - (1) Soliciting sales;
 - (2) Making repairs or providing maintenance or service to property sold or to be sold;
 - (3) Collecting current or delinquent accounts, through assignment or otherwise, related to sales of tangible personal property or services;

- (4) Delivering property sold to customers;
 - (5) Installing or supervising installation at or after shipment or delivery;
 - (6) Conducting training for employees, agents, representatives, independent contractors, brokers or others acting on the out-of-state seller's behalf, or for customers or potential customers;
 - (7) 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;
 - (8) Investigating, handling, or otherwise assisting in resolving customer complaints;
 - (9) Providing consulting services; or
 - (10) Soliciting, negotiating, or entering into franchising, licensing, or similar agreements.
- (b) Regular and systematic presence exists if at least 2 days of presence occurs in Michigan on an annual ("annual" meaning a 12 month period) basis.
- (c) Lawyers, accountants, investment bankers, and other similar professionals in Michigan, who perform their customary services for an out-of-state seller in their professional capacity, shall not be considered to be establishing or maintaining the market on behalf of the out-of-state seller.
- 7) If none of an out-of-state seller's contacts in Michigan fall under paragraph 6)(a) and its only contacts with Michigan are limited to any of the contacts listed below, such contacts will be presumed not to create nexus (except as noted in 7 (h)). If an activity is listed in (a) through (g) below and that activity also is described under paragraph 6)(a), then paragraph 6)(a) controls and the out-of-state seller is subject to Michigan's use tax collection responsibility.
- (a) Meeting with in-state suppliers of goods or services;
 - (b) In-state meetings with government representatives in their official capacity;
 - (c) Attending occasional meetings (e.g., board meetings, retreats, seminars and conferences sponsored by others, schools or other training sponsored by others, etc.);
 - (d) Holding recruiting or hiring events;
 - (e) Advertising in the state through various media;
 - (f) Renting to or from an in-state entity customer lists;
 - (g) Attending a trade show at which no orders for goods are taken and no sales are made;
- or

- (h) Participating in a trade show at which no orders for goods are taken and no sales are made for less than ten days cumulatively on an annual basis.

II. This RAB applies jurisdictional standards established by the U.S. Supreme Court from 1939 to the present. Judicial law is the controlling interpretation of federal law and must be given full retroactive effect in all cases still open on direct review and as to all events. Accordingly, the standards described within this RAB, with the exception of the limitations enumerated in paragraph I. 7), shall be enforced by the Department and given full jurisdictional effect to all open years and for cases still open and on direct review.

The limitations enumerated in paragraph I. 7) are not mandated by U.S. Supreme Court cases. Thus, while the State may have a basis for asserting nexus in these instances, it has been determined that beginning May 1, 1999 nexus will not be asserted if a taxpayer's contacts are limited to those described in paragraph I. 7).

III. Once nexus is established by a seller for use tax collection purposes, nexus shall exist for that seller from the date of contact forward for the remainder of that month and for the following 11 months. Either the seller or the Department may submit proof that a longer or shorter period more reasonably reflects the sales that were proximately caused by the seller's in-state contacts under the facts and circumstances.

Example:

An out-of-state seller whose representative enters Michigan on January 17th and again on February 15th. The out-of-state seller has nexus with the State of Michigan beginning on the day of second contact -- February 15th -- forward. The seller must file appropriate use tax returns for the remainder of the month of February and the next succeeding 11 months.

- IV. Sellers who fall within the State's taxing jurisdiction will be required to file appropriate use tax returns if they were present within the State consistent with the jurisdictional standards described in the Conclusions to Issue I. above.
- V. Through December 31, 2003, sellers who have had a filing responsibility under these nexus guidelines but are nonfilers and have not had prior contact with the Department regarding use tax, are eligible to request a Voluntary Disclosure Agreement under MCL 205.30c.

LAW AND ANALYSIS

Introduction

A seller is subject to the use tax collection responsibility of the Use Tax Act if it has nexus with the State of Michigan under the Due Process and Commerce Clauses of the U.S. Constitution. This bulletin is intended as a guide. Because commerce clause nexus is an ever-evolving area of law and is likely to change, readers are encouraged to review recent court decisions from Michigan and Federal appellate courts.

Jurisdictional Standard

The Due Process and Commerce Clauses of the U.S. Constitution define U.S. constitutional limitations on state

jurisdiction to tax. The nexus requirements of both Clauses must be satisfied before an out-of-state seller may be subject to the taxing jurisdiction of a state.

Due Process nexus is satisfied for application of the seller's use tax collection responsibility when a person has economic or physical presence in Michigan. Economic presence is satisfied when a business purposefully, on its own or through a representative, avails itself of the benefits of an economic market in Michigan. *Quill Corp v North Dakota*, 504 US 298; 119 LEd 2d 91; 112 SCt 1904 (1992); *Burger King Corp v Rudzewicz*; 471 US 462; 105 SCt 2210; 85 LEd 577 (1985); *International Shoe v Washington*, 326 US 310; 66 SCt 154; 90 LEd 95 (1945). For example, the U.S. Supreme Court has held that mailing catalogs into the state constitutes economic presence. *Quill*, 504 US at 308.

The United States Supreme Court held in *Complete Auto Transit, Inc v Brady*, 430 US 274; 97 SCt 1076; 51 LEd 2d 326 (1977), that a state tax satisfies the requirements of the Commerce Clause if it meets four requirements:

1. The tax is applied to an activity with substantial nexus with the taxing state.
2. The activity -- both in and out of the state -- is fairly apportioned.
3. The tax does not discriminate against interstate commerce.
4. The tax is fairly related to services provided by the state.

The U.S. Supreme Court has most recently addressed the Commerce Clause substantial nexus requirement for use tax collection in *Quill, supra*. In *Quill*, the Supreme Court stated that substantial nexus for use tax collection is a bright line physical presence test. The Court reaffirmed its twenty-five year old holding in *National Bellas Hess*, 386 US 753; 87 SCt 1389; 18 LEd 2d 505 (1967), that those persons whose contacts with a State do not exceed contact by U.S. mail or common carrier do not have substantial nexus and cannot be required to collect use taxes. The Court noted that substantial nexus for use tax collection is satisfied by the presence of a "small sales force, plant, or office" in the taxing state. The Court found that the nexus standard was a bright-line standard. The Court specifically rejected a facts and circumstances test for use tax collection nexus. Thus, any standard that would require a weighing of facts and circumstances to determine physical presence in the state is contrary to the Court's holding in *Quill*. Under the Court's holding in *Quill*, once an entity has physical presence in a state, the entity has crossed the bright line and has nexus with the state. Under the bright-line standard of *Quill* any physical presence in the state such as an employee present for one day constitutes substantial nexus.

For administrative convenience, to be compatible with the single business tax nexus standard, and to efficiently allocate the Department's resources to achieve maximum compliance, until further notice this RAB administratively limits enforcement of the use tax collection obligation to employee contacts that are two or more days. The Department maintains its adherence to the *Quill* principle that any in-state presence constitutes physical presence that crosses the bright-line and creates nexus, except for the activities noted in Conclusions I.7) and allowing for a one-day employee presence for the stated administrative purposes.

Under the bright-line physical presence test of *Quill*, delivery in an out-of-state seller's own trucks creates in-state physical presence that crosses the bright-line and creates nexus. *Miller Brothers v Maryland*, 347 US 340 (1954), which found to the contrary has been overruled by *Quill*. In *Miller Brothers*, the Supreme Court analyzed nexus as a Due Process question and found that physical presence through truck and employees was not sufficient for Due Process nexus. However, the Supreme Court in *Quill* has subsequently determined that Due Process nexus is satisfied by a much lower standard of economic presence. Accordingly, *Miller Brothers* is no longer good law.

The in-state presence of the out-of-state vendor need not be related to the sales activity subject to tax. *National Geographic Society v California Bd of Equalization*, 430 U.S. 551 (1977). In *National Geographic* the taxpayer

specifically asked the Supreme Court whether its presence in California had to be related to the sales activity in order for California to impose its use tax collection obligation. The Court held that the in-state presence need not be directly related to the sales activity. *National Geographic* at 560. Thus, once an entity is present in the state, the state may constitutionally impose a use tax collection requirement regardless of the nature of the contact. Accordingly, the standards in this RAB do not require any link between the in-state presence and the sales activity subject to tax.

Use tax nexus is not triggered solely by the presence of employees. The State may impose use tax collection responsibility if a representative of the out-of-state seller is present in the State. In *Scripto, Inc v Carson*, 362 US 207; 80 SCt 619; 4 LEd 2d 660 (1960), the U. S. Supreme Court held that a State may constitutionally require an out-of-state seller that hired independent contractors or jobbers to solicit sales on its behalf to collect use taxes. *Scripto* engaged ten in-state wholesalers as independent contractors to solicit sales of its products in the state. The independent contractors worked on a non-exclusive, part-time basis and were paid commissions. The company argued that it had no presence in the state because it had no employees in the state. The Supreme Court held that there is no constitutionally significant difference between an employee and an independent contractor. The state could require a nonresident seller who has no regular employees or agents in the state and does not own, lease or maintain any office, distributing house, warehouse or other place of business there to register as a dealer and collect its use tax. The regular solicitation of sales by part-time independent brokers satisfies the requirement of nexus. Calling a “salesman” an “independent contractor” does not change his local function and has no bearing upon the effectiveness of his local solicitation, which results in a flow of goods into the state. In fact, the Court determined that the part-time, non-exclusive efforts of the independent contractors were “continuous solicitation.” Thus, the court interpreted the presence required for nexus to be satisfied by periodic, cyclical contact rather than mandating unbroken, uninterrupted presence. This RAB follows the Supreme Court's principles that periodic presence of a representative of an out-of-state seller creates nexus for use tax collection.

Whether a representative creates nexus for an out-of-state seller does not depend on the title of the representative, but depends on the in-state activities of the representative. The United States Supreme Court reinforced its *Scripto* determination that mere representatives of an out-of-state company can create substantial nexus for that company in *Tyler Pipe Industries, Inc v Washington Dep't of Revenue*, 483 US 232; 107 SCt 2810; 97 LEd 2d 199 (1987). In *Tyler Pipe* the Court held that the activities of local sales representatives of an out-of-state corporation provided a sufficient nexus with the State of Washington to justify the collection of the wholesale tax on the corporation's local sales. For this purpose, it made no difference that the local representatives were independent contractors, rather than employees of the corporation. The Court specifically noted that the critical test was:

whether the activities performed in this State on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this State for sales.

In *Scripto*, the Court noted that it was the nature and extent of the in-state activity that matter for a nexus determination, not the title of the representative. In sum, the U. S. Supreme Court has held that substantial nexus exists when in-state activities are performed on behalf of an out-of-state company regardless of whether these activities are performed by employees, agents, representatives, independent contractors, brokers or others. This RAB lists some of the activities that establish and maintain the market for the out-of-state seller and thus, trigger nexus for use tax collection.

Definitions

The following definitions are used in this bulletin:

- (a) “Related Party” means any individual or entity that qualifies or would qualify as (i) an affiliated group or a controlled group of corporations under section 1563 of the internal revenue code or (ii) an entity under common control under internal revenue code regulation 1.414(c)-2 provided that 50 percent shall be substituted for 80 percent? in determining when an individual or entity is part of an affiliated group, a controlled group of corporations, or an entity under common control.
- (b) “Representative” means any individual or entity that conducts business activities in the taxing State on behalf of another. The term does not include employees. The term includes, without any limitation on the foregoing, agents, corporate or other business entities, related or unrelated to the other business, and independent contractors. The term also includes sub-representatives. A representative may be a resident or non-resident of the taxing State.
- (c) “Use” means the exercise of a right or power over tangible personal property incident to the ownership of that property including transfer of the property in a transaction where possession is given.