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Practice Update

Target Practice: When Does Virtual Presence Satisfy Substantial Nexus?

September 9, 2025

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This article was originally published in Tax Notes on August 18, 2025.

In the first article of this two-part series, [1] we examined the importance of virtual presence in establishing substantial nexus under the commerce clause. Our position is that the *Wayfair* Court [2] referenced virtual presence as a proxy for the bright-line physical presence rule articulated in its decision in *Quill*. [3] Before the internet age, it was assumed that the only way an out-of-state retailer could effectively compete with in-state businesses was to be physically present in the taxing state. E-commerce — spurred by the growth of the internet — changed all that.

Now, an out-of-state retailer "may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term." [4] For these reasons, in *Wayfair*, Justice Anthony Kennedy instructed that the substantial nexus requirement of the commerce clause must take into account the "'physical' aspects of pervasive modern technology." [5] But exactly which physical aspects of modern technology are relevant to the nexus determination? More importantly, what is the proper test for evaluating when an out-of-state retailer's virtual presence in a state rises to the level of substantial nexus?

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The Kaleidoscopic World of Mobile Marketing

The impetus behind the ultimate holding in *Wayfair* was the sea change in technology used to solicit sales of products and services across state lines. This statement is not open for debate. In *Direct Marketing Association*, Kennedy cited these "dramatic technological . . . changes" as calling into question the bright-line physical presence test in *Quill*. [6] Three years later, in *Wayfair*, Kennedy justified overturning *Quill* because of, as previously stated, the "continuous and pervasive virtual presence of retailers" that permitted being "present in a State in a meaningful way without that presence being physical in the traditional sense of the term." [7] The goal of the commerce clause, according to the Court in *Wayfair*, was to ensure that economically equivalent market participants "compet[e] on an even playing field." [8]

With this in mind, the features of modern technology that are most relevant to the substantial nexus question are those that mimic the experience of in-person shopping at a brickand-mortar retailer in the taxing state. Only in those instances can it be said that out-of-state retailers are competing directly in the marketplace with in-state retailers. When an out-of-state retailer uses mobile marketing tools to simulate a brick-and-mortar shopping experience, the argument for substantial nexus becomes more compelling.

There are myriad mobile marketing tools available to retailers. The marketing approaches are so numerous and granular that you would need hip waders and an advanced advertising degree to plod your way through them. There are several general categories of mobile marketing tools, however, that lend themselves to an intuitive understanding.

Perhaps the most elementary form of advertising is a website. On its own, a website markets indiscriminately. But, as with most marketing tools, there are levels of aggressiveness associated with

operating a website. For example, websites can be used to gather customer contact information, product preferences, and many other types of data. It is commonplace that a consumer can make purchases online without the need to have any direct person-to-person contact.

Businesses also engage in marketing through email. Email marketing spans a spectrum, with mass messaging to potential customers on one end and directed email to existing customers on the other. Email marketing encourages customer interaction but far from guarantees it — check your spam folder.

What remains are perhaps the most intrusive mobile marketing efforts directed specifically at the ubiquitous use of smartphones. Time for your hip waders.

One significant category of smartphone marketing is text messaging. There are many forms of text message marketing, including promotional text messages, transactional text marketing messages, conversational (or customer service) text messages, “drip” text campaigns, and survey/feedback texts.

Promotional text messages focus on encouraging the sale of a product. They are used to generate interest in a product and may include discount codes, coupons, and offers. Transactional text messages are designed to improve customer experience, increase loyalty, and boost the customer’s lifetime value. Examples of transactional text messages may include notifications that an order has been placed or has been shipped. Conversational text messages — not surprisingly — promote two-way communication between the customer and the seller. Those texts can be used to assist with customer service concerns or elicit interest in new products or services. A drip text message campaign involves a series of text messages that are sent to the customer’s smartphone at specific times. This approach can be used to welcome a new customer and then follow up with texts that introduce the

customer to new products or services. Finally, survey/feedback texts help a seller improve its offerings and keep the customer engaged.

One other marketing tool used by sellers is geofencing. A geofence defines a virtual perimeter for a real-world geographic area. As we all know from TV crime shows, our physical location can be tracked through our smartphones.

This can be accomplished through GPS, Wi-Fi, or cellular data. When a customer crosses a geofence border, they receive an alert from the seller. For example, ABC Inc. sets up a geofence around a brick-and-mortar retail location. When a smartphone user crosses that geofence, the user receives a coupon for that specific store location.

We would be remiss if we did not address the use of push notification advertising on smartphones. Push notifications are pop-up messages that sellers send to a customer's smartphone. A customer can tap on the notification to open the linked smartphone app (or website) to engage with the seller. The key difference between text message marketing and push notifications is that push notifications are tied to the fact that the customer has the seller's app on his or her smartphone because push notifications are sent through the smartphone app. Text message marketing is not reliant on the customer having the seller's smartphone app.

Once a customer engages in one of these marketing campaigns, he or she has access to the seller's entire sale inventory in detail that rivals any in-store experience.

But Do We Need a New Test?

"There is nothing new under the sun, but there are new suns." [9] With that in mind, we turn to the critical question regarding the proper test for determining the conditions through which an out-of-state retailer has substantial nexus with a taxing

state post-*Wayfair*. As explained above, there are innumerable virtual marketing strategies that can be employed by out-of-state retailers. What constitutional framework should be used to analyze the question of substantial nexus under a given set of circumstances?

The knee-jerk reaction is to conclude that, given the explosion of technology-based marketing approaches, a new constitutional test is needed. We question that conclusion. In many ways, the newer forms of mobile marketing tools are merely updated versions of age-old marketing efforts.

Consider the facts in *Quill*: An out-of-state seller solicited sales in the taxing state through the use of "catalogs and flyers, advertisements in national periodicals, and telephone calls." [10]

Our position is that there is no substantive distinction between the aforementioned mobile marketing tools and the antiquated marketing efforts in *Quill*. The only significant difference is how a marketing message is delivered to the customer. For example, text message marketing is simply the modern iteration of direct mail and personal telephone calls. Similarly, catalogs, flyers, and print advertisements are akin to the use of an out-of-state retailer's smartphone app and linked pop-up advertisements. A critic may quibble and note that print advertisements have a shelf life and terminate at a given time. That is certainly true. However, as smartphone users, we also have control — to some extent — over when we receive mobile marketing messages.

So where do we look for a constitutional approach to this vexing substantial nexus question? The answer may very well lie with decisions from the U.S. Supreme Court and the lower federal courts addressing jurisdiction over the internet under the due process clause.

Distinction Without a (Constitutionally Significant) Difference?

In *Quill*, the Court went out of its way to differentiate between tax nexus under the due process clause and the commerce clause. The nexus analysis under the due process clause is predicated on concepts of in personam jurisdiction as explained in seminal cases such as *International Shoe Co.* [11] and is concerned with an out-of-state taxpayer's "minimum contacts" with the taxing state and whether the taxpayer "purposefully avail[ed] itself of the benefits of an economic market in the forum State." [12] *Quill* defined substantial nexus under the commerce clause to be tied to the taxpayer's physical presence in the taxing state. [13]

Wayfair overruled *Quill* and redefined the substantial nexus requirement in the process. Post-*Wayfair*, the test for substantial nexus is amorphous at best. According to the *Wayfair* Court, an out-of-state taxpayer has substantial nexus with a taxing state when it "avails itself of the substantial privilege of carrying on business in that jurisdiction." [14] This articulation of substantial nexus in *Wayfair* looks an awful lot like the purposeful availment test under the Court's existing due process clause jurisprudence. It is fair to say that there is likely not — at least not yet — any constitutionally recognizable distinction between the two nexus tests. [15]

The *Wayfair* Court made a point to explain the similarities between nexus under the due process clause and the commerce clause. The Court instructed that "when considering whether a State may levy a tax, Due Process Clause and Commerce Clause standards may not be identical or coterminous, but there are significant parallels," adding that "the reasons given in *Quill* for rejecting the physical presence rule for due process purposes apply as well to the question whether physical presence is a requisite for an out-of-state seller's liability to remit sales taxes." [16]

In light of the Court's holding in *Wayfair* — effectively equating the nexus tests under the due process clause and the commerce clause — we think it is appropriate to look to cases involving due process clause challenges to assertions of in personam jurisdiction in disputes involving the use of the internet.

Personal Jurisdiction and the Internet

In *Ford Motor Co.*, an offline personal jurisdiction case (one involving tort claims), the U.S. Supreme Court recognized that the notion of purposeful availment in electronic commerce cases presented some difficult questions. [17] But before turning to this notion, the Court reiterated and described purposeful availment:

> The defendant, we have said, must take some act by which [it] purposefully avails itself of the privilege of conducting activities within the forum State. The contacts must be the defendant's own choice and not random, isolated, or fortuitous. They must show that the defendant deliberately reached out beyond its home — by, for example, exploi[ting] a market in the forum State or entering a contractual relationship centered there. [18]

In this case, Ford conceded purposeful availment in circumstances in which its facts were (and are) that of a large consumer-based business with nationwide physical presence. According to the Court, Ford solicited and advertised "by every means imaginable" (including TV, billboards, radio, and print and direct-mail ads), sold cars at dealerships in-state, and sold parts and repaired cars at their own dealerships as well as third-party shops. [19]

Interestingly, the Court contrasted Ford's widespread presence and contacts with those of a small internet seller. The Court designated "this exact fact pattern [of] a global car company,

extensively serving the state market . . . as an illustration — even a paradigm example — of how specific jurisdiction works." [20] The Court then dropped a footnote to clarify that the answer to the question whether a small internet seller would have personal jurisdiction likely would diverge, even though the analysis may be informed by similar concepts:

> None of this is to say that any person using any means to sell any good in a State is subject to jurisdiction there if the product malfunctions after arrival. We have long treated isolated or sporadic transactions differently from continuous ones. And we do not here consider Internet transactions, which may raise doctrinal questions of their own. ("[T]his case does not present the very different questions whether and how a defendant's virtual 'presence' and conduct translate into 'contacts' with a particular State.") So consider, for example, a hypothetical offered at oral argument. "[A] retired guy in a small town" in Maine "carves decoys" and uses "a site on the Internet" to sell them. "Can he be sued in any state if some harm arises from the decoy?" The differences between that case and the ones before us virtually list themselves. (Just consider all our descriptions of Ford's activities outside its home bases.) So we agree with the plaintiffs' counsel that resolving these cases does not also resolve the hypothetical. [21]

Justice Neil M. Gorsuch's concurrence (which was joined by Justice Clarence Thomas) recognized the many shades of gray in the majority's hypothetical and unanswered questions:

> The majority says this hypothetical supplies a useful study in contrast with our cases. On the majority's telling, Ford's

> “continuous” contacts with Montana and Minnesota are enough to establish an “affiliation” with those States; by comparison, the decoy seller’s contacts may be too “isolated” and “sporadic” to entitle an injured buyer to sue in his home State. But if this comparison highlights anything, it is only the litigation sure to follow. For between the poles of “continuous” and “isolated” contacts lie a virtually infinite number of “affiliations” waiting to be explored. And when it comes to that vast terrain, the majority supplies no meaningful guidance about what kind or how much of an “affiliation” will suffice. [22]

As suggested by the U.S. Supreme Court in *Ford*, applying a framework examining purposeful availment in the internet context presents challenges. In a seminal case analyzing if a subscription news website purposefully availed itself of Pennsylvania, a court applied a test looking to “the level of interactivity and commercial nature of the exchange of information that occurs on the Web site.” [23] The court described a “sliding scale” continuum consisting of, on one end, an entity doing business and making repeated sales over the internet and, on the other end, an entity passively posting information that is accessible to residents. [24] This approach, however, left a large no-man’s-land of activity between the two extremes and also seemingly did not take into account other electronic and nonelectronic activity aimed at instate residents.

More recently, the Fifth Circuit adopted a more refined approach in deciding if a baby product company had personal jurisdiction with Louisiana. [25] The court held that merely running a website, even one through which purchases can be made and that is accessible in all 50 states, is insufficient to establish the minimum contacts necessary for personal jurisdiction; the entity at issue must take additional steps targeting the state. [26] In this case,

the court held that the company did not purposefully direct its activities to Louisiana, where it had no offices, stores, salespeople, or business license; the company made sales to Louisiana customers through marketplace platforms like Amazon.com but not through its own website; a few third-party stores carried the company's products (none of the products at issue in the case); and the company shipped a single product to a Louisiana resident.

Moreover, the court highlighted the fact the company did not "direct any advertising at Louisiana in particular" [27] and rejected the plaintiffs' argument that because the company's website targets the entire United States, it necessarily targets Louisiana. The Fifth Circuit concluded that displaying, advertising, and offering products for sale on a website accessible to state residents is not synonymous with soliciting business in the state through targeted advertising. [28]

Interestingly, even when targeted advertising is present, courts are split on the legal significance. In *AMA Multimedia*, a U.S. company sued a foreign person (a citizen and resident of Poland) for copyright and trademark infringement. [29] The plaintiff's copyrighted works were displayed on the defendant's website, which also displayed geo-targeted advertising (advertising based on and tailored to a website visitor's perceived location) that the defendant maintained through a third-party advertising company. [30] Despite this fact, the Ninth Circuit held that the defendant did not purposefully direct his activities at the United States because the defendant:

> Does not personally control the advertisements shown on the site [because the website] contracts with third parties (not located in the United States) which tailor the advertisements themselves or sell the space to other parties who do. [Thus, the website's] forum-based traffic, absent other indicia of [the defendant's] personal

> direction, does not establish that [the defendant] tailored the website to attract U.S. traffic. [31]

In contrast, the Fourth Circuit reached the opposite conclusion on similar facts. [32] In *UMG Recordings*, the defendant sold advertising space to advertising brokers based in the United States and Ukraine, and the brokers resold the space to advertisers. [33] The advertising brokers and advertisers applied geo-targeting to display specific advertisements to countries, states, or cities. [34] Holding that the Russia-based defendant purposefully availed himself of conducting business in Virginia, the court found, regarding the geo-targeting advertising, that:

> It is immaterial whether the third-party advertisers or [the defendant] targeted California residents, or Virginia residents in Kurbanov's case. The fact that the advertisements targeted California [or here, Virginia] residents indicates that [the defendant] knows — either actually or constructively — about its California [Virginia] user base, and that it exploits that base for commercial gain by selling space on its website for advertisements. [35]

Proposed Standard for Evaluating Virtual Contacts

Informed by and built upon the precedent and principles examined in this article, we propose a balancing test for evaluating when an out-of-state retailer's virtual contacts in a state create substantial nexus under the commerce clause. The test measures the quality and quantity of the retailer's purposeful targeting of the state's market by examining various virtual factors, including:

- Advertising: Does the retailer use digital advertising to solicit in-state consumers, and if so, to what extent? Does the retailer direct its advertisement to in-state residents? Does it rely

on third parties to advertise or solicit customers, and if so, how much control or supervision does it exert over the process? What volume of targeted advertising is directed at in-state residents, and how is this accomplished (such as through emails, texts, or electronic notifications)?

- Online presence: Does the retailer maintain a website, and what level of accessibility does it provide customers or potential customers? For example, does the website permit the public to view the retailer's product/service offerings and make purchases directly from the website? Or does the retailer restrict the public's ability to view offerings and make purchases, such as by requiring the use of log-in credentials? Is the website aggressive in gathering customer data or preferences, or is it more passive and neutral? Are the retailer's products/services instead or alternatively available for review or purchase on any third-party websites?
- Smartphone application: Does the retailer offer a smartphone application? If so, does the application push advertising or other messages to the in-state resident in an effort to encourage them to engage with the seller or purchase the product?

In any nexus evaluation, alleged taxpayers would be remiss to omit consideration of traditional yet critical harbingers of nexus — greater than de minimis presence of employees, representatives, inventory, and offices in the state; where purchases are accepted and approved; where possession, title, or risk of loss passes; and where, how, and how much product delivery occurs.

As Zig Ziglar said: "You can't hit a target you cannot see, and you cannot see a target you do not have." This reminds us that in life, as well as state tax law, without a visible target and purposeful direction, we risk undertaking aimless, fruitless efforts. We hope this article advances the dialogue, injects clarity, and

offers guardrails into post-*Wayfair* substantial nexus standards.

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[1] Michael J. Bowen, Lauren A. Ferrante, and Lorie A. Fale, "Nexus Post-*Wayfair*: What Is the Relevance of Virtual Contacts?" *Tax Notes State*, Apr. 1, 2024, p. 7.

[2] *South Dakota v. Wayfair Inc.*, 585 U.S. 162, 181 (2018).

[3] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[4] *Wayfair*, 585 U.S. at 181 (internal quotation marks omitted) (citing *Direct Marketing Association v. Brohl*, 575 U.S. 1, 18 (2015) (Kennedy, J., concurring)).

[5] *Wayfair*, 585 U.S. at 181 (internal quotation marks omitted) (citing *Direct Marketing Association v. Brohl*, 575 U.S. 1, 18 (2015) (Kennedy, J., concurring)).

[6] *Direct Marketing Association*, 575 U.S. at 17 (Kennedy, J., concurring).

[7] *Wayfair*, 585 U.S. at 181 (citing *Direct Marketing Association*, 575 U.S. at 18 (Kennedy, J., concurring)).

[8] *Wayfair*, 585 U.S. at 183.

[9] This quote is attributed to science fiction writer Octavia E. Butler.

[10] *Quill*, 504 U.S. at 302.

[11] *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

[12] *Quill*, 504 U.S. at 307.

[13] *Id.* at 317-318.

[14] *Wayfair*, 585 U.S. at 188 (internal quotation mark omitted).

[15] In a well-regarded treatise on state taxation, the authors discussed the difference between the tests for nexus under the due process clause and commerce clause, saying, "We cannot identify such distinctions for the moment and, in light of the Court's reasoning in *Wayfair*, doubt that significant distinctions . . . will emerge in the future." Jerome R. Hellerstein, Walter Hellerstein, and Andrew Appleby, *State Taxation*, para. 6.03[4] (3d ed., with updates through April 2025).

[16] *Wayfair*, 585 U.S. at 177-178.

[17] *Ford Motor Co. v. Montana Eighth Judicial District Court*, 592 U.S. 351 (2021).

[18] *Id.* at 359 (internal citations and quotation marks omitted; alterations in original).

[19] *Id.* at 365.

[20] *Id.* at 366.

[21] *Id.* at n.4 (internal citations omitted; alterations in original).

[22] *Id.* at 377-378 (Gorsuch, J., concurring in judgment)

[23] *Zippo Manufacturing Co. v. Zippo Dot Com Inc.*, 952 F. Supp. 1119, 1124 (W.D. Pa. 1997).

[24] *See id.*

[25] *Admar International Inc. v. Eastrock LLC*, 18 F.4th 783 (5th Cir. 2021). *See also LaRocca v. Invasix Inc.*, No. 4:21-CV-03792, at *4 (S.D. Tex. Mar. 7, 2023) (concluding no personal jurisdiction exists over a defendant, citing *Admar* and observing that the defendant's website "is not directed to Texas in particular").

[26] *Admar International Inc.*, 18 F.4th at 785.

[27] *Id.*

[28] *Id.* at 787.

[29] *AMA Multimedia LLC v. Wanat*, 970 F.3d 1201 (9th Cir. 2020).

[30] *Id.* at 1204.

[31] *Id.* at 1211.

[32] *UMG Recordings Inc. v. Kurbanov*, 963 F.3d 344 (4th Cir. 2020).

[33] *Id.* at 348.

[34] *Id.*

[35] *Id.* at 354 (internal citation and quotation marks omitted; alterations in original). *See also Verizon Online Services Inc. v. Ralsky*, 203 F. Supp. 2d 601, 604, 620 (E.D. Va. 2002) (Defendants' alleged transmission of millions of spam emails to Verizon's subscribers through Verizon's online network via servers located in Virginia "constitutes sufficient minimum contacts to satisfy the demands of the Due Process Clause. . . . Defendants solicited business from Verizon's subscribers [and] knew or should have known that such trespass violated Verizon's public anti-[spam] policy and that the brunt of the harm . . . would fall on Verizon's servers." Further, "defendants' conduct and connections to Virginia were of their own choosing, not someone else's. Defendants allegedly purposefully transmitted missions of [spam emails] to Verizon's e-mail servers. They cannot seek to escape answering for these actions by simply pleading ignorance as to where these servers were physically located.").