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STATE AND LOCAL TAX NEWSLETTER

Business Strategists & Certified Public Accountants

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What is Public Law 86-272 and Why is it Important for the MBT?

GRAND RAPIDS, MI – Monday, June 23, 2008 – The business income tax is imposed on every taxpayer with a business activity in Michigan unless prohibited by federal 15 USC 381 to 384.

[Public Law 86-272] Enacted in 1959, Public Law 86-272 generally prohibits states from imposing a tax on the income of a corporation derived from interstate commerce if the only business activities within the state by or on behalf of the corporation are the solicitation of orders of tangible personal property where orders are sent outside of the state for acceptance or rejection and, if accepted, are filled by shipment or delivery from a point outside of the state. Additionally, PL 86-272 provides that independent contractors may engage in soliciting sales, making sales, and maintaining a sales office within a state without subjecting the corporation to taxation.

There are three reasons why Public Law 86-272 is important for the MBT:

First, a non-Michigan domiciled entity is not subject to the business income portion of the MBT if protected by Public Law 86-272.

Second, a Michigan domiciled entity's solicitation of sales outside of Michigan (without physical presence) may block the establishment of nexus and apportionment if protected by Public Law 86-272.

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Third, a Michigan domiciled entity may be protected from the imposition of an income tax by a state other than Michigan if their activities in the state are protected by Public Law 86-272.

This newsletter discusses the protections from nexus afforded by Public Law 86-272.

A taxpayer will not be subject to the business income tax if protected by PL 86-272 even if the general nexus standard of physical presence and active solicitation are present. [MCL 208.1201(1)]

In 1959, the U.S. Supreme Court in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), for the first time, held that a state could tax exclusively interstate commerce so long as the tax did not create any effect forbidden by the Commerce Clause. The *Northwestern* case concerned the constitutionality of a direct net income tax imposed on that portion of a non-domiciliary corporation's net income earned from, and fairly apportioned to, business activities within the taxing state, where such business activities were in furtherance of interstate commerce.

Immediately following the decision in the *Northwestern* case, the 86th Congress moved to limit the power of the states to impose a net income tax on income derived from interstate commerce. The Interstate Income Law, PL 86-272, was the result. Generally, the law prohibits any state from imposing an income tax on income derived from within the state from interstate commerce if the only business activity within the state consists of the solicitation of orders of tangible personal property by or on behalf of a corporation by its employees or representatives. The law also provided for a study to be made of all matters pertaining to state and local taxation of interstate commerce. After more than five years of study and hearings, the Special Subcommittee on State Taxation of Interstate Commerce introduced an Interstate Taxation Bill (H. R. 11798) embodying its recommendations. Hearings on this bill indicated that both the states and business had many objections to it. Since 1966 many versions of the Interstate Taxation Bill have been introduced but none has been enacted.

As a general rule, there would appear to be no question that the solicitation of orders in a taxing state by employees and representatives of a non-domiciliary entity, or person as defined in the MBTA, is sufficient to constitutionally subject that corporation to the imposition of a fairly apportioned, direct corporate net income tax. Public Law 86-272 protects only those businesses engaged in the sale of tangible personal property whose activities in Michigan are limited to the solicitation of orders from the imposition of net income based taxes. This is an exception to the general rule. There are

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many conceivable situations to which the limitations thus imposed may not apply, such as the income derived from services rendered in interstate commerce and sales of intangibles. For the in-state activity of a non-domiciliary business enterprise to be a protected activity, it must be limited solely to solicitation (except for de minimus activities and certain activities conducted by independent contractors).

Solicitation means:

- (1) speech or conducts that explicitly or implicitly invites an order; and
- (2) activities that neither explicitly nor implicitly invites an order, but is 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. 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 (solicitation).

The conducting of activities not falling within the foregoing definition of solicitation will cause the company to lose its protection from a net income tax afforded by PL 86-272, unless the disqualifying activities, taken together, are either de minimis or are otherwise permitted.

De minimis activities are those that, when taken together, establish only a trivial connection with the taxing State. An activity conducted within a taxing State on a regular or systematic basis or following a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether or not an activity consists of a trivial or non-trivial connection with the State is to be measured on both a qualitative and quantitative basis. If such activity either qualitatively or quantitatively creates a non-trivial connection with the taxing State, then such activity exceeds the protection of PL 86-272.

My book [The Michigan Business Tax Desktop Reference Manual](#) includes five full pages of lists. The first list is [Activities Protected From Net Income Taxation](#). The

second list is Activities Not Protected Under PL 86-272. These lists are helpful in determining whether an activity in a state is protected under Public Law 86-272.

Stay tuned for more news and follow the [MichiganStateAndLocalTaxBlog](#) for information as it becomes available. If you have any questions, please go ahead and contact me. I will be happy to be of assistance.

Sincerely,

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